KgPCo Exhibit No. ___
Witness: PMB

DIRECT TESTIMONY OF
PATRICK M. BOURKE
ON BEHALF OF KINGSPORT POWER COMPANY
D/B/A AEP APPALACHIAN POWER
BEFORE THE TENNESSEE REGULATORY AUTHORITY
DOCKET NO. 16-____

Q: PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A: My name is Patrick M. Bourke. My business address is 1 Riverside Plaza, Columbus, OH 43215.

Q: BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A: I am a corporate finance analyst for American Electric Power Service Corporation ("AEPSC"), a wholly-owned subsidiary of American Electric Power Company, Inc. ("AEP" or the "Parent"). I am responsible for, among other things, making recommendations regarding obtaining financing and maintaining the capital structure for several of AEP's subsidiaries, including Kingsport Power Company ("KgPCo" or the "Company").

Q: PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND.

A: I received a bachelor's degree in economics and political science from the College of Wooster in 2005. From June 2005 through October 2007, I was employed as Assistant Controller of ReCasa Financial Group, LLC, a company that operates in the residential rehabilitation industry. I began employment with AEPSC as a Corporate Finance Analyst in October 2007. Between October 2007 and August 2013, I worked in various capacities, but primarily focused on the AEP entity, its transmission subsidiaries and several other subsidiaries. In August 2013, my responsibilities shifted to include several of AEP's vertically integrated utility operating companies, including KgPCo.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to sponsor KgPCo's capital structure, cost of debt and overall rate of return for use in this proceeding.

Q. ARE YOU SPONSORING ANY EXHIBITS?

A. Yes. I am sponsoring two exhibits:

- Exhibit No. 1 (PMB): Recommended Cost of Capital
- Exhibit No. 2 (PMB): Actual Cost of Capital (As of December 31, 2014)

Exhibit PMB-1 displays the KgPCo recommended capital structure and overall cost of capital, adjusted to include the expected debt issuance discussed in this testimony. Exhibit PMB-2 displays KgPCo's actual, unadjusted capital structure and overall cost of capital as of the end of the test year.

Q. PLEASE DESCRIBE KINGSPORT'S SOURCE OF LONG-TERM DEBT.

A. KgPCo currently obtains its capital through financing provided by its parent, AEP. The long-term debt on KgPCo's balance sheet is provided through a senior note that is payable to AEP in the amount of $20 million at a rate of 4.52% (the "Intercompany Note"). This note has been in place since October 2010 and will mature in October 2020.

Q. PLEASE DESCRIBE KINGSPORT'S SOURCE OF SHORT-TERM FUNDING.

A. For short-term working capital needs, KgPCo, like AEP's other utility operating companies, is a member of AEP's utility money pool. This provides a benefit to KgPCo and its customers by allowing the Company to pool its liquidity needs with the rest of the AEP family and have access to more efficient and less costly sources of short-term funding than KgPCo could obtain on its own. As of year-end 2014, KgPCo's balance of money pool borrowings was approximately $22 million (See Exhibit PMB-2). As of the end of the first quarter of 2015, the balance had increased to nearly $26 million.

Q. PLEASE DESCRIBE KINGSPORT'S YEAR-END 2014 CAPITAL STRUCTURE AND OVERALL COST OF CAPITAL.

A. As of year-end 2014, KgPCo had $20.0 million of long-term debt (27.4% of total capital), $22.0 million of short-term debt (30.2% of total capital) and $31.3 million of equity (42.4% of total capital). This gives KgPCo a debt-to-total capital ratio of 57.6% as shown in Exhibit PMB-2. Using this capital structure, the overall cost of capital, based on the return on equity of 10.66% recommended by Company Witness Daves, is 5.85%.

Q. ARE YOU RECOMMENDING ANY ADJUSTMENTS TO THE CAPITAL STRUCTURE?

A. Yes. I am recommending that the Company's long-term debt and total capital be adjusted to include a projected $20 million issuance to reflect the Company's intention to enter into another long-term debt agreement in 2015 with AEP. KgPCo currently has applications for financing authority before the TRA and FERC. The issuance would take place once the Company has authority. This would allow the Company to replace a portion of its short-term debt balance with a long-term source of capital, thus reducing interest rate and liquidity risks that will be described later in this testimony.

Q. HOW WOULD THE LONG-TERM DEBT ISSUANCE BE STRUCTURED?

A. The additional long-term debt would be structured in a manner consistent with the currently existing intercompany note. The term would be for 10-years and it would be issued at rates consistent with market rates for AEP. As of May 1, 2015, four of AEP's investment banks provided quotes for 10-year debt at the Parent. The average of these indicative rates is the 10-year treasury rate plus 124 basis points ("bps"). The 10-year treasury rate closed on the same day at 2.12%, resulting in an indicative rate of 3.36%.

The issuance will be priced at the indicative rates at the time the note is executed as the coupon for the debt issued by Kingsport to AEP. However, interest rates vary over time and are higher today than they were on May 1, 2015. As a result, the actual issuance may have different rates or maturities than are discussed in this response. Because we do not know the exact timing of the issuance, I am recommending that we use a rate of 3.36% as the cost of the issuance, which would be representative of the expected cost of the issuance.

Q. IS IT APPROPRIATE FOR AEP TO PROVIDE FINANCING TO KINGSPORT?

A. Yes. AEP has a strong credit profile and significant name recognition in capital markets. These factors allow KgPCo and its customers to benefit from competitive financing terms that KgPCo may be unable to obtain on its own without additional cost from procuring a public rating. This arrangement allows KgPCo to pay the Parent's lower indicative cost of long-term debt rather than having to issue external debt to third parties.

Additionally, obtaining financing from the Parent allows KgPCo to avoid upfront costs normally associated with issuing external debt, which would normally be included in the cost of debt and result in higher rates to customers. For most 10-year issuances, the standard underwriting fee is 65 bps in addition to legal fees, trustee fees, and other issuance costs that can be avoided by utilizing the Parent as a source of financing.

Q. WHAT EFFECT DOES THE ADJUSTMENT HAVE ON THE OVERALL CAPITAL STRUCTURE?

A. This adjustment will not change the percentage of debt-to-total capital. It will, however, increase the percentage of long-term debt-to-total capital. It also lowers the percentage of short-term debt-to-total capital to a more appropriate level. The cost of long-term debt is currently 4.52%. This adjustment would reduce the cost of long-term debt to 3.94%. The proposed adjustments result in the overall weighted average cost of capital increasing from 5.66% to 6.69%. The adjusted capital structure is shown in Exhibit PMB-1.

Q. IS THE COMPANY'S PROPOSED ADJUSTED CAPITAL STRUCTURE APPROPRIATE?

A. Yes. The short-term debt balance as a percentage of total capital has grown from 16.0% in 2007 to 30.1% as of year-end 2014 and almost 34% by the end of the first quarter of 2015. This level of consistently high short-term debt balances indicates that short-term debt is being used as a source of long-term capital. It would be prudent for a portion of this capital to be replaced with long-term debt due to higher short-term debt levels creating increased interest rate risk, refinancing risk and liquidity risk. Short-term debt rates have historically been much higher than current rates. For 2000 through 2010, the average daily 3-month LIBOR rate was 3.00%, with a peak of 6.87%. These historical rates show the significant rate risk that KgPCo and its customers could experience as interest rates begin to rise if high levels of short-term debt are maintained. Issuing long-term debt now would mitigate these risks by locking in long-term debt rates in the current low interest rate environment and reducing reliance on variable rates. It also allows

KgPCo to improve its liquidity by increasing its capacity to borrow short-term debt in the future if necessary.

As shown in the chart below, a capital structure that is less reliant on short-term debt is representative of other regulated operating company subsidiaries within the region:

Company	Short-Term Debt	Long-Term Debt	Total Equity	Total Capital	Short-Term Debt / Total Capital
Alabama Power Co.	$ -	$ 6,927	$ 5,789	$ 12,716	0.00%
Appalachian Power Co.	$ -	$ 3,969	$ 3,452	$ 7,422	0.00%
Duke Energy Carolinas	$ 300	$ 8,585	$ 11,216	$ 20,101	1.49%
Duke Energy Progress	$ -	$ 5,957	$ 6,050	$ 12,007	0.00%
Georgia Power Co.	$ 840	$ 9,993	$ 10,406	$ 21,239	3.95%
Gulf Power Co.	$ 23	$ 1,347	$ 1,337	$ 2,707	0.85%
Kentucky Power Co.	$ 1	$ 845	$ 669	$ 1,514	0.05%
Mississippi Power Co.	$ 30	$ 2,331	$ 2,197	$ 4,558	0.66%
Ohio Power Co.	$ -	$ 2,275	$ 2,008	$ 4,283	0.00%
South Carolina Electric & Gas	$ 610	$ 4,303	$ 4,809	$ 9,722	6.27%
Virginia Electric Power Co.	$ 1,588	$ 8,936	$ 10,173	$ 20,697	7.67%
				Average	**1.90%**

$'s in millions as of March 31, 2015
Source: Companies' Q1 2015 10-Q Filings

The Company's planned issuance would reduce short-term debt as a percentage of total capital to about 3% on a pro-forma basis, bringing the capital structure in line with this peer group. This adjustment allows the Company to utilize the cost of capital associated with its expected capital structure and execute its planned issuance.

Q. WHAT IS THE TIMING FOR THE ANTICIPATED ISSUANCE OF LONG-TERM DEBT?

A. As mentioned previously, KgPCo currently has financing applications that are being considered by the Federal Energy Regulatory Commission ("FERC") and by the Tennessee Regulatory Authority ("TRA"). The applications that are being considered are Docket ES15-35-000 at FERC and Docket No. 15-00067 at the TRA. The financing will be completed following the fulfillment of necessary regulatory approvals in those dockets.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

KINGSPORT POWER COMPANY
T.R.A. DOCKET NO. 16-____

Recommended Capital Structure and Cost of Capital

	Amount Outstanding	Cost	Weight	Weighted Return
Long-Term Debt	$ 40,000	3.94%	54.78%	2.16%
Short-Term Debt	$ 2,039	0.29%	2.79%	0.01%
Preferred Equity	$ -	0.00%	0.00%	0.00%
Common Equity	$ 30,983	10.66%	42.43%	4.52%
TOTAL	**$ 73,022**		**100.00%**	**6.69%**

$’s in thousands.

Pro-Forma Cost of Long-Term Debt

	Balance	Rate
Affiliated Notes, due 2020	$ 20,000	4.52%
Pro-Forma Debt[1]	$ 20,000	3.36%
Total	**$ 40,000**	**3.94%**

[1]Assumed debt issued at rate of 3.36%.

KINGSPORT POWER COMPANY
T.R.A. DOCKET NO. 16-____

Actual Capital Structure and Cost of Capital
As of December 31, 2014

	Amount Outstanding		Cost	Weight	Weighted Return
Long-Term Debt	$	20,000	4.52%	27.39%	1.24%
Short-Term Debt	$	22,039	0.29%	30.18%	0.09%
Preferred Equity	$	-	0.00%	0.00%	0.00%
Common Equity	$	30,983	10.66%	42.43%	4.52%
TOTAL	**$**	**73,022**		**100.00%**	**5.85%**

$'s in thousands

Cost of Long-Term Debt

	Balance	Rate
Affiliated Notes, due 2020	$ 20,000	4.52%
Total	**$ 20,000**	**4.52%**