

BEFORE THE

FEDERAL ENERGY REGULATORY COMMISSION

IN THE MATTER OF: : Docket Nos.

THE NEW PJM COMPANIES: : ER03-262-001

AMERICAN ELECTRIC POWER SERVICE CORP. : ER03-262-004

ON BEHALF OF ITS OPERATING COMPANIES : ER03-262-005

APPALACHIAN POWER COMPANY : ER03-262-007

COLUMBUS SOUTHERN POWER COMPANY :

INDIANA MICHIGAN POWER COMPANY :

KENTUCKY POWER COMPANY :

KINGSPORT POWER COMPANY :

OHIO POWER COMPANY, AND :

WHEELING POWER COMPANY :

:

COMMONWEALTH EDISON COMPANY AND :

COMMONWEALTH EDISON COMPANY OF :

INDIANA, INC. :

THE DAYTON POWER AND LIGHT COMPANY :

:

AMERICAN ELECTRIC POWER COMPANY, INC. : EC98-40-000

AND CENTRAL AND SOUTH WEST CORPORATION : ER98-2770-000

: ER98-2786-000

AMEREN SERVICES COMPANY : EL02-65-006

ILLINOIS POWER COMPANY : EL02-65-000 ET AL.

RT01-88-016

Hearing Room 5  
Federal Energy Regulatory  
Commission  
888 First Street, NE  
Washington, DC

Monday, September 29, 2003

The above-entitled matter came on for hearing,  
pursuant to notice, at 9:00 a.m.

BEFORE:

HONORABLE WILLIAM J. COWAN  
ADMINISTRATIVE LAW JUDGE

APPEARANCES:

COMMISSIONERS:

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WILLIAM L. MASSEY  
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Federal Energy Regulatory Commission

888 First Street, NE

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P R O C E E D I N G S

(9:00 a.m.)

PRESIDING JUDGE: Good morning, everybody, this is a Commission inquiry into issues surrounding the Midwest Independent System Operator, PJM Regional Transmission Organizations, as directed by Commission Order issued September 12th, 2003 in Docket Number ER03-262, et al.

I'm Judge Cowan. I've been designated to preside over these proceedings. With me today, I'm honored to have the Chairman of the Commission, Pat Wood, Commissioner Nora Brownell, and just joining us, Commissioner Bill Massey.

As the Commission ordered, we have received prefiled testimony from those entities ordered to file, namely, the American Electric Power Company, Commonwealth Edison Company, Dayton Power and Light Company, Illinois Power Company and Ameren Services Company.

We will take this testimony into evidence in the form of sworn testimony subject to cross examination by the Commission and Advisory Staff. I will take the testimony in the order I just presented, AEP, followed by ComEd, then DP&L, Illinois Power, and Ameren.

Representatives of the Midwest ISO, PJM, and North American Electricity Reliability Council and the affected states, including state commissions and impacted Canadian parties are also invited to submit testimony. Of

those entities, the PJM and Michigan Public Service Commission have filed testimony. That will be received following the testimony of the regulated entities I just mentioned above.

The testimony of Commissioner Chappelle from the Michigan Public Service Commission, I understand is going to be taken in by telephone, and we'll make arrangements for that as we progress. I'm going to ask for the assistance of counsel for the Michigan Public Service Commission to use the phone that's available here to make that call and get Commissioner Chappelle in. I'm not sure if she wants to participate in the entire proceeding, in which case you're welcome to do that now, Mr. D'Allesandro.

MR. D'ALESSANDRO: Thank you very much, Your Honor. In fact, the phone, as I understand it, has been turned on. Commissioner Chappelle is listening in.

PRESIDING JUDGE: Very well, you are way ahead of me.

MR. D'ALESSANDRO: Thank you, Your Honor.

PRESIDING JUDGE: We will also receive testimony from other interested parties as invited by the Commission. I have received testimony from Detroit Edison Company, the International Transmission Company, PP&L Electric Utilities Corporation, a joint filing headed by Edison Mission Energy, and a filing from the Michigan and Wisconsin Stakeholders.

That will be taken following the testimony from the state interests.

All parties presenting testimony will be allowed and encouraged to briefly summarize their presentations before undergoing cross examination. I would ask that you keep this relatively brief, but make the major points that you want to make in this summary. Parties will be given an opportunity for oral rebuttal, to the extent that time permits.

As you know, we are limited to two days. We're going to try to fit a lot of testimony and questioning in that timeframe. I urge the parties to be concise in their presentations, and you should be direct and responsive in replies to questions. I would ask that you be respectful to your colleagues and specifically ask that you turn off ringers on cell phones and keep any necessary communications among yourselves at a low volume.

The first order of business this morning will be to identify those who are here as participants. I would ask the representatives ordered to be present by the Commission to identify themselves, followed by the representatives of other invitees.

You should respond only if you intend to present testimony or otherwise participate today and tomorrow. I'll start with American Electric Power.

MR. DUFFY: Your Honor, on behalf of American Electric Power, I am Kevin Duffy, from the Legal Department. I'd also like to enter the appearance of Joseph Hartsoe, who is our Vice President of Federal Regulation, and our witnesses are Dr. E. Linn Draper, Susan Tomasky, and Craig Baker.

PRESIDING JUDGE: Thank you. Representatives of Commonwealth Edison?

MS. HILL: Good morning, Your Honor. I'm Karen Hill, attorney, Vice President for Federal Regulatory Affairs with Exelon Corporation. I'd also like to enter the appearance of Elizabeth A Moler, the Executive Vice President for Government Regulations, Government Affairs, and Environmental Policy.

PRESIDING JUDGE: Thank you, Ms. Hill. Welcome, Ms. Moler. Dayton Power and Light?

MS. BRUNER: Your Honor, I'm Becky Bruner of the law firm of White, McAuliffe. Our witness is Patricia Swanske, Vice President, Dayton Power and Light.

PRESIDING JUDGE: Thank you. Illinois Power?

MR. PALMER: Your Honor, I'm Randall Palmer, inhouse counsel for Illinois Power Company. Also with me today is Larry Altenbaumer from Illinois Power Company.

PRESIDING JUDGE: Thank you, Mr. Palmer. Ameren Services?

MS. THOMPSON: Good morning, Your Honor and Commissioners. I'm Carolyn Thompson with Jones Day, here on behalf of Ameren Services Company. Here as our witness is David A. Whiteley, Sr. Vice President of Ameren Services.

PRESIDING JUDGE: Thank you very much, Ms. Thompson. I'd now like to ask Commission Staff to enter an appearance and identify the Staff members that will be asking questions today.

MR. BARDEE: Good morning, Your Honor. My name is Michael Bardee. I'll be appearing on behalf of Advisory Staff this morning. Also appearing on behalf of Advisory Staff are Kevin Kelly, Cynthia Marlette, William Hederman, Daniel Larcamp, Alice Fernandez, and Michael McLaughlin.

PRESIDING JUDGE: Thank you, Mr. Bardee. I now turn to other invited parties. Is there a member of PJM Interconnection?

MR. SPECTOR: Your Honor, my name is Barry Spector, with the law firm of Wright and Talisman, counsel for PJM Interconnection, LLC. With me today is Richard A. Wodyka, Sr. Vice President of PJM, who will be our witness.

PRESIDING JUDGE: Thank you, sir. How about the Midwest ISO?

MR. FLETCHER: Steve Fletcher, Your Honor, with the law firm of Duane Morris, representing Midwest ISO. With me is Jim Torgerson, CEO of Midwest ISO, Steve Cosi,

General Counsel, Midwest ISO, and Alex deBossier, Vice President for Government Relations.

PRESIDING JUDGE: Thank you. Representatives of the North American Electricity Reliability Council?

MR. COOK: Good morning, Your Honor, David Cook on behalf of NAERC.

PRESIDING JUDGE: Thank you, Mr. Cook. Welcome. On the phone, we have a representative of the Michigan Public Service Commission. Is that correct, Mr. D'Alesandro?

MR. D'ALESSANDRO: Yes, Your Honor, we have on the phone, Commissioner Laura Chappelle. I'd like to enter my appearance, David D'Alessandro with the law firm of Stinson, Morris, and Hecker.

PRESIDING JUDGE: Thank you very much. Are there representatives of other state commissions or state entities in the room? Please identify yourself.

MR. HEMPLING: Scott Hempling on behalf of the Missouri Public Service Commission. With me is Mr. Dan Wright, General Counsel, Missouri Public Service Commission.

PRESIDING JUDGE: Thank you, Mr. Hempling. Other state entities?

MR. LEVIN: Your Honor, Abe Levin, Assistant Counsel, Pennsylvania Public Utility Commission.

PRESIDING JUDGE: Thank you, Mr. Levin. Yes,

sir?

MR. EILBACH: Your Honor, Eli Eilbach from Duncan Weinberg Genzer and Pembroke, on behalf of the Virginia Commission.

PRESIDING JUDGE: Thank you, Mr. Eilbach.

MS. HALL: Sandra Hall, on behalf of the Maryland Public Service Commission.

MS. WISSMAN: Kim Wissman.

PRESIDING JUDGE: Thank you. Any other state entities in the room?

(No response.)

PRESIDING JUDGE: Any Canadian parties represented today?

(No response.)

PRESIDING JUDGE: I see no response. The other parties that have submitted testimony, I would like to get your appearances in next. Detroit Edison Company?

MR. SMITH: Good morning, Your Honor, Roger Smith with the law firm of Troutman Sanders, on behalf of Detroit Edison. I'd also like to enter the appearance of William Gerasmo of the same firm and Ray Sturde, Inhouse Counsel for Detroit Edison. With us today is Barry Hartwell, the Director of Regulatory Affairs.

PRESIDING JUDGE: Thank you, Mr. Smith. International Transmission Company?



MR. MacGUINEAS: Good morning, Your Honor, Biard MacGuineas for International Transmission Company. With me today is Larry Bruneel.

PRESIDING JUDGE: Welcome, Mr. Bruneel. Thank you, Mr. MacGuineas. PPL Electric Utilities Corporation?

MR. KAPLAN: Yes, Your Honor, my name is Donald A. Kaplan of the law firm of Preston Gates and Ellis. I'd also like to enter the appearance of Heidi M. Werntz of my firm, and Paul E. Russell, Associate General Counsel of PPL Services Corporation.

I will have with us tomorrow, John F. Sifficks, Vice President, Asset Management of PPL Electric Utilities Corporation. Tomorrow he will be the President of PPL.

(Laughter.)

MR. KAPLAN: Also with me today is Gabriel Lutzow of PPL Electric Utilities.

PRESIDING JUDGE: Thank you, Mr. Kaplan. The entities headed by Edison Mission Energy?

MR. O'DONNELL: Your Honor, Earle O'Donnell, from the law firm of Dewey Ballentine. I'd like to enter the appearance of Andrew Young, also of that firm.

With me today are John Mathis, who will be testifying here for you today or tomorrow, and the General Counsel of Midwest Generation.

PRESIDING JUDGE: Thank you, Mr. O'Donnell. How

about the Michigan and Wisconsin Stakeholders. Are they represented? Yes, sir?

MR. BACHMAN: Good morning, Your Honor, Gary Bachman with the law firm of Van Ness Feldman, representing Wisconsin Electric Power Company. With me today is Mr. David Heller, Director of Policy and Planning for Wisconsin Electric Power Company, who is presenting testimony on behalf of the Wisconsin-Michigan Stakeholders.

PRESIDING JUDGE: Thank you, sir. Are there any other entities represented here today that will be submitting testimony or comments?

(No response.)

PRESIDING JUDGE: Okay, very well, I'd like to advise, first of all, that any pending motions that have not already been addressed by the Commission, will be considered in due course. I will not be ruling on those from the Bench. I believe some of the interventions are under consideration and may be ruled upon as early as today.

Are there any preliminary matters before we begin taking the testimony, that anybody wants to raise before we start?

MR. DUFFY: Your Honor, just two minor procedural points.

PRESIDING JUDGE: I didn't think we were going to get away with that one.

(Laughter.)

PRESIDING JUDGE: We came very close.

MR. DUFFY: I assume that the rebuttal statements will be put on after everyone has testified on direct and been crossed?

PRESIDING JUDGE: That's my intent, yes.

MR. DUFFY: The other issue is that we have joint witnesses, joint testimony filed by Susan Tomasky and J. Craig Baker. We would like to put them on as a panel.

PRESIDING JUDGE: There are a couple of such cases in here. I'll leave it to you as to whether you want to try to fit the two people up at the witness box. There is a chair. I didn't test it out. Or, you can do it from the table.

Is there anything else before we proceed?

(No response.)

PRESIDING JUDGE: What I'd like to do now is to get all the witnesses to take the oath, all witnesses that will be offering testimony today or think you will be speaking today. Please raise your right hand and stand up.

(Witnesses sworn en banc.)

PRESIDING JUDGE: Thank you. Please be seated. As I indicated, the procedure we'll follow today is, I will call each witness that will offer sworn testimony. Their counsel will be expected to present the witness and ask for

the witness to summarize his or her testimony, then offer that testimony for introduction into evidence.

I will mark the testimony as an exhibit and rule on its admission. Counsel will then offer the witness for questioning. Joint testimony may be heard as a panel. Copies of the testimony should be supplied to the Reporter for marking as exhibits, and questioning today will be undertaken exclusively by the Commission Staff and the Commissioners and likely exclusively by them. I may participate to a small extent, if I feel the need to do that.

I will rule on any objections that may be taken during the course of the questioning. Before we begin, I'd like to ask the Commissioners if they have any opening comments. Mr. Chairman?

CHAIRMAN WOOD: Thank you, Judge Cowan. Thank you for the parties, the Staff, and counsel for all the parties for being here and for participating in this. Our goal today is a little different than the traditional Commission on-the-record hearing.

We do have a number of proceedings before the Commission in various different dockets, I think, which most of you referred to, collectively among yourselves, and the testimony that we've read recently --

There are some questions we have about how we're

going to get the proper RTO formation in the important midwestern part of the country. I think we've got certainly most, if not all the players in this joint inquiry proceeding to try to get some discussion about that.

This is not a "gotcha" proceeding; this is a proceeding to really understand the complicated and interwoven issues and look for solutions, perhaps even some out-of-the-box solutions that may facilitate forward progress, while recognizing as much as possible, the different parties' needs as far as business needs and as far as customer needs are involved.

With pending cases, it's best to address the process like this as we're doing today, and I'm pleased to have the capable Judge Cowan back at the Commission and in charge of this proceeding to steer it through the shoals for us.

PRESIDING JUDGE: Thank you. Commissioner Massey?

COMMISSIONER MASSEY: All the parties represented here today and the Commission have been struggling with this issue of RTO formation in the Midwest for quite some time now, so I hope we can make progress today. I appreciate all interested parties attending.

COMMISSIONER BROWNELL: I look forward to getting a better handle on the actual facts since we have a lot of

competing information to deal with here. I would remind everyone that I think we all at this point share the frustration that was expressed by the state commissioners at our recent meeting in PJM, almost unanimously, that it's time to get on with this. It's time to bring the value to customers.

While I think we have a lot of competing interests to balance, I don't think the interests of customers ought to be considered in that category. So, let's put the customers first, and figure this out in a way that we can move forward and kind of quit wasting the customers' money on these kinds of proceedings.

PRESIDING JUDGE: Thank you, Commissioner Brownell. I am going to begin now with the taking of the testimony and the questioning of the witnesses. Mr. Duffy, you lead off.

You have three witnesses. Two will appear as a panel and one separate.

MR. DUFFY: Yes, Your Honor. We call Dr. E. Linn Draper, Jr.

PRESIDING JUDGE: Mr. Draper, I remind you that you've been previously sworn, and you're under oath. You may proceed.

Whereupon,

E. LINN DRAPER, JR.,

a witness, having been called for examination, and, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. DUFFY:

Q State your name, title, and business address?

A I am Linn Draper, Chairman, President, and CEO of American Electric Power Company. My address is 1 Riverside Plaza, Columbus, Ohio, 43215.

Q Dr. Draper, did you prepare prefiled direct testimony in this proceeding?

A Yes.

Q Do you have before you, what has been marked for identification as Exhibit AEP-1?

A I do.

Q Is that your testimony?

A Yes, it is.

Q Do you have any changes or corrections to that testimony?

A Yes, there are several.

On page 2, line 19, the words "our [50 to 60] million orange road project installed" should be changed to "the 56 million invested in projects."

On page 3, line 1, the words "at least" should be struck.

On page 4, line 15, the brackets around 185 should be deleted.

On page 6, line 8, the word "to" before "encouraging" should be struck.

On page 7, line 3, the word "operation" should be "operational" a-1.

And finally, on page 8, lines 5 and 6, the word "disagreement" should be changed to "some agreement."

MR. DUFFY: Thank you, Dr. Draper.

Your Honor, first of all, we apologize for the number of clerical mistakes but this was a rather expedited proceeding here. Secondly, we have copies of the fully-corrected testimony that we can give to the Reporter. That's probably the best way to do this.

PRESIDING JUDGE: That would be appreciated.



Are you offering the testimony for admission, Mr. Duffy? Or do you want to summarize it first?

MR. DUFFY: We'd like to ask Dr. Draper to summarize his testimony.

PRESIDING JUDGE: You may proceed, Dr. Draper.

THE WITNESS: Thank you, Judge Cowan, Chairman Wood, Commissioners Massey and Brownell, as I said, I'm Linn Draper, Chairman of the American Electric Power Company. My testimony stresses two points.

First, AEP is committed to meaningful progress on RTOs. We've spent and committed about \$50 million and a tremendous amount of time and energy of our employees, managers, top executives in pursuit of RTO membership. I can assure you that we don't commit this level of resources for goals that we don't seriously intend to achieve.

Second, I want to set the record straight. AEP supports competition and embraces open access, but we have two fundamental interests at stake here. The first is protection of the value of the AEP transmission system. You need only look at a map to appreciate the extent and strength of the AEP transmission system relative to the surrounding systems and the interest of stakeholders in using the AEP system for access to low-cost power supplies, particularly in higher priced regions such as Michigan and the Eastern Seaboard.

The AEP transmission system has been a prize that many market participants and stakeholders are fighting over. We can support the elimination of pancake rates to support competition, but only with a full and contemporaneous revenue neutrality mechanism. To do otherwise would represent a massive wealth transfer from AEP shareholders and native load customers to other users of our system.

I want to be clear that we won't stand by while others make decisions about our transmission system to the detriment of our customers and shareholders. Also, I believe that actions that diminish the value of transmission assets are not good public policy. There's a recognized need to provide incentives for transmission investment. The Commission's focus in the past several years has been on reducing the delivered price of power to end users or to encouraging the development of generation. And while these are laudable goals, the Commission, in my view, has often lost sight of the significant benefits to a competitive marketplace that a robust transmission system can provide.

The second fundamental interest is the protection of the integrated transmission system. Some advocate splitting AEP's eastern transmission zone, having AEP participate only in those states that have approved or do not object to such participation. This is not a solution and we'll vigorously oppose it.

It may be technically feasible but the numerous legal regulatory operational, political and other issues associated with it would make it a lengthy, expensive, and certainly not a cost-effective process. It does not make sense and, indeed, it would be counterproductive to introduce costly and complicated operational changes to a robust transmission system that held together during the blackout, and prevented a further cascade.

There must be a better solution to accommodate some of our state's desire to carefully examine the ramifications of our RTO participation, particularly since the definition has changed so significantly since our merger commitment was accepted three years ago.

We've been asked to propose a solution to the current delay in our RTO plans. A forced solution is not likely to be in anyone's long-term interest. I strongly urge a workable compromise among all of our regulators that doesn't unfairly penalize our company to satisfy any particular set of regulators or stakeholders. I will commit the necessary resources to see that this takes place.

I think there's common ground for a meaningful compromise. Everyone seems to agree on certain aspects of RTOs, particularly the need for an independent entity to strengthen the reliability of the grid through a broad, regional approach. These were the essential RTO elements at

the time of our merger commitment. It's the market aspects that have engendered the concerns.

Let's at least compromise on those areas in which we have some agreement, then we can deal with the other issues. I appreciate the opportunity to address this group and pledge my commitment to a successful resolution of these complicated issues.

MR. DUFFY: Thank you, Dr. Draper.

We move the admission of Exhibit AEP-1, subject to cross examination.

PRESIDING JUDGE: Any objections?

(No response.)

PRESIDING JUDGE: AEP-1 will be received.

(The document referred to was marked for identification as Exhibit Number AEP-1 and was received in evidence.)

PRESIDING JUDGE: Mr. Bardee, you may inquire.

MR. BARDEE: Your Honor, Mr. Larcamp will begin the questioning of Dr. Draper.

MR. LARCAMP: I'm a West Virginian and was raised on AEP power, so it's a pleasure to have you here today.

THE WITNESS: A pleasure to be with you.

CROSS EXAMINATION

BY MR. LARCAMP:

Q I'd like to start on page two of your testimony. You reference the merger condition. I just heard you testify about the merger commitment. I'd like to clarify the distinction between those two terms. Could you confirm that I'm correct when we talk about the merger commitment, this is the stipulation the company filed with trial staff on May 24, 1999?

A Yes.

Q When we talk about the RTO condition, that was the Commission's directive for this order, accepting the voluntary commitment that the company entered into it with trial staff?

A Yes.

Q You indicate and I believe in your oral summary, you address some \$50 million that the company has spent or committed on complying with the commitment. Do you have a rough breakdown between the amount you spent and the amount that you've committed?

A I don't have that but I'm certain it's available.

Q Can you also detail for staff the relative breakdown between what you spent on the various state proceedings and what you spent at the Commission in attempting to fulfill the commitment?

A No, sir. I don't have that. Mr. Baker will follow me and he, perhaps, will have that information.

Q Thank you. I believe, at the bottom of page two, if I'm correct, with the revision to your testimony, on line 19, it now talks about major investments in transmission infrastructure, such as our \$56 million invested in projects installed. Is that the way it reads?

A Yes, sir.

Q Could you detail what those expansions to the transmission grid involved?

A I can enumerate a couple of them. Again, we could doubtless provide a complete list, but major among them are the Orange Road Substation Project, north of Columbus near the town of Delaware. There were also activities undertaken in the Marysville area in Ohio. As I said, there are others as well.

Q Were those certificated projects by the Ohio Commission?

A Yes.

Q I think your testimony is that those projects were to increase the transmission capability for transactions from the south and east to the north and west?

A Yes, sir.

Q In your state certification procedures, did you identify which beneficiaries of those expansions would be paying for those expansions?

A I don't know.

Q Would Mr. Baker be able to testify to that?

A He's nodding his head, so yes, the answer is yes.

PRESIDING JUDGE: Mr. Larcamp, if I may interrupt at this point, just for a second? There are a lot of sort of commitments being made to furnish additional information, and that kind of thing. I think, before we conclude the AEP testimony, we'll need to pin down more specifically when that will be provided. We'll have a proposal from AEP and you can react to that, I guess. Okay?

MR. LARCAMP: Thank you, Your Honor.

BY MR. LARCAMP:

Q Dr. Draper, on page three of your testimony, you talk about the company's capital and O&M expenditures over the last ten years, I believe. Will the company be able to detail those at some point?

A Yes. We have that data by year.

Q Also provide information about whether those expansions required state commission authorization and whether the costs for those upgrades were identified in the applications how they would be paid for.

A I'm certain we can provide that information.

Q On line 13 on page three, Dr. Draper, you reference that there are others making decisions about the company's transmission system to the detriment of customers and shareholders. Are there any Commission orders that you

believe fall within that statement and, if so, could you detail those and explain?

A I can't detail those and explain what Commission orders there are. There are a number of parties that have suggested ways in which our transmission system should be dealt that we think would be detrimental to the customers and shareholders of AEP, and it's those collective decisions that we're concerned about.

Q Thank you.

Moving to page five of your testimony, I believe you also addressed this in your oral summary, about your desire, appropriate, I believe, to protect the value of the company's transmission system. On page five, you indicate that you're not talking about trying to protect the company's generation from the competition. But then, on page four, and maybe I'm misreading your testimony, the inference I draw is that you're suggesting the value of the transmission system is tied by your ability to transmit power from your large, mostly coal-fired plants. And I just want to make sure I understand that.

A The attempt was to describe how our system had been built. It is a large, geographically dispersed system. Much of the generation capacity being along the Ohio and Kanawha River, and many of the load centers distant from that. So we built a transmission system that was integrated



to move power to our native load customers over the last 75 or 100 years. That system also has the capability to move lots of power for other people.

I'm not suggesting that we're trying to protect our generation; I'm simply trying to describe how the system was built.

Q Thank you.

When you're moving other companies' generation, that's your testimony about the \$185 million of revenue for third parties and the \$86 million of transmission service to non-native-load customers?

A Yes.

Q Could you provide a breakdown, explaining where the revenues from those transactions went back in your cost of service?

A Let me see if I can get it. Can we do that?  
Yes.

Q You've also just indicated that the transmission system can also be used for off-system sales by the company. Can the company provide a breakdown, maybe for the last three years, of the off-system sales.

It's my understanding, under the company agreements, that those off-system sales are credited back to the individual offering the company, pursuant to a formula tied to, I believe, the off-systems sales the year before

the merger with CSW, or has that now been modified?

Mr. Baker again is nodding so we can ask those of Mr. Baker?

A Mr. Baker.

(Laughter.)

BY MR. LARCAMP:

Q Thank you.

Dr. Draper, on page six, I believe, starting at line 6, you talk about the Commission's focus has been reducing delivered price of power and encouraging the development of generation, and you go on to say that those are laudable goals, so I assume that you agree that the Commission should be moving to do those things?

A I do.

Q But you go on, I think, to suggest that the Commission -- and let me ask this question -- is it your testimony that the Commission should spend more time on transmission incentives?

A I don't know about time, but I think that transmission incentives are important if there's a desire to have a more robust transmission system, which I think is something that this nation needs.

Q Is it correct that the company, since the merger, has only filed for one transmission rate increase?

A I don't know the answer to that.

Q So we can ask Mr. Baker about that, as well?

(Pause.)

MR. BARDEE: Your Honor, if I could, there's one small issue I'd like to raise with Mr. Draper, and ask him a couple of questions about that.

PRESIDING JUDGE: Proceed.

CROSS EXAMINATION

BY MR. BARDEE:

Q Dr. Draper, could you turn to page six of your testimony. On lines 19 and 20, you say that splitting the AEP system is not a solution, and we will vigorously oppose it?

A Yes.

Q On page seven, lines 9 and 10, you say that any solution to the current impediments to RTO development that comprises these principles cannot be said to represent voluntary action on AEP's part.

Is it the company's position that splitting AEP East, as the means of fulfilling the merger commitment, is not a voluntary action by AEP?

A Yes, sir, it is.

Q Your company has suggested a different approach toward meeting the merger commitment, which would involve fulfilling the Order 2000 functions as part of PJM but excluding AEP from certain other aspects, such as doing it in real-time markets.

A (Draper) Yes, sir.

Q If that type of approach is used as the means of fulfilling AEPs merger commitment, is it not a voluntary action by AEP?

A (Draper) Yes, it would be if the conditions were right.

Q Can you explain that last part?

A (Draper) I think it depends on the details, but our objective is to be sure that the transmission system is operated efficiently, that it provides access to all comers, but we are concerned about the aspect of either splitting the system or detailing with these market issues to which some of our states have been so violently opposed.

(Pause.)

Q Are you suggesting that the approach your company has proposed in its testimony is voluntary if all of your states go along with it?

A (Draper) Well, we certainly think that if the proposition for incorporating the AEP system in PJM recognizes the rate issues that are of concern to the

states, that they would be supportive, or at least neutral.

Q Let's talk about a third approach to integrating AEP and the PJM, an approach under which AEP is fully integrated into PJM, including congestion management, real-time and day-ahead markets. If that is the means for integrating AEP into PJM, is that a voluntary action on the part of AEP?

A (Draper) I think it probably would not be if we had states that are vigorously opposed to it. After all, we must live with the states for a very long time and it's our view that this is best handled by working out an agreement between the Federal Commission and the several State Commissions that accommodate the needs of each. We have suggested a possible way to do that. We would hope there would be dialogue and that the needs to all parties could be accommodated.

Q In the merger commitment the company made with trial staff, was there any condition stated along the lines that your commitment was premised on acquiescence or support from each of your states?

A (Draper) No, there wasn't. But you will recall that the RTOs, as then envisioned were quite different from what they now are and it was our expectation that the states would find the functions then contemplated by an RTO acceptable. As RTOs have evolved over the last several

years, that circumstance no longer prevails.

MR. LARCAMP: One more, your Honor.

FURTHER CROSS-EXAMINATION

BY MR. LARCAMP:

Q Dr. Draper, I'd like to talk a little bit about your statement as RTOs have developed. The Commission issued its Notice of Proposed Rulemaking for what because Winter 2000 on May 13th, 1999.

Would you accept that subject to check?

A (Draper) Yes.

Q The Commission, in its proposed rule at the docket number -- I'd like to quote Your Honor from the section on Congestion Management, I, talks about "The market mechanisms must be accompanied by participation by market participants and must provide all transmission customers with efficient pricing signals to show the consequences of their transmission usage decisions."

That was, would you agree, a proposal that was known to the company when it entered into the merger commitment on May 24th, 1999?

A (Draper) No doubt.

Q Can you explain -- this is not according to your testimony, an essential RTO element at the time of the merger commitment?

A (Draper) I think Mr. Baker is best prepared to

respond to that detail.

MR. LARCAMP: Thank you, Dr. Draper.

PRESIDING JUDGE: Does Staff have any other questions of Dr. Draper?

(Pause.)

PRESIDING JUDGE: While Mr. Kelly gets settled, anybody that's going to be speaking, either for the record or for the overflow room, you need to sit near a microphone when you speak, otherwise we can't hear you and the Reporter can't hear you.

CROSS-EXAMINATION

BY MR. KELLY:

Q Good morning.

A (Draper) Good morning.

Q The thing I wanted to focus on was your emphasis on the integrity of the AEP system.

A (Draper) Yes.

Q Could I conclude from that that AEP has to have a single system for managing congestion, it wouldn't do to use one congestion management system in part of AEP and a different congestion management system on another part of AEPs grid?

A (Draper) My focus really is on the physical reliability of the system. And I think that one of the huge advantages of the AEP system is strength of the transmission

network. We have, as you know, a 765 KV system that runs from Michigan down to Virginia; that's the backbone of our system and really provides much of the strength of the eastern interconnect. Beneath that we have a 345 system. When the events occurred on the 14th of August, the 765 system never flickered. The 345 system did just as it should do -- it sensed disruptions in the surrounding systems and disconnected automatically. It seems to me that to take a physically strong system of that type, which provides the sort of reliability that it has provided over time and split it up in some way along state lines or otherwise is a huge mistake if we're concerned about the physical reliability of the physical transmission system.

Q Could I confer from that that splitting management systems would be a huge mistake also?

A (Draper) Mr. Baker might have an opinion on that. I'm more concerned about the physical circumstance.

MR. KELLY: Any other questions from Staff?

MR. BARDEE: Marty, could I ask one further question of Mr. Draper?

FURTHER CROSS-EXAMINATION

BY MR. BARDEE:

Q Mr. Draper, let's assume for the moment that the three approaches discussed a minute are all considered, not only by this Commission, but by each of your State



Commissions, and none of them satisfies all of the constituents; meaning, not only FERC, but all of your States, so that we're in a position where none of the three proposals would be supported by every one of your regulators. What would you suggest at that point as an option for this Commission to consider in following-up on your merger commitment?

A (Draper) I think that would be totally dependent on the facts at that time. It's very important to try to get all of the interested regulators to agree on the fundamentals. If we cannot, then at that point, depending on what position various entities have taken, I think a decision would then be made. But it depends entirely on the conversations that take place and the positions the various regulators take.

PRESIDING JUDGE: Anything else from Staff?

(No response.)

PRESIDING JUDGE: Mr. Chairman?

CHAIRMAN WOOD: Dr. Draper, from your perspective as head of the company, how do you see from that level the RTO that you committed to joint in '99 being different from the one that you have filed to join back in April of this year?

WITNESS DRAPER: I think, Mr. Chairman, it is principally the functions that have to do with the market as

opposed to the reliability of the system and the assurance that all prospective users of the system would be treated fairly.

CHAIRMAN WOOD: So none of those aspects existed in PJM in 1999?

WITNESS DRAPER: You will recall at the time we were discussing we had not been committed to PJM. We were talking about first Midwest ISO and then the Alliance, so we had not probably focused much on PJM at that stage.

CHAIRMAN WOOD: Thank you.

PRESIDING JUDGE: Commissioner Massey.

COMMISSIONER MASSEY: Let's suppose as we move forward there are great efforts to try to achieve a consensus and not to prejudge what will happen. Let's assume we get to a point where somebody has to make a decision about what is in the best interest of the intrastate market in this region of this country. Should we be satisfied with some sort of stalemate? How would you suggest that we break through this problem? We essentially have an agency with clear Federal authority and some states with clear state authority disagreeing about what the best policy is for this region of the country. How do we break that stalemate?

WITNESS DRAPER: I'd start where you started, Commissioner Masser, with the assumption that it wouldn't

fail, that we would be able to reach consensus. But your question then went on to say despite best efforts it did in some way fail. Then I think that's a legal question. It's certainly not my competence to answer that legal question.

COMMISSIONER MASSEY: Your voluntary commitment to participate in PJM, can you describe your goal in making that commitment? What were you trying to achieve that you considered to be in the interest of your company or the interest of your ratepayers in your region?

WITNESS DRAPER: Let me recite the history as best I know it and then, to the extent you want more detailed description, Craig Baker can talk about it. But you'll recall our history of discussions of RTOs started with the Midwest ISO that encompassed five companies that later were called the alliance. In those early discussions with the Midwest ISO, we were able to perfect a mechanism to provide us revenue neutrality. The suggestion then was that the five companies that sort of formed a crescent on the east and north of MISO had more in common than did other MISO companies and the alliance was proposed. Again, there was appropriate revenue recognition agreement among those various entities. We came to the Commission on a number of occasions -- Craig can recite when and what happened on those, but a number of preliminary approvals were given but ultimately it was decided that the alliance did not have the

appropriate characteristics for a stand-alone RTO. And so the proposal to form the alliance came apart and the various companies went different directions. Our discussions with the Midwest ISO again revolved around the revenue aspects of our participation and the earlier agreement that we had reached on revenue sharing was no longer available to us. We had similar conversations with the PJM and they were more supportive of a way to provide revenue neutrality in the short-term while working out a long-term arrangement. It was for that reason, among others, that we found the PJM more desirable.

COMMISSIONER MASSEY: Did you believe that making this commitment would allow you to fulfill your reliability mission as a company?

WITNESS DRAPER: We did.

COMMISSIONER MASSEY: Did you feel like it would provide for an economical coordination of facilities in your region?

WITNESS DRAPER: We thought it would.

COMMISSIONER MASSEY: Thank you.

PRESIDING JUDGE: Commission Brownell, do you have any questions?

(No response.)

PRESIDING JUDGE: Anything further from the Staff or the Commission of this witness?

(No response.)

PRESIDING JUDGE: Thank you very much for your testimony, Dr. Draper, you are excused.

(Witness excused.)

MR. DUFFY: We call Susan Tomasky and Jerry Craig Baker. Whereupon,

SUSAN TOMASKY

and

JERRY CRAIG BAKER

were called as witnesses, and, having been previously duly sworn, testified further as follows:

PRESIDING JUDGE: Ms. Tomasky, Mr. Baker, I remind you that you have been previously sworn and remain under oath.

Mr. Duffy, you may proceed.

DIRECT EXAMINATION

BY MR. DUFFY:

Q Please state your names, and business addresses, and titles. First, Ms. Tomasky, then Mr. Baker.

A (Tomasky) My name is Susan Tomasky. My business address is 1 Riverside Plaza, Columbus, Ohio, 43215. I am the Executive Vice-President for Policy, Finance and Strategy at AEP. I also serve as the company's Chief Financial Officer.

A (Baker) My name is J. Craig Baker, Senior Vice

President of Regulation and Public Policy. I am at the same business address as Dr. Draper and Ms. Tomasky.

Q Did you cause to be prepared prefiled direct testimony jointly?

A (Tomasky) We did.

Q Do you have before you what has been marked as Exhibit AEP 2?

A (Tomasky) We do.

Q Is that your direct prefiled testimony?

A (Tomasky) Yes.

Q Mr. Baker, do you have any changes to be made to that prefiled testimony?

A (Baker) Yes, we have two changes to be made.

On page 27, I would propose striking the last sentence starting with "In addition" through "staff data requests."

And on page 34, line five, in the parenthetical, I would scratch the "s" in the last word and make it "mechanism" rather than plural. Other than that, there are no changes.

MR. DUFFY: Thank you, your Honor. Again, we have corrected copies which we can provide to the Reporter.

BY MR. DUFFY:

Q Ms. Tomasky and Mr. Baker, if I were to ask you the questions in your prefiled testimony as changed would

your answers be the same?

A (Baker) Yes.

Q Ms. Tomasky, would you be so kind as to summarize the direct testimony?

A (Tomasky) In accordance with your request, Judge Cowan, I will attempt to be brief. There are certain matters that have been elaborated upon that were touched upon in Dr. Draper's testimony. I will not recite those for the group. I want to emphasize that we're here today to fundamentally described AEPs efforts to participate in an RTP and to answer this Commission's questions about the impediments that have prolonged that process. That prolongation has happened or frustration -- we understand it has happened to the frustration of the Commission. It's certainly happened to the frustration of some but not all of our states. And it's happened to the frustration of our neighbors and competitors. Many of us are here today to advise you on how to make our system more readily available to them.

AEP has been criticized for just not making it happen, but the fact is the regulatory landscape has shifted radically over the last couple of years. This is not to say that that shift was wrong, that that shift was not appropriately embedded in policy, but it has many facets to it and, as a consequence, people have begun to look at the

RTO formation differently.



This Commission has done so. It has begun to couple RTO formation with principles of standard market design that may have been preliminarily identified in Order 2000 that certainly were not completed and articulated to the full extent that we now understand them to be. Similarly, our states have, either through a growing understanding, concern, rightly or wrongly, of the risks of competition with the identification of the significant costs of transforming diverse electrical systems into RTOs and also come to look at these issues differently.

So the simple answer to your question as to what the impediment to the RTO formation is is that the political turmoil around RTOs is huge. We have many, many people with different views as to how we should proceed. We have our own views as to how we proceed. We was an apparently consensus around where RTOs are moving now has some dissenting voices. Again, that is not to challenge the basic principle but that is to recognize that when you serve many masters the policies do have to come together. The intellectual arguments may be still quite valid and it is absolutely the case, as the Chairman has said, that AEP has not withdrawn from its wish to join an RTO. We want to do that as a business matter and also a means of fulfilling the commitment we made at the time of the merger. But the fact is that the consolidation of the industry that this

Commission ultimately seeks, however appropriate its purpose, costs money, poses risks, and, at this point at least, there are some clear winners and losers. It is the questions around that that are going to have to be answered for our dissenting states as we move forward. We're eager to participate in the solution to that crisis but we believe that that is as important a job for the Commission as it is figuring out what your legal path is for going forward.

Finally, our testimony outlines in detail the history of AEP's efforts to participate in an RTO. Dr. Draper also referred to some of these and I won't repeat them here, although I'll be happy to answer questions that you may have about the legal issues associated with that. That the fundamental fact is that there's no RTO formation efforts other than those perhaps associated with tight power pools that hasn't been beleaguered by organizational and economic complexities that are associated with bringing together diverse electrical systems and what are, in fact, large economic engines. Outside of the pools, there are no proven success stories precisely because true collaboration of such diverse entities is a true challenge.

As our testimony outlines, however, we think there's no alternative to collaboration in theory, and we state this in our testimony. FERC has legal authority to override the processes in place in the states that have

asserted jurisdiction and in those that dissent and we have discussed that in other filings before this Commission. We would, quite reluctantly, in fact, prefer this option to unfortunate compromises such as the disintegration of our unique and, we believe superior transmission system.

Ultimately it's not just AEP who has to live with our dissenting states. In order for the Commission to accomplish its public policy objectives, the fact is that over time there will be countless matters on which state and Federal cooperation will be required as we move forward to deal with these complex issues. It is for that reason that we have outlined in our testimony a collaborative -- what we think is the beginning of a collaborative solution for moving forward. It seems quite clear that the most strident controversy with our states who are dissenting has accompanied, as I mentioned earlier the company's participation in RTO and standard market design elements.

We are therefore suggesting as a starting point the possibility that AEP participate in PJM on a limited basis, adopting all functions except those related to its markets. Obviously this is not ideal to those who want full functionality, but it does achieve full independence, non-pancaked rates with a adequate loss to revenue recovery mechanism -- which, as you know, is important to us -- market monitoring, regional planning, and independent

reliability coordination. It also, we believe, responds to some of our dissenting states' concerns, although ultimately they will be the ones, as the questioning has acknowledged, that will determine that. We do believe such a solution would fully satisfy our merger commitments. And as for markets, PJM's markets are voluntary in any event, both AEP and other PJM market participants could engage in bilateral transactions assisted by other features of this proposal and accomplish, we hope, some of the results that the Commission is otherwise thinking.

I'll wish to close by simply noting that AEP does find itself at the center of this controversy but we firmly believe it's not because we did anything wrong but, in fact, because historically AEP did something that was very right. It built an excellent transmission system that serves our customers very well. It has made a very significant contribution to the integration of western and eastern markets. We continue to want to participate as constructively as we possibly can in these efforts and, As Dr. Draper said, we'll lend our full resources to doing so. I do not think stalemate is an inevitable outcome, but I do think that compromise is in fact the only alternative.

Thank you.

PRESIDING JUDGE: Thank you, Ms. Tomasky. I may bother you with a few more minor questions.

Did you cause to be prepared certain exhibits attached to your testimony?

WITNESS TOMASKY: We did.

PRESIDING JUDGE: Were those exhibits prepared under your direction or supervision?

WITNESS TOMASKY: My direction, yes.

PRESIDING JUDGE: Thank you.

Are there any changes to the exhibits?

WITNESS TOMASKY: No.

MR. DUFFY: Your Honor, I move the introduction of Exhibits AEP-2, -3, -4, and --5, subject to cross-examination of the witnesses.

PRESIDING JUDGE: Any objection?

(No response.)

PRESIDING JUDGE: The aforementioned exhibits will be received into evidence.

(Exhibits AEP-2, AEP-3  
AEP-3 and AEP-5 were  
marked for identification  
and received in evidence.)

PRESIDING JUDGE: Staff, you may proceed when ready.

#### CROSS-EXAMINATION

BY MR. BARDEE:

Q Good morning.

Can you tell me how much of AEPs power sales are at wholesale and how much is at retail?

A (Baker) I would believe that the vast majority is clearly at retail. I would think something along the order of 80/20 as a percentage split, plus or minus some percentage. But that would normally be what we use.

Q 80/20 retail/wholesale.

A (Tomasky) We can provide you some historical data on that, Mr. Bardee, but that's basically correct. Obviously what happens on our system: when retail demand increases, generation goes to those retail customers. We've actually experienced a decline in what you would call FERC contracts or requirement contracts. When load to the retail, load to the system, is down power is obviously marketed elsewhere.

Q Focusing on the part that is wholesale, can you tell me roughly what is the annual amount of revenues from those sales?

A (Tomasky) Wholesale revenues, we, I believe, had stated last year a breakdown on what we call system sales, which is in the neighborhood of about \$300 million total and we can provide you the breakdown in that.. That includes a variety of things, including revenues paid by our generation under the FERC tariff to transport transmission, as well as the amounts we receive from FERC parties.

Q Can you clarify that last part?

A (Tomasky) I'm sorry, I gave you transmission revenues. I'm sorry, I apologize for that. That was the issue I was speaking to, is transmission revenues. You were talking about the system sales numbers? I'd have to go back and check, but I believe last year, it was in the \$3-400 million range.

Q Then for the part that is transmission service, can you tell me the annual revenues from that, approximately?

A (Tomasky) Last year, it was around \$300 million. That was the discussion I gave you earlier, which was split between that which was paid internally and, therefore, does not produce net earnings, so, from amounts that are paid under the FERC tariff by our generation to transmission and roughly the other half comes from third parties.

So, roughly half of the \$300 million?

A (Tomasky) But we can give you that breakdown precisely.

Q Roughly half of the \$300 million is internal?

A (Tomasky) Roughly a little less internal.

Q Can you tell me how those revenues, both wholesale sales and the transmission for non-AEP companies are treated in your retain rates by the state commissions?

A (Tomasky) Craig, you probably know the details

more.

A (Baker) It varies. The way it flows back to customers, the important thing to note is that both the generation margins or profits, as well as the transmission revenues get flowed back to customers to ultimately reduce rates.

In some cases, that is a base rate item. The adjustment will be done during a rate case. In other cases, they are flowed back in a more expedient manner through fuel clauses, so each state has its somewhat unique way of treating those revenues.

Q Can you estimate approximately how much of those revenues is given back to retail customers through a fuel clause approach, compared to a base rate approach?

A (Baker) At today's point in time? Because they change. We have certain rate freezes that, in effect, once they go off, the treatment may be different, but right now, I believe the number would be approximately ten percent of the generation margins flowed back to customers immediately. That would be the number.

Q Can you provide, under whatever procedures we later work out, a specification of the flowback arrangements for each of the operating companies in each state?

A (Baker) Certainly.

MR. DUFFY: Point of clarification, Mr. Bardee.



Are we talking about our Eastern states?

MR. BARDEE: Yes. I'm focusing only on the east part of AEP.

BY MR. BARDEE:

Q Could you turn to page 13 of your testimony? I just wanted to get some background built out here, if I could, please.

You say here that AEP has filed applications in four states for authorization allowing AEP East to join PJM and that the four states are Virginia, Indiana, Kentucky, and Ohio. Can you tell me which of your operating companies operate in each of those four states?

A (Baker) Certainly. In the case of the Indiana Regulatory Utility Commission, that's our Indiana-Michigan Power Company; the Kentucky Public Service Commission, that's Kentucky Power; the Public Utilities Commission of Ohio, we have both Ohio Power and Columbus Southern Power; and in regards to the Virginia State Corporation Commission, that is Appalachian Power.

Q What are the other states that regulate parts of AEP East, beyond these four that we've mentioned?

A (Baker) Tennessee, West Virginia, and Michigan.

Q And which operating companies provide service in those three states?

A (Baker) In the case of Tennessee, it's Kingsport

Power. In the case of Michigan, it's Indiana-Michigan, and in the case of West Virginia, it's Appalachian Power and Wheeling.

Q Now, you say that Appalachian Power has authorization from the four states I mentioned a minute ago. Can you tell me why AEP did not seek authorization from the other three states?

A (Baker) The other states either do not have state laws which require us to file when we are transferring control, or they haven't interpreted transfer of control to be moving the assets, moving the functional control assets to an RTO.

I'd have to go through each state's language to determine which it was.

Q That's fine for now, Mr. Baker. No further mention is needed on that.

Focusing on the four states I identified a minute ago -- Virginia, Indiana, Kentucky and Ohio, can you tell me how much of the total load in AEP East is in each of those four states?

A (Baker) I can approximate it. In the case of Virginia, I would believe it is in the 13- to 15-percent range; in the case of Kentucky, it runs from six to eight percent; Ohio would be, I believe, in the 40-percent range; and Indiana would be around 20 percent.

(Pause.)

Q Can you tell me how much of the total generation in AEP East is in each of those four states?

(Pause.)

A (Baker) I don't have those numbers. I'd be too approximating it for you. We'd be happy to supply that.

Q If you could provide that later, thank you.

I have the same question for transmission investment total for AEP. Can you tell me, in each of these four states, how much of AEP East's total transmission investment is in each of the states?

A (Baker) We would have to supply that. We have ownership and then we have our pooling agreements, which provide for equalization. My numbers -- I can't separate out the actual investment in my heard.

Q Can you provide that information for all seven of your states, that is, total transmission investment as a percentage of AEP East's total transmission?

A (Baker) Yes.

Q Then the question I asked a minute ago about generation, can you provide the same information as to the other three states as well, not just the four we've been discussing?

A (Baker) Let me ask a clarifying question. Yes, we can supply it, but I'd like a clarification.

Are you interested in ownership or are you interested in physical location?

Q Can you provide it for both, please?

A (Baker) Somehow I knew when I asked that question, the answer I'd get.

(Laughter.)

BY MR. BARDEE:

Q On page 19 of your testimony, you say that AEP filed an application in Kentucky for approval to transfer functional control of transmission facilities to PJM. Then you say on line 14 and 15 that the evidence showed net benefits for AEP East as a whole.

Can you please describe that evidence?

A (Baker) Yes, I can, but it was not our evidence. PJM also filed in support of our transferring functional control to PJM.

They had done a study previously that indicated a benefit that range from \$60 to \$81 million for AEP joining PJM. And then what we had shown was our cost which was in the range of \$50 million a year to join.

So it showed a net benefit, if you took those on an AEP system basis, to be somewhere between \$10 and \$30 million a year.

Q Did AEP, in that case, take any position on the validity or lack of validity of PJM's estimate?

A (Baker) The position that we took at that time was that we agreed that the directional signs of the various components that made up the \$60 to \$81 million were correct, but we had not had a chance to really get in and analyze how the \$60 to \$81 million was calculated, so we couldn't give - - couldn't in any way validate that the number was correct, just that the various components of how we would receive benefits, seemed directionally correct.

Q You had a number for costs that your company put into evidence in that case. Comparing that to the PJM number, are you saying that your company agreed that there were net benefits after costs for AEP to do this?

A (Baker) No. What I'm saying is that we know what our costs would be. That's very easy to look at in the PJM tariff and multiply the various component costs to be a member, whether it be a generator or be a load-serving entity -- multiply it times our load we serve and generation output, and we can accurately project what our costs would be, of course, ignoring any cost increases that would change the tariff numbers.

What we didn't know was whether the \$60 to \$81 million of benefits was a correct number, whether the number would be higher or lower than that, once we had had a chance to fully analyze the work that they had done.

Q So at that time, your company was not sure

whether the benefits ultimately would be more or less than the costs that you estimated?

A (Baker) That is correct.

(Pause.)

PRESIDING JUDGE: Have you since done any further updates on that?

WITNESS BAKER: We have been working since March with PJM to update and to work together to produce a benefits value. That work is still in progress. We've been sharing cases with PJM and we do not have the final set of cases that works first on NAEP system basis, because you have to do it first, considering the total system and a single dispatch for the whole system.

Then we have to take it down through our various pooling agreements and jurisdictionalize it, so the first step is getting the AEP, as a whole, done, and then jurisdictionalizing it.

So that's a process we're working on as we speak.

PRESIDING JUDGE: Do you have any estimates as to completion time for that effort?

WITNESS BAKER: We believe it will take us about a month, after we get a full set of cases that will give us one year of cost-benefit, and we have engaged a consultant to help us take that out for multiple years, and we are projecting that the multiple years will likely take us out

where we'll be able to make a filing in Kentucky in the early December timeframe.

PRESIDING JUDGE: Thank you. Sorry for the interruption, Mr. Bardee.

BY MR. BARDEE:

Q Can you provide for us here, the cost analysis produced in the Kentucky proceeding?

A (Baker) Yes, I believe I can. If I can't give you exactly what was done prior to that, I can give you what our latest estimate is.

Q That will be fine.

(Pause.)

The analysis that you're working on now, is that assuming the type of integration into PJM that the company has suggested in its testimony here?

A (Baker) No. That is to assume full integration into PJM markets.

Q Can you briefly explain for us, the types of costs that your analysis at that time indicated, both categorically, and, if you can recall, any numbers for each category?

A (Baker) I just remember that there were load-based charges; there were generation-based charges. They are all tariff charges that PJM has that they charge users of PJM, multiplied times the various megawatt hours or

megawatts associated with our system, but I don't have the breakdown in front of me.

Q Were there costs in your estimate of \$50 million that were not tariff charges from PJM, but, instead, were costs incurred directly by AEP to integrate with PJM?

A (Baker) I believe that also included an amortization of our costs that we were going to spend, expenses we were going to spend, but I would need to check that to make sure.

Q Let me turn now to Indiana. Indiana has recently approved, with conditions, AEP's request to join PJM; is that right?

A (Baker) That's our interpretation of the order that we received.

Q Can you describe the conditions?

A (Baker) There are a number of conditions, some of them not dissimilar to the conditions that this Commission put in to our moving our assets into PJM.

They raise questions about the timing of the joint and common market, a single integrated dispatch, and a solution to the question of inter-RTO charges for through and out.

Q Were there any conditions imposed that will affect in some significant way, the analysis you're now undertaking to estimate the costs and benefits of



integrating into PJM?

A (Baker) The analysis that we are doing will be somewhat dependent on the outcome of the through- and out-rate cases that are in front of the Commission today, because that would change the potential for transfers.

We are trying to determine how to incorporate positive -- possible outcomes in that analysis. Other than that, I'm not sure I know of any other things that would impact the study.

Q Can you explain what you meant when you said "trying to incorporate possible positive outcomes"? Is that what you said?

A (Baker) I said possible outcomes. I think I started with "positive" and then I corrected it to "possible."

Q For the work that is underway at this point in that net analysis within your company, what assumption are you making so far or which options are you evaluating for the through and out rates?

A (BAKER) Where we are right now is we are assuming as a base case, you have to have obviously to change from that AEP is not in an RTO and that the through and out rates are still in place for the AEP system. Then what we will do is, we will run a case where we are in the market and we will remove the through and out rates.

Q You mean remove in the sense of not recover those revenues in any way?

A (BAKER) No. This is purely a dispatch analysis so you will take them off as a transactional charge. And you will assume that there is no charge for the generators to move to any point in the load as a transactional cost.

Q Let me ask you a couple of questions quickly about Ohio and Virginia. You say on page 24 of your testimony that Ohio has held AEP's filing in abeyance. Is there any indication when that status may change?

A (BAKER) We don't have any information as to when it will change

Q Then, in Virginia that status is that state law prohibits utilities from participating in an RTO until July 2004. After that it requires approval from the Virginia

commission, is that right?

A (BAKER) That is correct.

Q I have a few questions now about the split system proposal that you discuss in your testimony. One possibility discusses splitting the system so that part of the AEP East joins PJM and part does not and, on pages 25 to 27 of your testimony you give some reasons for the company's position opposing this proposal. For example, you say on page 25 reason number two is that holding company systems are required to provide system wide transmission service under a single tariff. When you say this is required, do you mean required by this Commission?

A (BAKER) Yes.

Q So if this Commission determines that the split system proposal was the most viable solution for bringing net benefits to customers, could the Commission waive that requirement?

A (TOMASKY) The Commission certainly could if it so chose based upon reasonable evidence that there was actually a benefit to change it's policy. I would assume it would also have to defend why it felt it appropriate to abandon that policy in this case since the reasons for a single tariff were extraordinarily well articulated.

(Laughter.)

BY MR. BARDEE:

Q Assume for the moment that under the split system proposal isolating one or two states would require certain costs but that this proposal still produces net benefits from customers. I'm just stating that as an assumption. If that happens, what would be your company's position on which customers should pay those costs incurred in isolating the one or two states? Should the costs be split across all of AEP East's customers or allocated to the customers in the states that are isolated?

A (BAKER) I think you have to think of costs in a broader spectrum than I think you're asking the question. There are physical hardware change costs setting up a control area doing metering at differing points, changing the telecommunications. There are also costs that are likely to result because of changes in the pooling agreements or various RTO requirements. I think you've got a multiple set of costs. It is hard to determine without knowing exactly how the proposal would work as to who should incur those costs.

But one of the things that we have found is that it is very rare that seven states agree on how those costs should be allocated amongst themselves. It always is a challenge when we incur those kinds of costs as to how we get recovery of them.

A (TOMASKY) Mr. Bardee, I think this is very much

a question that this Commission knows how to answer, has answered time and again, and there are a number of different methods, as you know, available to you for deciding whether you want to socialize those costs broadly, whether you want to create incentives and advantages to particular users of the system by the way that you structure them. AEP as we have looked at this issue have really tried to separate ourselves from the issues involved.

We honestly believe that, as a matter of public policy, that we have, and when I say "we" I mean all of us, the Commissions as well as the companies, gone a bit too far in not attaching to users the full cost of the utilization of our systems in the way which we do now for competition. These were alluded to somewhat in Dr. Draper's comments.

We think the Commission ought to be exploring some methods whereby the costs of the infrastructure which in fact are quite significant are going to grow if we want to grow the system. We have certainly learned that users do bear a greater share of those costs that perhaps has been inherent in the design and the direction that we've been going in the past, but ultimately as a transmission provider, we are indifferent as long as the Commission doesn't choose to allocate the costs back to us as the transmission provider. That's what we don't think is the job of rate design.

Craig is right. We would certainly look at the specifics of any particular proposal. We encourage you to think about socializing wholesale costs so broadly but that's partly, quite frankly, a political compromise.

The other issue you will hear from us from time to time has to do with timing. Timing is extremely significant. We live in an environment right now in which the investors in utilities which are not always easy to come by in this sector these days, are very, very concerned about issues like security of revenue stream. It is basically the major thing. That and dividends are the major things that we have to offer investors right now in this marketplace so we guard this very closely. There is no question about that.

Timing, you can have theoretically a full cost recovery but differences in timing because of the allocation between the states and federal government that are so significant that it significantly affects the financial profile of a company. So you will also hear from us issues around timing that are extremely important in putting this whole picture together.

Q On page 27 you state that, under the split system proposal, congestion management will become significantly more difficult than it is today. What I'd like you to do is compare this split system proposal and its effect on

congestion management systems to a scenario in which Commonwealth Edison is fully integrated into PJM and using LMP but AEP is integrated along the lines you advocated in your testimony, meaning it's not using LMP. If you have a split system proposal for AEP, in which parts of AEP East are no longer doing congestion management in the same way as other parts of AEP East, is that harder, easier or the same as a system in which both sides outside of AEP East are doing LMP and AEP is not.

A (BAKER) We have looked at certainly not the level that Com Ed and PJM have looked at at integrating Com Ed into the PJM market using single LMP or an LMP across that whole region.

We didn't see any major problems with it. We think it works. When you look at the situation of splitting the AEP system I see it differently. That is the question that has been debated for a very long time and continues to be debated in the reliability plans of NAERC and their analysis of what will happen in PJM and MISO when you have market on one side and not market on the other.

There are many people who are concerned about that and are not sure exactly how it works. I think the same questions would have to be fully analyzed and addressed in a split the system scenario for AEP because you would have market in part of it and non markets on the other.

Q If I understand you right, and correct me if I'm wrong, you're suggesting that having markets operate adjacent to non markets is difficult whether it's the concept you've advocated of having AEP East not do LMP yet surrounded by LMP, or having parts of AEP East do congestion differently than the rest of AEP East, is that what you're saying?

A (BAKER) What I'm saying is people have raised in the discussion about how MISO and PJM will manage the business at the seams. Most of us around know that's a relatively hotly debated topic, one of the questions. There are various phases as we all know. There is the non market to market phase. That is when MISO doesn't have a market, doesn't have the spot market and the day ahead and the LMP. Then you have PJM that has a market.

That has raised a lot of questions by parties and people are continuing to analyze the impacts of that.

Your next life cycle, I'll call it is two markets side by side having different computer systems but based on the same market design. People are raising questions about how well that will work. Then you get to what has been termed the desired end state, which is a single common market across the whole region and people are pretty comfortable if you can get over the technology issues around having that broad a market that that will not provide



issues. I'm just suggesting that we would be in that first stage which people raise the greatest number of issues about. We would not be in the end state which would be integrated in the market with all the rest of PJM.

Q Could you turn to the attachment AEP 5? Exhibit AEP 5?

A (BAKER) I'll have to get a copy of that one.

(Handing document to witness.)

WITNESS BAKER: Yes, we have it now.

BY MR. BARDEE:

Q On the first page of the cover letter that is part of AEP 5, the second full paragraph, there's a couple of statements that I wanted to ask you about right about the middle of the paragraph. It says, "Returning to the split system proposal that such a scenario would increase the cost to survey AEP's customers."

Then it ends the paragraph by saying, "Would result in significant additional costs."

The question I have for you on that is, are you saying the split system proposal would increase costs even after considering whatever benefits there are from it, or that just focusing on the cost side of the equation and not the benefits, there will be costs involved in implementing the split system proposal.

A (TOMASKY) Quite frankly, Mr. Bardee, we don't

know what those benefits are and I think we don't have a cost number associated with them. If we saw those benefits enumerated, specifically we could perhaps compare them to the costs but we certainly have not seen that. We know only that there are generalized claims of benefits by having at least some of AEP involved. We know that some people seeking transmission paths across AEP who don't particularly care to go into Virginia but would like to go into eastern markets, may actually realize some benefits.

But in terms of customer benefits, we haven't seen an analysis that tells us what the benefits of just part of AEP would be. So we don't have anything to compare it to. With respect to the costs, you are essentially talking about duplicate systems, you're talking about taking systems information systems, coordination systems that are highly integrated and having to recreate them, you're talking about SCADA security systems in which we've invested tens of millions of dollars that would have to be separated.

You're talking about a huge amount of things that, over 50 years have been built into our system on an integrated basis, all which would have to be reconsidered. I am not suggesting you have to rebuild AEP but I can assure you that the kind of system work, A, would take a very long time and take us well past the middle of 2004, which is the position, the point at which we would hope that we would be

in a position to have an agreement with Virginia that would permit us to move forward and the costs would be significant.

Q Are you saying that there are no benefits to the split system proposal for customers or that you have not done or seen an analysis of what those benefits might be?

A (TOMASKY) We are not aware of what those benefits are.

(Pause.)

Q Could you turn to the next page of the letter that we've been looking at here. In the next to last full paragraph, it says, "Splitting AEP East may call into question AEP East's continued compliance with the integration requirements of PUHCA. Has the SEC issued any ruling on the idea of splitting AEP East?"

A (TOMASKY) Not to my knowledge.

Q Has the company made any filings with the SEC to ascertain its views on that proposal?

A (TOMASKY) We have not.

Q On page 4 of the letter, it raises the issue of how to split AEP East, whether by operating company or state boundary? For example, it says "The Appalachian Power Company provides services and owns facilities in West Virginia. If the split system proposal is implemented, would AEP recommend that APCO be split at the state boundary

or that all of it be excluded from PJM?

A (TOMASKY) That's a very difficult question to answer, Mr. Bardee, because we think the efforts to try to split up APCO is absurd. So the notion that we would try to accomplish it with a company that has been integrated financially, operational and physically for a long time, is not acceptable. I cannot imagine that it is equally, we believe, untenable, to talk about excluding major portions of our system from RTO participation if what is going on here is an attempt to move forward in some way. Then the choices the Commission has in front of us are to undertake this, what we think is massive, which we will do our best to prevent from happening by all legal means possible, and move forward with that, try to get that done as a means by which to lay the groundwork for our participation, or you move forward on the basis of the more limited RTO commitment which, on that basis, brings the entire company in. It is very hard for me to imagine why the latter is not a preferable step to the Commission and, as a consequence, it is very difficult for me to draw lines between whether it's preferable to split APCO in half or leave it out of the RTO. Obviously between the two, we'd rather leave it out of the RTO completely.

Q Just to ask a couple of questions related to that, you have -- could you give us an estimate of how much

of APCO's services or revenues are in Virginia versus West Virginia.

A (BAKER) It's about 50-50.

Q Could you turn to the data responses included in AEP 5? In the last paragraph of the response, right at the bottom of page 9, it states that, "Transferring all of AEP East except Virginia to PJM would require significant" -- excuse me?

A (BAKER) We need you to point where it is.

Q Question 4 of the data response is right at the bottom of page nine. At the bottom of page nine, it says, in the last paragraph, they're transferring all of AEP East except Virginia, to PJM would require significant additional capital investments of \$7 million to install new equipment and make other hardware and software changes. Are those one-time startup costs?

(Pause.)

A (Baker) The answer was looking at a startup cost that would be one time. We haven't analyzed whether there would be ongoing, other capital additions required over time. That was just an initial investment.

Q Then it goes on to say, AEP would have to expand staffing by about nine to thirteen full time workers. That would be ongoing costs, correct? Ongoing, non-capital costs?

A (Baker) Yes.

Q Can you give us an estimate of dollars associated with expanding staffing by about nine to thirteen full time people?

A (Baker) This was again a response that had to be done in a very short period of time to answer these questions. We did not take it to pricing out all the component costs associated with a plan that we didn't think was a good one.

A (Tomaksy) I would also stress that the discussion in that paragraph really refers to the costs that are described in the paragraph. We also enumerate a large number of additional activities that we have not attempted to estimate. We have not attempted to estimate the absorption of personnel who currently exist into those issues. We could spend a little bit of time and try to give you a full cost estimate, but I can assure you it would be much more substantial than just to deal with the narrow issues of control and function that we talk about later on in that paragraph.

Q Can you provide that later, please?

A (Tomaksy) Sure.

Q Turning to Kentucky, since the sentences we've just looked at dealt with Virginia, would you expect the same amount of costs to be incurred if Kentucky also were not included in PJM?

A (Tomaksy) I don't think the costs -- it would be very difficult to say. But the costs really have to do with the fact that we have one system, and you would be forcing us to have two. There would be some incremental costs associated with how many systems, and some incremental costs associated with operating additional systems but I can't, off the top of my head, talk about that. It is really integration of a highly complex system that is supported by

many, many people, many, many computer systems that we're talking about here.

A (Baker) I think another aspect on why it's difficult to do is to know exactly what this kind of proposal means. The physical location and the wires don't connect directly Virginia and Kentucky, so we don't know whether you would need one additional control area or multiple additional control areas. Without fully fleshing out the aspects, we couldn't estimate that.

A (Tomaksy) To give you a sense of the proportion of this notion, let's go back the AEP/CSW merger. We created a contract path line and we created coordination between those systems, just to figure out how to make that work, where we were not fundamentally disrupting customers and service arrangements on either side of the system. It took many months just to figure out the economics, the figure out the dispatch arrangements. Then, once that was done, we had everybody else's opinion on whether that was right or wrong that had to be dealt with. The Commission would certainly face no less here and in fact it would be creating something far more complex and far more difficult to do.

I cannot assure you that we could even figure out what would be involved in this, except over a period of several months.



Q In terms of the cost estimate that you indicated you could provide subsequently, just to clarify, when you provide that, do you consider it in the context of Virginia and Kentucky both being excluded from PJM, and then also state whatever other assumptions you made in estimating those costs along the lines you've just suggested. There are a lot of considerations.

A (Tomaksy) Does that imply a resolution of the issue you asked me a moment ago about the separation of APCO?

Q I think you'd have to make some assumption. I would leave it to the company to make whichever assumption it felt appropriate so long as, at least the Virginia part of APCO was considered to be excluded from PJM.

A (Tomaksy) We will certainly do this. But I will tell you two things. First of all, it would be highly hypothetical and, second, we really do do this under great protest. We think this is a very wrongheaded thing for the Commission to be thinking about.

Q Let me say, at this point, that I ask these questions for the purpose of eliciting relevant facts for the Commission's consideration, and not with any intent to suggest that the Commission has chosen whatever course it may take on this matter.

Which agreements within AEP would need to be

changed to implement a split system proposal?

A (Baker) Ones that would have to be looked at are the two transmission pooling agreements that were entered into, the generation and transmission agreements that were entered into at the time of the merger, which are the integration agreements, then each of the companies. The East would have their generation pool agreement, their transmission pool agreement would have to be looked at, as well as the joint operating agreements for various power plants that are jointly owned by Appalachian Power and Kentucky Power. Those are the ones that come to my mind now. There may be others as well. But those clearly would likely have modifications required, depending on the approach used.

Q Of the agreements you've just identified, would changing any of them require approval by the SEC?

(Pause.)

MR. DUFFY: Mr. Bardee, I think that's a legal question. I'm not sure that our witnesses could appropriately answer that. We could look into it.

(Laughter.)

MR. DUFFY: Not to suggest Mr. Tomasky is not a fine lawyer.

WITNESS TOMASKY: The answer is to Bardee is I honestly don't know, we'd have to check.

BY MR. BARDEE:

Q Are each of the agreements you identified on file with this Commission?

A (Baker) I believe they are.

Q Would the split system proposal require changes to the reliability plan between PJM and MISO?

A (Baker) I would expect that that's a question better answered by PJM and MISO than for AEP to opine on it.

Q Would the split system proposal require changes to the joint operating agreement between PJM and MISO?

A (Baker) I believe that the joint operating agreement is part of the reliability plan, and I would again say they are better able to answer that question.

PRESIDING JUDGE: Mr. Bardee, I'm looking for a convenient time to take a break. Do you have a lot more to go?

MR. BARDEE: Ms. Fernandez will have a set of questions pertaining to AEP's proposal of partial integration into PJM, and other people at the table may have miscellaneous questions. This might be a good time to take a short break.

PRESIDING JUDGE: We'll take a ten- to fifteen-minute break.

(Recess.)

PRESIDING JUDGE: When we broke, Mr. Bardee was

questioning Ms. Tomasky and Mr. Baker. You may continue,  
Mr. Bardee.

MR. BARDEE: Thank you, Your Honor. I would now  
turn it over to Alice Fernandez for further questioning.

PRESIDING JUDGE: Very well. Ms. Fernandez, you  
may proceed.

CROSS EXAMINATION

BY MS. FERNANDEZ:

Q Good morning. I'd first like to sort of ask a  
clarifying question on the merger with CSW. When did the  
merger actually take place?

A (Tomaksy) The merger was completed in June 2001.

Q June 2001?

A (Tomaksy) Yes.

Q So that it was completed and I believe Order 2000  
was issued in December 1999?

A (Tomaksy) Yes.

Q As a result of the merger, there were certain  
functions that AEP had independently performed by the  
Southwest Power Pool, I believe, and that would qualify as a  
market monitor. Could you describe what those functions  
are?

A (Baker) What we were required to do, as part of  
the merger condition, was to out source the calculation of  
TTC and ATC. That's total transfer capability and available

transfer capability at the various points of interconnection that AEP has with other utilities. That was part of the function that was out sourced to SPP. In addition, the question in regards to people making requests to reserve transmission service on the AEP system. The acceptance or rejection of those requests were out sourced, as well, to SPP.

The market monitor functions, the market monitor took what had been written into the order, and made a proposal to the Commission about what functions he would perform or what analysis he would perform. That was accepted by the Commission.

Q In terms of the transmission service, does AEP administer the transmission tariff other than the calculation of ATC, TTC, and the acceptance or rejection of transmission requests?

A (Baker) I believe that's the case. I'd have to go component by component, but we do, for example, the billing we receive the revenues directly. I think most all of the other tariff provisions we manage.

Q In terms of day-to-day operation of the system, AEP manages that and not SPP?

A (Baker) Other than reservations, and they also look at the scheduling to make sure that the schedules can flow.

Q Would you explain how the scheduling is done?

A (Baker) I believe what they do is, once you have a reservation, you have to analyze that the system has the capability to take the actual schedule and reliably flow it. That's a coordinated activity of AEP, SPP and our reliability coordinator PJM.

Q Actually, maybe that's sort of a good lead-in. I was going to concentrate on the alternate proposal that AEP discussed, starting around page 31 of the testimony. Could you explain, briefly, how this proposal differs from the existing arrangement you have with SPP and with the market monitor?

A (Baker) Yes. As I pointed out, as people have defined functional control, as it was originally looked at for ISOs and the early RTOs, as I understand it, all of these functions make up the functional control. This would be taking the total functional control as defined in those earlier days of the transmission system, and putting it within PJM. We do some of our own tariff administration, as your question asked, and it's under AEP's OATT. This would propose to put it under PJM, and under the PJM OATT. In this case, for the calculation of TTC and ATC, that would be moved from SPP to PJM. They would continue as AEP's reliability coordinator.

We have entered into an agreement with PJM to do

that. Someone else could do it as well, but since it is a function of an RTO, we would put that in as part of the total functions they perform.

The same thing with the market monitoring. Right now, we are not part of any regional planning process. And then we would then -- PJM would have the functional control so that they would include our system, I would believe, in the joint operating agreement where it presently would not be in that.

Q Let me ask, first, is AEP's proposal an interim solution, or is this an end state?

A (Tomaksy) I think that ultimately is going to be for this Commission, in talking with our states, to decide. We actually are fully supportive and, as we have said from the beginning, we have been willing to move into PJM with its full functionality. As I suggested earlier, the shifting that has occurred among various views has raised with it a bunch of concerns around risk, cost shifting, and those sorts of issues.

This could unfold, in my view, in either of a couple of ways and the Commission's leadership in figuring this out would be pretty important. One way, of course, that it would be a step, a first step, and that over time, through the negotiation of resolution of various issues through the allaying of concerns through perhaps the

negotiation of transition mechanisms and, quite frankly, over time as the conditions of those states change. Understand that those states now sit on significant reserve capacity. At some period of time, that capacity, that reserve will erode. They may have different interests in terms of access to that market over a period of time, so a lot of factors could combine, including workable solutions, with the Commission, the commissions together that could move that on.

Alternatively, the Commission could accept this for a period of time and say, this has worked for a while, states. We have given you ample opportunity to reserve this. We think it's time to move on. The Commission would take that step.

The third alternative, of course, is that the Commission, the interim solutions that we would negotiate would be sufficient, in this Commission's view, to support the market, and you could accept it for a longer period of time. I don't know, I think this Commission would have ample authority and ability to review that over time.

The fundamental question is, what can you work out to put this in place with the states.

Q So I guess I can take it that AEP is still interested in joining PJM in all aspects, including the markets?



A (Tomaksy) We are interested in doing so, but as we have stated repeatedly, we are not prepared to do so without the authorization of our states. And unless the Commission chooses to preempt those states and, as a consequence, we have to move on a basis that's acceptable to those states.

Q What type of time line did you envision for implementing this solution?

A (Baker) If we're talking about step one?

Q Yes, the solution that's proposed starting on page 31 of your testimony.

A (Baker) We'd have to assume that it was a solution that was acceptable to the various regulators that we have. I would expect that if we were to find ourselves in that situation with that agreement, we'd probably be looking at the spring of next year to implement the initial approach.

A (Tomaksy) I would like to add that, like many things we talk about here, this is not a timeline that is wholly under our control. The kinds of things that we talk about, in terms of the studies that we'd need to be done, certainly our commitment of resources would facilitate that and, obviously that's a time frame that coordinates with the statutory lifting of the prohibition in Virginia. So that would permit Virginia to move forward if they had a solution that was acceptable to them. Obviously, we can't control, or perhaps even influence, this Commission's additional requirements or the Commission's requirements of the states in what would have to be put together. But I think that's a reasonable time frame to shoot for.

A (Baker) Could I just interject one more thing?

Part of this would, of course, we'd have our states, we'd also have to enter into negotiations with PJM about their willingness to do this, and what the cost would be for this type of service arrangement as opposed to full integration.

Q I take it from your answers that the four states I think you identified earlier in your testimony where you had made applications for AEP to join PJM, that you would have to file similar applications for this solution?

A (Tomaksy) We probably would, but I'm sure there are procedural devices available to us to expedite that. This Commission knows well that if there is support and there is enthusiasm, things can move pretty quickly; and if there's not, they don't.

A (Baker) Also, there are none of those dockets that are completely closed the filings that we made, so we have ongoing dockets in each of those states that would not require starting from scratch.

A (Tomaksy) I would also add, we need to emphasize this, that there is a spectrum of viewpoints. We have no reason to believe that Ohio shares the view of Virginia, for example, with respect to the issues around PJM integration. I know that our chairman from Ohio is here, so I won't go any further than that in speaking for him, and I wouldn't do it even if he weren't here.

(Laughter.)

WITNESS TOMASKY: Also, it's going to be a bigger and a different issue, but each of those states had devices available to move if everybody is where they need to be.

BY MS. FERNANDEZ:

Q I guess my question is also that you believe that this proposal could not move forward without the authorization of those four states?

A (Tomaksy) I believe the Commission does have preemptive authority under some circumstances, so the Commission may choose to impose that. We have to see what the specific elements of that solution would be before we could comment on it completely, but it may be available to this Commission.

Q But you believe that it would either be as a result of state authorization or federal preemption of the rules or statutes in several of those states?

A (Tomaksy) Based on what I know how, Ms. Fernandez, obviously there's a lot of detail in here and it's kind of hard to say with precision, but in abstract, that is what I would think.

Q Have you done any studies to ascertain any cost benefit analyses of this new proposal?

A (Baker) No, we haven't. This is somewhat new as a thought at AEP in response to what we have been asked to do recently. And until we have an idea of what the costs

are, we could look at modifying our study, but we have not done that.

Q Are you doing any studies of what the benefits would be?

A (Baker) We haven't entered into that kind of a study yet, no.

Q Did you intend to, or were you planning on waiting until the Commission acts?

A (Baker) We have, in front of our commissions, the state commissions, a requirement to do cost benefit which was really focused on full integration of the market. That's where we've been focusing our efforts. If we thought that this was an option, that was a possible solution, we could certainly develop a cost benefit analysis that would look at a smaller set of functions.

Q In the various state proceedings, would you be required to do that type of analysis before the states would authorize?

A (Baker) I believe the Virginia statute would require it. Kentucky, there's no statutory requirement for a cost benefit analysis, although they have asked it now of each of the companies who have come in, and had RTO participation. Either they were participating or would in the future.

Q In terms of the proposal, AEP would give up its

transmission tariff and take service under PJM's transmission tariff. Is that the proposal?

A (Baker) Yes.

Q What type of customer, or I suppose it's better to ask, would that require changes to PJM's tariff?

A (Baker) It may require some changes, but I would point out that we initially had a phased-in approach to go into PJM, and we were going to have a day one, which is basically the functions we've outlined here in this proposal, and then a day two, which was full integration in the market. As I point out, this parallels day one. So that work, I would believe, has been done by PJM, what is necessary to incorporate us in a PJM tariff under just these functions.

Q I guess what I'm curious is that under PJM's tariff, any imbalances by network customers are results of the energy markets. How would that apply to AEP under the proposal?

A (Baker) That was not going to be the case under day one. In our initial plan to join PJM, it would have been managed the same way it is under AEP's OATT. I believe that's the way it was set up to work.

Q So under your proposal, that's now how you would plan on resolving it?

A (Baker) Yes.

Q So that the balancing provisions in 888 would apply to any imbalances on AEP's system?

A (Baker) Yes, under this approach.

(Pause.)

Q PJM currently operates as a single control area. My understanding is, with the PJM west, there was more of it operates as one area functionally, although certain functions are still performed by the utilities. Would AEP continue to operate as a separate control area?

A (Baker) The answer is yes, but I think -- my understanding is that there is a distinction that PJM West is a separate control area but it is one market. I believe that's the distinction. No, I'm getting -- I will back that up. I'm not sure.

Q That's something to ask PJM, I take it?

A (Baker) Yes.

Q I think, in your statement, you state that PJM would have control over transmission but there wouldn't be a central dispatch. What types of controls, if any, would PJM have over generation located within AEP's service territory?

A (Baker) They could require redispatch, as they can today, as the reliability coordinator.

Q If it's necessary for reliability, they could require redispatch?

A (Baker) Yes.

Q They would have no ability to require redispatch for economic?

A (Baker) That's correct.

Q With the dispatch of generation, AEP's territory would basically be the same as it is today?

A (Baker) Yes.

Q In your testimony, you also say, under this solution, that you would not adopt the LMP system for managing congestion. Could you explain how congestion would be managed within AEP's system and between AEP and PJM, or PJM West?

A (Baker) At least until there was an alternative that could be achieved, we would be using the TLR approaches that are presently being used, which of course involves removing transactions during periods of congestion and perhaps redispatch, as necessary.

Q So basically it will be no different than today?

A (Baker) That is correct.

A (Tomaksy) I would like to add one thing to this discussion. I would like to stress that what we've come forward here with is a starting point for discussion and a request for a process. It is not an answer to every single question that you will have, though you undoubtedly will raise terrific questions, and the ultimate compromise out of this process, I would hope, would be, quite frankly,



informed by a lot of other people besides us in coming to solutions to some of these problems.

We don't have hard and fast positions on every single element that is being described here. What we are trying to do is outline the beginning point, not the end point.

Q I'd also like to ask, just in terms of the various functions that would be performed by PJM as the RTO for AEP. Under Order 2000, one of the functions that's listed as congestion management, Section 35.34(k)(2), describes what congestion management means. One of the aspects of the regulations is that the RTO must satisfy the requirement for a market mechanism to manage congestion within one year after it commences initial operation. As far as the AEP territories, how would the proposed solution satisfy that requirement?

A (Tomaksy) Again, as a starting point on the first day, we don't propose that it does. I would imagine that in the discussions that occur with the states, the Commission would take the position that in order to get to the goal of Order 2000, that is something that would have to be incorporated and be addressed. Again, the point, this is something to try to reach agreement with on the states, but I would agree with you that on day one, there is not the solution. The point would be to work toward it.

Q So on day one, there would be, it would not comply with the requirements of Section 35 and the objective would be to work out an arrangement so that it could comply with the requirements of Order 2000 in the future?

A (Baker) As I read Order 2000 -- and I think you pointed out that once you're in an RTO, there is a year time frame looking at what has been a different use of the term day one, day two -- people looked at that, using the same terms for congestion management. When I think of congestion management prior to SMD, there were a lot of market-based approaches that were being discussed that didn't require the full implementations of spot markets and day-ahead markets that people were looking at as a day two solution. They never were fully fleshed out because SMDs superceded that and LMP was really what people were looking at.

But that could be discussed, as Susan pointed out, with the various regulators. There may be alternative market-based approaches to congestion management that they would be more amenable to.

Q But any congestion management approach that's adopted would depend on negotiation with the states? Is that what you're suggesting?

A (Baker) We've suggested that to move this along, a dialogue with the states in finding a compromise will move it along faster than other approaches.

A (Tomaksy) Ultimately, this Commission, of course, has the authority to impose that. What we are simply trying to suggest here is that this is not something that we, AEP, can create by itself, and the two opportunities available to this Commission are to work with the states to come up with something, or to impose it on the states, and therefore on us.

Q One of the other functions of Order 2000 is ancillary services. Section 35.34(k)(4)(iii) requires that the RTO must ensure that its transmission customers have access to a real time balancing market. How would that function be met under the proposal?

A (Baker) When we were looking at earlier versions of approaches to RTOs, we looked at, for example, bulletin boards for balancing. That was one approach. That could be part of the dialogue between AEP, PJM, and the various regulators as an approach to solve the market-based imbalance.

Q So that's another item where your proposal, there would need to be further negotiations in order to develop that. Is that what you're saying?

A (Baker) Yes.

Q In terms of the regional planning process, how would AEP participate in the process? It's my understanding that the transmission owners in PJM currently agreed to

basically construct or pursue construction of any facilities that are identified as necessary for reliability. Is that the type of role that AEP would be agreeing to?

A (Baker) Yes.

Q So you would participate the same as any other transmission owners within PJM?

A (Tomaksy) Yes. Obviously, to actually go out and do the work would require the same sort of permitting process that occurs in each of our states.

Q PJM and MISO have been working under a joint operating agreement to resolve the seams issues in the midwest, particularly seams between PJM and MISO, which I think you reference in your testimony. Have you had any discussions with PJM as to whether or not this proposal would require changes in the joint operating agreement?

A (Baker) I have not had those discussions. As I say, this is somewhat new and the only discussions I've had with PJM were really around the fact that it was very similar to what they planned for day one. But we didn't get down to the level of talking about the joint operating agreement.

Q Is this something where PJM agreed that this would be an acceptable solution or is that a matter that's still under discussion.

A (BAKER) The level is, we talked about it. They indicated that they looked at this as a day one solution. We did not get into working out every detail or what the cost would be so it wasn't the final agreement, but the impression I got from PJM was that they were amenable to this kind of an approach, but I think you could ask them if they would agree.

Q In terms of the Joint Operating Agreement, there's a large amount of data sharing that would need to go on between PJM and MISO. Under the proposal, would AEP be supplying PJM with all of the data that's necessary to meet those commitments, particularly, there's an awful lot of information that gets into generation that, without a central dispatch, I wasn't certain how under the proposal that information would get to PJM.

A (BAKER) I would certainly expect that we would be sharing the same kind of information that other transmission owners in MISO in PJM would be sharing. We haven't progressed to the point of saying what exactly do they need from a generation aspect, but certainly that's something that I think wouldn't take long to work out.

Q In terms of the market monitoring function, what

information would be available to the market monitor? Would the market monitor be monitoring the bilateral market that AEP engages in?

A (BAKER) I think that's probably a question better addressed to PJM.

A (TOMASKY) We are quite used to cooperating with market monitors. It's our experience that we give them what they ask for. Whatever it is that comes out of this requirement, I'm sure we'd make available to the market monitor.

But again, we can't design those programs.

Q But you would be willing to abide by however it's designed, is that what you're basically saying?

A (TOMASKY) Yes, we'd certainly abide by however it's designed. There are always logistical issues so we reserve the right to ask if information could be presented in a different way than they request, but if people need information, we'll make it available.

Q Actually, what I'd like to do is a follow up to some questions I think that you had with Mike when you were talking about the revenue flow back. As I understand it, about 10 percent is flowed back on a current basis, the revenues from wholesale transmission or wholesale sales.

A (BAKER) Wholesale generation I would estimate to be about 10 percent.

Q In the other states, I take it that, right now there is an estimate that was put into the base rates for the wholesale generation and so that there was a credit that was developed when those rates were initially set?

A (BAKER) Yes.

Q Do you have rate caps in those other states?

A (BAKER) We have rate caps in some states and in some states neither AEP has requested a rate case nor has anybody else asked us to come in for a rate case. It's not precisely a cap but the rates are fixed until someone comes in and makes a filing.

Q In the states where there are caps, which states are those?

A (BAKER) There are in some places there are caps and in some places there are freezes. As Ms. Tomasky pointed out to me right now, we are under one of those regimes in Ohio, Indiana, Michigan, and Virginia.

Q In those states when the caps or freezes end, is there any requirement for AEP to come in and revise its rates?

A (TOMASKY) Ohio is different from other states because Ohio has moved to competition and unbundled. We are currently subject to a rate agreement that extends with respect to our wires charge, which is what remains regulated in Ohio. That extends to 2007 and we may negotiate a

further extension of that in some form.

With respect to other states, they roll off at various times and they include, there is some subtlety to them. Virginia, for example, has a kind of a rate freeze and a kind of an opportunity to come in once during their transition period for a rate adjustment.

Kentucky, we recently received an environmental surcharge. That rate is also, I believe, a rate that simply has not been challenged, as opposed to be subject to a freeze. I think that's similarly true for West Virginia.

Q Are there any requirements by the states for AEP to file a rate case?

A (TOMASKY) The state may do so at any time. There is no current requirement in our eastern system other than Ohio, which is governed under a different statute and Virginia has a little bit of an issue because of its governing statute, but basically they can require us to come in if they choose to.

Q But otherwise, it's at AEP's or some other party's, initiation?

A (TOMASKY) That's correct.

MS. FERNANDEZ: I think that's all I have.

PRESIDING JUDGE: Proceed, Mr. Larcamp.

CROSS EXAMINATION

BY MR. LARCAMP:



Q On page 7 of your testimony, you note that PJM has been AEP's reliability coordinator since February 2003. Did that change require NAERC approval?

A (BAKER) I believe it did.

A (TOMASKY) We think so, yes.

Q I think you testified that, as a reliability coordinator, PJM could direct AEP to redispatch its system to maintain reliable operations, is that correct?

A (BAKER) Yes.

Q Did that type of change in the control of your system require any approval from the SEC?

A (TOMASKY) No.

Q Did it require any approval from any of your seven state commissions in the Eastern Zone?

A (BAKER) The reliability coordination function has been being done for quite a few years prior to our transferring it to PJM. So that activity had been in place, I believe, since the '90s or maybe late '90s.

There were questions raised by certain members of the Virginia staff as to whether we should have received approval to transfer those functions to an RTO, and we indicated to them that we believed it was unnecessary because those functions had already been done by an independent party previous to that and have not gotten any orders or anything from the Commission, the Virginia

commission since then.

Q Was your response in a docketed proceeding?

A (BAKER) No.

Q So your testimony is that PJM has been doing reliability coordinator functions at AEP since the late '90s?

A (BAKER) No. What I'm saying is, we had had, ECAR was our reliability coordinator. Then, when we had what was termed the "Alliance Bridgeco," Alliance Bridgeco performed that function and it was just as pointed out in the testimony recently that we turned it over to PJM.

Q So your testimony is that none of your seven states in your Eastern Zone has to date asserted any jurisdiction at the change in the reliability coordinator function from ECAR to PJM, required any type of state authorization?

A (BAKER) They have not claimed jurisdiction over that.

Q On page 8 of your testimony you talk about the Alliance RTO. Were all of the states in the Eastern Zone okay with the Alliance ITC proposal to your knowledge?

A (BAKER) I believe there were certain states. It was not their preferred option and, as a matter of fact, Indiana at the time just before we got the order from FERC, had given us a disallowance of transfer of control and we

were analyzing what we could do to make Indiana comfortable with it at the time we got the order from this Commission.

Q That similarly would have been an all or nothing proposition from the company's perspective?

A (BAKER) We have to live with our states and our preference is that they are comfortable with our decisions.

Q I take it that's a yes?

a (BAKER) Yes.

Q Were any of the states concerned with the Alliance ITC's congestion management proposal, to the best of your knowledge?

A (BAKER) When we were close to bringing the Alliance on, we had a day one approach, which I tried to outline earlier. We were working with the various stakeholders toward a day two, in which we were analyzing different approaches and, not surprisingly at that point, there were parties who were saying what we need to be doing is full LMP, and there were others who were saying we need to be doing something that is less than that. That was a dialogue that was going on with the stakeholders at the time the Alliance was not allowed to go forward.

Q To the best of your knowledge, were any of those parties state commissions? And, if so, which ones?

A (BAKER) I would have to go back into the records and determine which of the states took what positions as far

as congestion management. I don't remember.

Q On page 12 you indicate that AEP was under pressure to join an RTO. Was this before you executed the voluntary stipulation to the trial staff in May of '99?

(Pause.)

A (BAKER) I'm sorry, where on page 12 are you pointing to?

Q Line 12.

A (BAKER) This is a chronology and this statement follows the fact that -- the September 30, 2002, time frame.

Q When you say you were under pressure to join an RTO, that was pursuant to your voluntary commitment?

A (TOMASKY) No. Let's be very clear. AEP has been under pressure to join an RTO since people started thinking about RTOs. That's okay, but that's been a political reality of this debate for some time.

Q The company could have proceeded with hearing in the merger case, but elected not to do so?

A (TOMASKY) A hearing? We had a hearing in our merger case.

Q As I recall coming out of that, the company agreed to RTO participation.

A (TOMASKY) We did because we never actually objected to RTO participation, that's correct.

Q And that was intended to address transmission

market power concerns.

A (TOMASKY) The requirement of the Commission and the basis for the Commission's position and the position of the staff was to address the Commission market power concerns, that's correct.

Q The basis upon which those concerns would have been met would have been independent operation of the transmission system.

A (TOMASKY) That was certainly an element, yes.

Q And that element has not been satisfied to date.

A (TOMASKY) What we have done is consistent with the Commission's orders, transferred the scheduling and other functions that Mr. Baker enumerated as an interim step. We have been pursuing various options, indeed, have the Alliance move forward, we believe we would indeed be in an RTO and would have been there some time ago, primarily because we would have done with our states as we enumerated earlier, exactly what we are proposing to do now, which is to work with them to resolve these concerns.

When the Alliance option was no longer available to us, we began to pursue PJM and we're in the middle of those processes now.

Q On page 21 of your testimony you quote from certain aspects of the Kentucky Commission comments and I just want to make sure.

MR. LARCAMP: Your Honor, we have a number of data matters that we need to review. Perhaps we can review those with Mr. Duffy at lunch and come back with a complete list, but I just want to make sure at this point, when we've asked for it, I think the company has agreed to provide a breakdown of the off system sales by state and operating company that we will be able to from that see what the off system sales come from Kentucky and the other states.

WITNESS TOMASKY: Yes, as I'm thinking about it, Mr. Larcamp, I am seeing some problems in precision because the sales are made by operating companies and the ownership of those operating companies is governed by agreements and sort of jurisdictionalizing it physically may in fact be a challenge, but we will do our best to do it.

WITNESS BAKER: What we will have to do is give you the revenues that flow back to the states through the pool agreement, which is independent of the generator that is used to serve the off system sale.

What I think you're interested in is the revenues that would go back to the various state jurisdictions that could be included as a credit to cost and service. I believe that's what you're looking for and that's the way we would approach this.

BY MR. LARCAMP:

Q The reason that certain units are dispatched

differently is that the operating agreement itself for the East Zone is a least cost dispatch operating agreement?

A (BAKER) Yes, it's a least cost dispatch for the entire AEP commitment for load in that hour, including off system sales.

Q So in that respect, the companies' existing arrangements are not fundamentally different from the way PJM would dispatch its system?

A (BAKER) I think that's correct. The difference, probably the only difference, that I can think of is that we do it on a cost basis and PJM does it on a bid basis. That would be a clear difference.

Q When you say you do it on a cost basis, is that for purposes of allocating the revenues from off system sales back to the East Zone companies or are you saying that the transactions take place at cost based rates?

A (BAKER) No. What I'm saying is, the dispatch of the generating units to meet the lowest production cost for the AEP system total load is based on the variable production costs at each of our generating units at various load levels at each generating unit. That's how we determine which generation should be on to serve the total load.

Q For purposes of sales above that that you may have in your system, are those sales at cost-based or market-based rates or a combination?

A (Baker) The majority of them are at market-based.

Q So that when we see the breakdown of the off-system revenues, we can get that type of determination about what type of contract they're being made under?

A (Baker) Yes, that would just add additional time to the process, but, yes, we can do that.

Q On page 26 of your testimony, you talk about splitting the system and also about economics. When you talk about economics there, are you talking primarily about generation and facilities, cost of dispatch economics, or are we talking about economics of the operation of the transmission system, or can they be separated?

A (Baker) I think we're talking about both. There would be potential additional costs from the transmission system. If there were G-tariffs, there would be the additional costs associated, as we discussed earlier, with putting in additional facilities control areas, metering equipment, things like that.

There would also be effects on the integrated dispatch to meet lowest total cost for the whole load, as opposed to segments of the load.



Q I think your answer is, both.

A (Baker) Yes.

Q On 26, Item 9, you indicated that this split arrangement might require changes to the AEP pool agreements, and past efforts at changing the agreements you say have resulted in complex, costly, time-consuming FERC proceedings. The last time we went through that, was that for state restructuring programs?

A (Tomasky) Yes. Those are a corporate separation.

Q Which was necessary to comply with?

A (Tomasky) It was, again, that changing landscape affects things, but the original design of that corporate separation program was to address requirements in Texas, primarily, and an administrative provision of our settlement in Ohio, to bring generation, unregulated generation under separate ownership.

Of course, that didn't have anything to do with separation of the transmission system. Since that time, we have opted to sell the Texas generation, and, as a consequence, the Texas Commission has been willing to permit us to deal with that issue through that divestiture, which is currently ongoing.

That particular piece, which was, again, to separate the unregulated generation, leaving in place, the

integrated system in those states that have not moved to competition, that was basically the corporate separation proposal that we went to.

And even that, that was in principle, relatively simple and did not involve huge, huge issues of harm and value to other systems in the West, took a very long time to get through.

Q I want to make sure I understand, under the alternate proposal, again, Ms. Fernandez asked the question, but I didn't quite understand about how congestion management would work under the alternative proposal -- is it fair to say that AEP would continue to operate a TLR system for dealing with congestion?

A (Baker) That's not the way I would represent it. The security coordinator is the person who runs the TLR system.

What the company can do, just as a company within an RTO, if they see congestion or constraints on their transmission system, they can make a request to the reliability coordinator to take TLR actions, but it is up to the reliability coordinator to make the determination on whether or not to go forward with those actions.

MR. DUFFY: Your Honor, I might note that Mr. Baker used the term, both security coordinator and reliability coordinator. Those terms are really one and the

same.

PRESIDING JUDGE: So noted.

BY MR. LARCAMP:

Q To summarize your testimony, that's another area that's open for discussion?

A (Tomasky) And we're very open to different solutions.

Q But I want to come back to the point that I asked Dr. Draper about this morning. When you entered into your commitments in May of '99, what were the central features of the RT0? Do you agree that one of the central features when you made that commitment was a market-based approach to congestion management?

A (Tomasky) That was certainly one of the objectives of Order 2000 at the time, absolutely.

Q So that the company would be willing, any of the alternatives under your alternative proposal that you would be looking for for congestion management, would be market-based?

A (Baker) We are certainly interested in pursuing market-based solutions to congestion management. We think that is positive.

The specifics of it is something that would need to be worked out during a day one activity and whether the states would all be comfortable with a full market approach

or something that is less than that.

A (Tomasky) The question is, do we believe we need to get there in order to satisfy the requirements of Order 2000? The answer is yes, we're asking for a process by which we get there, and we don't know right now and don't pretend to be clever enough to have figured out all those answers to figure out how to get there.

Q A question on page 32 of your testimony, and I want to make sure I understand: If this Commission -- and I'm not suggesting whether or not the Commissioners will move in that direction, but if they provide support for your alternative proposal, I assume the company is willing to amend your pending state authorizations to reflect any change?

A (Tomasky) Absolutely.

(Pause.)

Q On page 36 of your testimony, you state that the notion of shipping power from Nebraska to Philadelphia at a single rate was startling at the time of the merger order.

As I understand your integrated requirement between the West and the East Zones, you've got a contract path, so that it is conceivable for purposes of integration, that you could have been shipping power from Oklahoma to Virginia.

A (Tomasky) That was startling to people at the

time of the merger.

Q I just wanted to look at the statistics. It didn't seem very far off, and I wanted to see what was startling or not startling.

This morning, I believe you heard Dr. Draper testify about the Commission needing to do more about transmission incentives. Is that a fair question to ask you all about?

A (Tomasky) Certainly.

MR. LARCAMP: Your Honor, I ought to do this for a living. I'd like to ask the witnesses about a statement that the Company made in their letter of transmittal in their last rate filing before the Commission, which has subsequently been withdrawn.

I have copies of that letter of transmittal that I can give to Your Honor and counsel.

PRESIDING JUDGE: Why don't proceed to do that. If there's an objection, we can deal with it.

(Documents handed to Presiding Judge, to Commission, and to counsel.)

BY MR. LARCAMP:

Q Could you turn to page 5 of the letter of transmittal, the first full paragraph? And would you mind reading -- well, let me ask you this:

There's a sentence that begins, "In fact, ..."

I'd be happy to read that or allow you all to read that, if you'd prefer.

PRESIDING JUDGE: Why don't you read it, so that we get it into the record.

BY MR. LARCAMP:

Q "In fact, the Commission places a premium on upgrading and expansion, and has given special incentives to encouraging upgrading in the past. For example, in a Commission Order concerning the West, the Commission stated it is in the public interest to provide incentives to timely completion of transmission enhancements, including projects already underway, in order to increase transmission capacity at the earliest possible date.

In addition, Orders No. 2000 and 2000-A, encourage expansion and upgrading. The RTO must have ultimate responsibility for planning and directing or arranging necessary transmission expansions, additions, and upgrades within its region. It will enable the RTO to provide efficient, reliable, and nondiscriminatory service.

The AEP anticipates transmission upgrades and additions, once the expanded PJM is operational."

Is that an accurate statement, to the best of your knowledge, from the letter of transmittal?

PRESIDING JUDGE: You left out the word, "significant," "significant transmission upgrades."

MR. LARCAMP: Sorry, Your Honor.

WITNESS BAKER: Yes, it is accurate. If we look at the full paragraph, we were looking to justify the use of levelized rates, and believe that that could be another method that the Commission would use to incent the transmission upgrades and additions, so that was the purpose of it.

These are the kinds of things -- there have been some actions by the Commission, clearly to incent transmission. In the case of some the adders on our OE that we've seen, that doesn't always work because it doesn't necessarily flow through to all of our customers.

We can get it wholesale, but then, on the other side, we see at times the elimination of out- and through-rates, which could be a disincentive and make investors wary of investing in transmission.

BY MR. LARCAMP:

Q To be clear, this case has been withdrawn. The company did seek an ROE adder in that case?

A (Baker) Yes, it did.

MR. LARCAMP: I have no further questions, Your Honor.

PRESIDING JUDGE: I want to mark this for identification as Exhibit S-1. We'll include that in the record. Any objection?

MR. DUFFY: No objection.

PRESIDING JUDGE: We'll receive that into evidence.

(Exhibit Number S-1 was marked for identification and received in evidence.)

PRESIDING JUDGE: Does Staff have any further questions for the panel?

MR. BARDEE: Your Honor, Mr. Kelly does.

CROSS EXAMINATION

BY MR. KELLY:

Q Just one question, I think, because of the long introduction: I remember, Mr. Baker -- I think I remember, about a year ago, you appeared before the Commission and said that one of your reasons for choosing PJM was because they had markets that could support the retail access programs in Ohio and Virginia.

I remember visits to Columbus, talking to Ohio industrial consumers and their support for an RTO in the Ohio area, so that they could get away from TLRs and feel more confident in buying from generators farther away, and I think they meant generators other than AEP sometimes; and that if they were TLRs, they would have a real-time balancing market to turn to and that that would give them confidence that they wouldn't feel they had to pay a very



high price because their transmission was cut of and there was no local generation available from a real-time balancing market.

It seems to me that your proposal, while it's got a lot of -- to me, it had a lot of initial appeal -- has a number of downsides, including those that I just mentioned.

I wanted to just suggest to you an alternate starting point for, say, discussion with states and get your reaction to its general pros and cons, which was, if you think of AEP as a transmission company, on the one hand, and on the other hand, everything else, a generating company, a load-serving entity, and so on, in a sense, AEP, the transmission company, could join PJM and participate fully in the sense of supporting PJM's efforts to put in a real-time, day-ahead market, to have LMP congestion management, to provide balancing services.

Yet if some states had concerns -- I imagine retail access states would be very happy with that arrangement and would want to take advantage of it, but other states may not.

Those states, in a kind of Pike County sense, a state could say to AEP, look, we don't want you to buy from the real-time market; we want you to use your own generation to engage in firm bilateral contracts because we don't want

to take the risk of having some California-like meltdown in the markets, and that wouldn't at all violate the PJM rules.

Now, as I read your testimony, you really focused on the states' concern, though, with the costs to AEP transmission of participating in the PJM full market, sort of the cost of getting to a real-time market or day-ahead market, congestion management. That was more of the focus of your testimony than the risks.

So the question, I guess, is, since PJM has already developed the systems, and to your west, MISO has developed the same systems, the investment is largely made.

If the incremental cost now of adopting that is something that is -- you have a handle on what size it is. Would dealing with the allocation of that cost be a more appropriate starting point for discussions with the states than the one you have put on the table? It's a long question, but it's my only question.

A (Baker) I'll start and say that the issue that has been raised is about turning over transfer of functional control of the transmission system, and to say we have a transmission company that we could put into PJM, would mean that we have to disintegrate individual operating companies and move the transmission into a separate company that was one company for all of AEP.

That would, I think, require a lot of state activity to get that accomplished. So I'm not sure that that short-circuits the problem that we've outlined.

I think a second part of your question is, if you were looking at an incremental charge associated with being in the market, could states become more comfortable with that? History has said that wasn't a very workable solution.

With this Commission, we had proposed that back last Spring, a year ago Spring, I guess it is now, and we had suggested moving the Alliance into MISO under the MISO umbrella, and had asked to only be charged the incremental costs incurred by MISO, and that was one of the -- in the Order that we received from the Commission, it was indicated that we really needed to pay a rolled-in share of the total RTO costs, not the incremental cost.

Q Do you have a sense of what that rolled-in cost share is during PJM?

A (Baker) If we would do it on a fully-integrated basis, \$50 million a year.

MR. KELLY: Thank you.

PRESIDING JUDGE: Anything further from Staff?

MR. BARDEE: No, Your Honor.

PRESIDING JUDGE: Mr. Chairman, do you have any questions?

CHAIRMAN WOOD: Ms. Tomasky, thinking about what, in the pure sense, you're a policy person, I understand too. If you didn't need states' or FERC approval, how would you, in the ideal world, set up an RTO commitment in a way that brings advantages to the company and its customers?

WITNESS TOMASKY: Believe it or not, Mr. Chairman, I'm actually the kind of person who sits around and thinks about stuff like that.

I believe that AEP, and AEP has said for some time, that its interests, both for our customers and for our shareholders, are best served by a logical progression to competitive markets.

I don't think that we feel any different about that today than when we first went forward. As a consequence, the basic principles of independence of attempting to create markets through rate structures that

encourage movement are really important elements of that. Obviously, revenue neutrality is an important corresponding principle for us. But I would want all those things front and center. I do think -- and this is a personal view -- that locational marginal pricing has much to commend itself. But I think that what fundamentally we haven't come to grips with, and by this I mean all of us, are the issues of economic dislocation that have to do with the fact that we're joining together markets that have different views of what their power costs have been and what they should be.

As a consequence, I think that we would probably, if left to our own devices, move toward the design that you talk about, but we probably would pursue it in steps. And the reason we would be comfortable pursuing it in steps is, quite frankly, because what has happened in the larger marketplace. We have made huge progress in the introduction of the values of competition already, even without all of our market structures in place. We see prices have moderated in the wholesale market significantly in the midwest, and in many regions of the country, we have over capacity.

The reason I am not anxious about having to solve this problem today is because I honestly believe that the single most important set of issues that we have to address is getting the rules of the road right and rebuilding this

consensus for the time that the next generation of capacity investment is made. It seems to me that, as a consequence, we accept that AEP is going to be central to this debate. We understand that we have certain things we need to protect. We protect those, but beyond that, we are reasonably flexible. But it seems to me that the most important thing we need to do is to get everybody, including people who have different economic goals for their states, on the same page with respect to the fundamental principle of RTO participation access across the systems and resolution of the seams issues in a fair way.

If you get that, then I think you can begin to talk reasonably about critically important issues like congestion management and all the rest of it. For AEP, we have a couple of points where congestion is extremely important. In a lot of our systems, we do not. So those are how I think that the way that I would proceed is, let's see if we can get the basics in place. Let's try to get a solution.

There's a point in time in which the Commission may actually decide, okay, it's time to move. We're going to go ahead and just finish this job. I don't think that point is yet today because I don't think we've figured it all out yet as a group.

CHAIRMAN WOOD: Earlier in the question, you

suggested something along the lines -- I can't put words in your mouth -- but something about process. How many more years of that do we need? Give me one that works. You've worked here, you've worked with states now, we've invited states to come here. We have some of them that are involved in their own proceedings and are not participating. How does this happen when you've got kind of independent sovereigns here that you all have to work for?

WITNESS TOMASKY: I agree. That's a really hard question. To me, the big obstacle in all that is one short-term one which is that the states have now actually initiated some processes and until they come to some conclusion with respect to those, they're not likely to come to the table. One of the things is that a good idea brings people to the table where they weren't previously there. That's one of the reasons we've put this out. I don't know if it's a great idea. We came here hoping that mostly what we would get would be other good ideas, but that often brings people to the table.

I think that time lines bring people to the table, saying here's a list of five issues we want to have identified, here's what we like of what AEP said, here's what our concerns are. Let's see, in a discrete way, if we can come to some very specific concrete resolutions that take these conflicting economic issues into concern. And

Mr. Baker identified some issues with Kevin's proposal. But the basic concept of trying to find a different treatment for those states that don't want to be part of it through bilateral activity may be something that we want to work on. We can work on that with this Commission. It's got to be done in a small group. I understand your frustration over the process but the world just changed so much right out from under us. And I don't know how to get the momentum back, again, unless this Commission just wants to say that's the rule.

And as we said in our testimony, we all have to live with the states, so I'd make another stab at it, look at 2004 in the middle of June as the date that the Virginia statute runs off, and try really hard to have something in that time frame, but I understand the frustration.

CHAIRMAN WOOD: I'm looking at page two. You all quoted a pleading that was put forth by Ohio Michigan and the Pennsylvania State Commissions, and quoted that approvingly, as I guess, kind of a source point for your alternative proposals. Let me see where I read that. Line 21 and '2. This was again quoting from the other state commissions, but indicating that contracting with an independent third party who has no interest in the generation market or operates a transmission system, which could be PJM or somebody else, in a manner that need not



require legal transfer of functional control or state approval.

Is it your read that your proposal would in fact obviate the need to seek state approval in particularly Kentucky and Virginia?

WITNESS TOMASKY: I don't think it would, Mr. Chairman. I think we'd still have to get, if we're turning over full operation of all our system, irrespective of the market rules, I believe that we would have to, at least under their interpretation, go back to them. But I also believe, as I said earlier, that when you go back to people with a proposal that actually works, things can work a little faster.

CHAIRMAN WOOD: Clearly, the Kentucky Commission has spoken in an order, but do we have any indication, or have you got any indication from the Virginia Commission as to what their concerns with your joining PJM are specifically?

WITNESS TOMASKY: I know of a couple of things. I'll let Mr. Baker add. First of all, it is our understanding that the Virginia Commission has some basic concerns just around what they perceive as a jurisdictional transfer of authority. That I would emphasize more a function of some of the proposals that were embodied in the standard market design as opposed to something that's

triggered simply by AEP's RTO participation, which is another reason why we favor this.

It was our experience that Virginia was initially pretty sympathetic to AEP's RTO participation. And when we were talking about the alliance, they were actually talking about PJM. That is not their position today, as we understand it. I wouldn't want to represent it that way.

I think what really happened in Virginia was the coupling of standard market design with RTOs, which deeply elevated -- if there is such a thing -- their concerns to a very significant extent, because they became concerned that what would happen was that the marginal price of electricity in our region would be set by natural gas, as it is in PJM, instead of by coal as it is for regional customers under the regulated rate that we have. And there were in fact some charts that would not be hard to challenge if you had a chance to look at them, but they even ran in the newspapers, that showed volatility around spot gas prices in PJM. And all of that volatility, whether it was up or down, still was raised a significant level above the basic price that you paid under AEP.

And the argument went, well, we're going to live with all this volatility and all the prices in our area will go up because of this market that's being created. So right there, I say first of all there's a lot of confusion around

these issues. There are ways in which these things can be addressed, but we'd really have to sit down with the states. We'd have to have agreement that we're not trying to eradicate the value that AEP provides for those customers, and be open to some means by which that value is preserved but still get us under the PJM rubric. That's the general way in which I think you'd try to deal with Virginia.

Craig?

WITNESS BAKER: There were two other things that I've heard when I've been down in Virginia. One is the concern about LMP. If you remember, there was some very large costs incurred by people on the peninsula, which you have done some, had hearings on. That was raised as a concern that that could be in other parts of Virginia as well.

And lastly, I would add that the costs of the RTOs -- people are concerned that the costs are skyrocketing to be in RTOs and to have these markets, and that balancing of if you're a low-cost generating company, how do you possibly achieve benefits to offset those costs? So those are the two other areas.

CHAIRMAN WOOD: I haven't heard those.

Excuse me for being inartful, but why are we just now doing a cost benefit for Kentucky? I mean, isn't that something that has been kind of an issue with people across

the country is, show me? What does it take?

WITNESS BAKER: First of all, we didn't do a cost-benefit study because we felt we had this merger commitment and we were going to need to go forward with it. In the case of Kentucky, there is nothing in the statute that requires cost benefits, and actually in a court case the Commission was somewhat taken to task for asking for a cost-benefit study as their single determining factor in a previous case. So we really didn't think that it was required, and we had some form of study which showed a level of benefits and a level of costs.

All of that led us not to be concerned about doing a sophisticated cost-benefit study until the Virginia legislation passed, which clearly required it as a first step in moving forward.

CHAIRMAN WOOD: Then a final question on I guess it's an issue that Dr. Draper had kind of I guess generically punted to you all as well.

On the rate support for your transmission business, with the change to the rate design on the through and out rate, what is a rate design that balances? I heard Ms. Tomasky say the need to get the efficiency there, as well as preserve the benefits of the transmission business. What's a rate design that basically eliminates the transactional fee but yet keeps the company whole?

WITNESS BAKER: I believe that we had a solution in the Illinois Power settlement, the SECA approach, which basically says the benefiting customers, the load who benefits from the lower cost of generation paying some kind of demand charge and access fee that's on an annual basis.

CHAIRMAN WOOD: Let me ask a question on that specifically. Would the benefiting customer be defined on a flow-based-type benefit or on a contract path-type benefit?

WITNESS BAKER: It would be where it sank, and you would look at what had been collected by the companies historically.

CHAIRMAN WOOD: So it would be more the contractual path as to who bought the power, as opposed to where it actually went physically.

WITNESS BAKER: Exactly. And as we see that, that is a transitional mechanism that we need to put a certain period of time where you put that kind of mechanism until we find another one.

CHAIRMAN WOOD: What's wrong with that one as a permanent fix, if that's where the benefiting customer is?

WITNESS BAKER: Because over the long term you will have changes in the flows. I'm sorry, not the flows; I'll change that to the sources of the generation. So I think you really do need at some point to move onto something else.

A flow-based approach, a distance-sensitive approach -- those are all alternatives. I think in an order that you put out, Mr. Chairman, you talked about parties who import a lot picking up a share of the revenue requirement as an approach. I think there are a lot of alternatives that could be studied during a transition period and put in as a long-term solution going forward, again that would be demand-related and not transactional in nature.

CHAIRMAN WOOD: Thank you.

PRESIDING JUDGE: Commissioner Massey, do you have any questions?

COMMISSIONER MASSEY: Ms. Tomasky, I am interested in your conclusion that ultimately, if the Commission wants to insist on your full participation in PJM, that we have the authority to do that. Is that your conclusion?

WITNESS TOMASKY: Well, that authority has never been tested, so I can't assure you that you'd ultimately win. We have, after all, a Supreme Court. But I believe there's a very sound legal basis for doing that if the Commission chose to. I think it wouldn't be easy, not only from the perspective of its ramifications, but I also think it would be hard to figure out how to be so thoroughly preemptive that you'd actually resolve all the issues, which is what your job would be if you were going to do it. But I

do think it's possible.

COMMISSIONER MASSEY: Your argument is that we ought to continue to try to work things out rather than preempt? It seems to me that's what you're saying.

WITNESS TOMASKY: Yes.

COMMISSIONER MASSEY: I guess what we're talking about here is how much process is really required here. At what point does the Commission simply say that we've got to meet this goal, and we must do it fairly quickly? It seems to me that's what we're talking about here: how much more process is necessary.

WITNESS TOMASKY: I think that's right, obviously, Commissioner Massey. I also would suggest that, although we understand the importance that many people who use our system beneficially place upon AEP, my view is that this goal that you talk about, if the Commission is going to act, should be administered fairly to everyone. If you really want to impose this solution, I do not believe that it would be inappropriate simply for AEP. I think you really have to decide who you want in what RTO, and make it all happen.

COMMISSIONER MASSEY: Do you believe stronger regional coordination of the transmission grid is in the national interest?

WITNESS TOMASKY: I do.

COMMISSIONER MASSEY: Do you, Mr. Baker?

WITNESS BAKER: Yes.

COMMISSIONER MASSEY: Was AEP's commitment to fully participate in PJM designed to meet AEP's reliability goals, at least in part?

WITNESS TOMASKY: To be candid about that, Commissioner Massey, we really believe that there are enhancements that can occur through RTOs, but we fundamentally believe that the best and most successful way to meet reliability goals is through the talent, operation and the design of the system and the coordination with the reliability coordinators and with NAERC. We have not seen RTOs as a step that was fundamentally necessary to address reliability concerns.

We do believe that RTOs, if they become the organizing principle whereby the grid operates, must assume a very significant reliability function. But the key issue at that level is the reliability coordinator, and it is appropriate to house that in the RTO, if you're going to have RTOs.

WITNESS BAKER: I would just add that when I was



here, a little over a year ago, talking about AEP's choice, and now we're not discussing in an RTO or not in an RTO, but which one, our constraint area that we have on our system is down in southwestern Virginia, so it is better managed by parties who are overseeing the Dominion system and the Allegheny system, and looking at the only significant constraint point on the AEP system. That was one of the reasons for our choice at the time.

COMMISSIONER MASSEY: Was AEP's commitment to fully participate in PJM designed to promote the economical coordination of facilities in your region, at least in part?

WITNESS TOMASKY: Yes.

WITNESS BAKER: Yes.

COMMISSIONER MASSEY: Thank you.

PRESIDING JUDGE: Commissioner Brownell?

(No response.)

PRESIDING JUDGE: No questions, all right.

During the lunch break, which I want to go into right now, I'm going to expect that the staff will meet with AEP and work out a schedule for the data exchange that is necessary to complete the answers to your questions. We will resume at 1:45 with a presentation of Exelon, Commonwealth Edison, and former Chairman Moler.

(Witnesses excused.)

PRESIDING JUDGE: We're in recess.

(Whereupon, at 12:50 p.m., the hearing was recessed for lunch, to reconvene the same day, Monday, September 29, 2003, at 1:45 p.m., in the same place.)

A F T E R N O O N      S E S S I O N

(1:45 p.m.)

PRESIDING JUDGE: We're resuming the inquiry after a lunch break.

I understand that staff has informed me that staff and the AEP have worked out an arrangement for the exchange of data. Is that correct, Mr. Duffy?

MR. DUFFY: That's correct, Your Honor. We had a working lunch with staff. We have mutually agreed what the data requests are. Mr. Larcamp has asked that I read them into the record. I'm sure that if I get anything wrong, either Mr. Larcamp or Mr. Baker will jump all over me. So let's give it a try.

First of all, there was a reference in Dr. Draper's testimony on page 2, line 8, that we have spent or committed \$50 million in pursuit of RTO membership. We will provide a breakdown of how much of that \$50 million was spent and how much is committed.

There was also some reference to a breakdown between state and federal of that. Staff has withdrawn that because we said it's just not possible to get.

The second is that also on page 2 of Dr. Draper's testimony, it talks about \$56 million invested in transmission projects. We were asked whether there was any state certification and we will provide any state

certifications that were sought with respect to those projects, so that staff can determine what we said in those state certification applications.

Third, Dr. Draper talked, at page 3 of his of testimony, about how, in the past ten years, we have spent \$185 million per year on transmission capital investment. We were asked for a breakdown for the past three years, to provide the projects that are involved in those, and a description of how much were incurred for generator interconnections, and what the remainder were incurred for. And a description that the remainder of costs were spent for internal system improvements.

Four, we were asked to explain how, under our cost allocation formulas, these projects which we are providing details of for three years, how the costs of those are allocated as among our operating companies. Some are directly assigned below a certain voltage level and others are spread pursuant to our transmission pool.

Number five, how many dollars have been allocated under our system transmission pool agreement for the past three years. When I say the three-year period, we're talking about the years 2000, 2001 and 2002. So the question is, how many dollars were allocated to which of our eastern operating companies under the transmission pool for that period.

We will also show how much investment, under the transmission pool agreement, there was for those operating companies for the three years in question.

Question number six. How much in net revenues from off-system sales was allocated to each of the operating companies for that same three-year period under our pool agreement, and what capacity equalization charges were paid by those companies under our pool agreement.

Seven, there was a reference to \$300 million in transmission revenues for the year 2002. There was also a reference to \$185 million in revenues under our open access transmission tariff. The question is to explain the relationship between those two numbers.

Eight, we will provide, for those same three years, a measure of the member load ratio for each of the operating companies. The member load ratio is an allocation factor under our system pool agreements. We will provide the member load ratio, or MLRs as we call them, for those three years.

Question nine. We will provide the Kentucky cost analysis that was the basis for our claim, or the reference in the Kentucky Order of \$3 million for our participation in PJM. We'll provide the analysis from which we arrived at that figure.

Question ten. I hope I'm not skipping numbers

here. We will provide a breakdown of the ongoing costs associated with the nine to thirteen employees we mentioned in connection with the split system proposal. Also, we will give some indication of whether or not there will be additional costs in connection with adding Kentucky and potentially other states to that split system proposal.

Finally, we will provide the manner in which system sales net revenues are flowed back to retail customers in each of our eastern states.

PRESIDING JUDGE: When will this be completed?

MR. DUFFY: We will provide information that is readily available one week from today, and we will make best efforts to provide the information that's not as readily available in a week after that. And if we really run into a crunch or a problem with any particular item, we'll give staff a call and try to work something out.

PRESIDING JUDGE: Very well. All set then on that?

MR. BARDEE: Yes, we are.

PRESIDING JUDGE: Thank you very much for your cooperation.

Let's proceed now to take our next witness. I'm going to turn to Ms. Hill to present her witness.

MS. HILL: Thank you, Your Honor. Karen Hill on behalf of Exelon Corporation and Commonwealth Edison.

PRESIDING JUDGE: Let me just say, former Chairman Moler, you were previously sworn and remain under oath. You may proceed.

Whereupon,

ELIZABETH ANNE MOLER

was recalled as a witness herein, and having been previously duly sworn, was examined and testified further, as follows:

DIRECT EXAMINATION

BY MS. HILL:

Q Ms. Moler, please state your name and business address for the record.

A My name is Elizabeth Anne Moler, 101 Constitution Avenue, Northwest, Suite 400E, Washington, D.C. 20001.

Q Are you the same Elizabeth Anne Moler who submitted pre-filed testimony on behalf of Exelon and Commonwealth Edison in this proceeding?

A Yes, I am.

MS. HILL: Your Honor, I supplied two copies of Ms. Moler's testimony to the Court Reporter, and to you, Your Honor. I asked that they be marked as Exhibit EXC-1.

(The document referred to was marked for identification as Exhibit Number EXC-1.)

BY MS. HILL:

Q Ms. Moler, do you have any technical corrections

to your testimony?

A Yes, I do. Unfortunately, when we submitted the earlier copy for the Commission's record, we inadvertently failed to number its lines, so the change is to number the lines. I have no further technical corrections.

Q Ms. Moler, would you please summarize your testimony?

A I would be delighted to. Let me say at the outset, I'm delighted to be here today. This is my first time in the witness box. I've been in this room many times and, indeed, a lot of us have spent a lot of time in this room when we were here for weeks and weeks and weeks with Judge Wagner in a previous incarnation of this same proceeding, when we were settling differences between Midwest Independent System Operator and what were then the Alliance Companies.

In that sense, it is not a pleasure to be back because this has been going on for so long. I've wanted many times to pick up the phone and call you, Mr. Chairman, and tell you how to fix this. But being familiar with the Commission's ex parte rules, I have chosen not to do so. But now I get my chance.

The most important thing this Commission could do to break the logjam in the midwest and in the mid-Atlantic region, would be to direct AEP to join PJM by March 1st,



2004. Just tell them to do it. And to direct PJM and MISO to complete and file the joint operating agreement and reliability plan that has been underway between the two entities within 30 days.

In addition, the Commission should insist that MISO should not be allowed to delay implementation of its planned market. The Commission should reject the attacks of MISO members to delay or scuttle implementation of the MISO market. Implementing the MISO market should proceed as the Commission has directed, along with implementing the joint and common market.

Specifically, I believe the Commission should first require AEP to satisfy its merger condition by joining the RTO of its choice, which is PJM, as soon as possible, which we believe would be next March 1st, 2004.

Second, I would require MISO and PJM to complete their proposed joint operating agreement and for PJM to file its reliability plan as soon as possible, preferably within 30 days. If the plan requires updating, once DOE and NAERC and the Canadian authorities release their conclusion about the cause of the blackout, it can be supplemented as appropriate.

Third, I would require MISO to establish its market no later than next spring, as contemplated by the Commission order issued May 21st, 2003. I would note that

in a filing made last week, MISO now proposes to delay market implementation particularly for the day-ahead markets until November 2004, which is not in accord with the Commission's requirements.

Finally, I would require PJM and MISO to establish a joint and common market by October 2004, as required by Commission order issued July 31st, 2002. Some have urged the Commission to revisit the issue of whether it should have approved the RTO choices of the former Alliance companies. I would strongly urge that the Commission should not do so. Rather, the Commission should insist that the integration of the former Alliance companies into their RTOs of choice should be completed as soon as possible, and that PJM and MISO should complete and implement the proposed joint operating agreement and reliability plan.

I believe that this very direct course of action, which I believe the Commission has the authority to take under Section 5 of the Public Utility Regulatory Policies Act, as outlined in a motion that we submitted to the Commission last March, which is appended to my testimony, is the fastest, surest, most expeditious way to get on with it.

Q Thank you, Ms. Moler. Do you have anything to add to your testimony?

A I would like to comment on two matters. First, after my testimony was filed, on Friday, Exelon Corporation

and Dynegy issued a press release after the market closed on Friday, announcing that Exelon and Dynegy are in a period of exclusive discussions regarding the possible acquisition of Illinois Power by Exelon Corporation. It is a 45-day period from the time that the agreement was signed.

We are very hopeful that that negotiation will come to a successful conclusion. If that negotiation does come to a successful conclusion, and we hope it will, we would intend to file to put Illinois Power under PJM, rather than under MISO, thereby bringing the vast majority of Illinois into the same RTO, which we think would be a step forward.

Secondly, in order to have some further progress in this proceeding, I would like to comment briefly, and I'm sure we'll get into it in response to questions on AEP's proposal that is before this Commission today.

First let me say that I give them a lot of credit for stepping up and putting a proposal before the Commission. I think that we are looking for a solution to what has been a longstanding, vexing problem. Our friend, Ms. Tomasky, has characterized it as a starting point for discussion and a request for a process. We are delighted to have a new starting point for discussion and a request for a process.

She also says that they don't have hard and fast

positions on every single element, and I think that's a positive statement as well.

As we look at the proposal, and as the Commission has only had a very brief opportunity to think about it and talk amongst ourselves, we do want to point out that we do not believe it meets their merger condition. As AEP concedes on page 34 of Ms. Tomasky's and Mr. Baker's testimony, their merger condition requires them to join an RTO that is Order 2000 compliant.

My problem with the proposal that's before the Commission now, and whether it meets that requirement, is that it specifically accepts some sort of market-based congestion management system from the way they would go forward. In particular, Order 2000, as was elicited in Ms. Fernandez' questions, does require market-based congestion management. It does not mandate LMP locational marginal pricing, but it does real out non-market-based methods, such as TLRs. And Mr. Baker did indicate that that would be the way they would manage congestion on this day-one approach.

Furthermore, we find out that the statement that Order 2000 did not require RTOs to administer markets is somewhat misleading. Order 2000 clearly says that RTOs have to have a real time balancing market, as was also elicited in the staff testimony.

AEP is proposing to exempt itself from the PJM

congestion management, which is not voluntary under PJM, the ICAP requirements and the balancing market. We had discussions with PJM about how we would go and come in under a, quote, "day-one scenario." Through extensive discussions with PJM, we were told that there's only one way to join PJM, and to really join PJM, and that's to go under the PJM tariff. The AEP proposal does not meet those requirements.

I'll be happy to elaborate if the Commission so desires.

Q Thank you, Ms. Moler.

If I asked you the same questions as in your prefiled testimony today, would your answers be the same?

A Yes.

MS. HILL: Your Honor, I move for admission of Exhibit EXC-1.

PRESIDING JUDGE: Any objection?

(No response.)

PRESIDING JUDGE: The aforementioned Exhibit will be received into evidence.

(The document labeled Exhibit Number EXC-1 was received in evidence.)

PRESIDING JUDGE: Mr. Bardee, you may proceed.

CROSS EXAMINATION

BY MR. BARDEE:

Q Good afternoon, Ms. Moler.

A couple of factual questions for you. First, as with Commonwealth Edison, can you tell me what percentage of its power sale revenues are for wholesale sales, as compared to how much are for retail sales?

A Virtually all of its sales are for retail sales. We have very little by way of wholesale markets.

Q Approximately what do those revenues come to each year?

A I don't have that information. I have with me today, Steven Malmon, Vice President of Wholesale Market Development for Exelon Corporation. I also have Susan Ivy, who is a Vice President for Transmission of Exelon Corporation. If we want to get into detailed technical questions, I will have to ask them to help me, or we would be happy to provide that information for the record.

Q For my purposes, that's the only question of that kind of detailed nature that I would have for the Company, so perhaps we can have you provide that at a later point. I don't imagine that would take you long to provide that.

A No, it certainly would not. Steve probably knows it off the top of his head.

Q Understanding what you just testified to, the question I have, to start with, is, assuming AEP is not in PJM at all, is it your Company's position that Commonwealth Edison can join and should be allowed to join PJM in any event?

A Yes, it is our Company's position that in the April 1st Order this year that the Commission issued, that it gave authority for Commonwealth Edison to go ahead and join PJM.

We have expended a lot of time and resources and made financial commitments in aid of doing so. Prior to the blackout, we had been hoping originally to have Com Ed integrated completely into PJM as of October 1st of this year.

That date had slipped to November 1st, but we are planning to proceed. Doing so is now temporarily on hold while PJM assess, in discussion with MISO, the causes of the blackout and whether any changes to their proposed methodology for collaborating between the two that are

embodied in the joint operating agreement and the reliability plan, are necessary.

But we are hopeful we will be given the green light to proceed soon.

Q Assuming you get that green light and Commonwealth Edison joins PJM and AEP is not in PJM, what kind of benefits do you see from that change?

A We believe that that would not be the most ideal scenario. The ideal scenario would be to have AEP in as well, but we see it as a net plus for our customers.

We see that we would have the development of a marketplace in Illinois and in Com Ed. We see that generators that are located in the Commonwealth Edison service territory, would have access to that market.

We see that it would facilitate transactions between our generators that are located in the East, that are used to serve Com Ed's load, Exelon-owned, and other generators that are located in the East to serve Exelon's load.

And we also see that it would facilitate further transactions between generators that are located inside the Com Ed service territory as they seek to sell their generation to PJM, which is the largest market available to them.

Q Has your Company estimated in any way, one of



more of the kinds of benefits you've just described under this arrangement where Commonwealth Edison is in and AEP is not?

A No, we haven't done any detailed cost-benefit analysis.

Q Assuming that arrangement, are there any kinds of operational concerns of having your company in and AEP not?

A We believe that we have successfully addressed the operational concerns that would come about if Commonwealth Edison were to join PECO, which is also one of our affiliates in PJM.

We have spent months and millions of dollars addressing those concerns, and we're good to go as far as we're concerned.

Q Recognizing your position that AEP should be in PJM, what kinds of economic problems, if any, would you see, of using a congestion management model of LMP, both for Commonwealth Edison and for PJM, but not within the AEP area?

A As I said, I believe we would be better off than we are today, if we were to go ahead. But if AEP continues to use the TLR congestion management model, which, unless you have a market-based congestion management model, is the only real tool of choice, we believe that it will inhibit

transactions that would otherwise occur, that would make it possible to have lower-cost electricity delivered to our customers, and it would also potentially inhibit transactions where generators that are located within our service territory would be simply cut off, rather than having a congestion management system where they can buy through, get the FTRs, and go ahead and transact. We've embraced that model.

Q One option that was discussed this morning was what I call the split system proposal for including part of AEP East in PJM, but not other parts, such as Virginia.

Does your Company have a position on that proposal?

A It is not our first choice, as is obvious. I believe AEP made some fairly compelling arguments this morning on why it would be a bad idea.

Q When you say it's not your first choice, if the Commission concluded that it was the most viable proposal for getting AEP into PJM, would it be preferable to having AEP not in at all?

A Yes. And far be it from me, of all people, to question this Commission's judgment on something of that sort.

(Laughter.)

BY MR. BARDEE:

Q If the split system proposal were implemented, would that make any difference on the arrangements Commonwealth Edison has for integrating with PJM?

A No, I do not believe it would. As I reflect upon that answer, as AEP testified this morning, their worst constraint place is in Virginia, and by splitting the system and sectioning off Virginia, I think it would not address the worst constraint, that is, the worst AEP constraint.

It wouldn't be a problem for our integration, but it would fail to address a very real and known congestion point in the region.

Q You testified a few minutes ago as to AEP's proposal of AEP participating in PJM only in certain functions and not for others, that you are not convinced that it met Order 2000.

A Correct.

Q Other than the issue of congestion management methodology that you discussed, are there any other concerns about that proposal by AEP that you would like to describe at this point?

A That is really our principal concern, Mr. Bardee. It does not have a proper mechanism for dealing with the congestion issues. We do believe that we need a security-constrained dispatch methodology.

There are seams and coordination issues that

would need to be addressed as well. We favor what is known as the Congestion Management White Paper as a mechanism for dealing with the seams coordination.

I'm really not sure and haven't had an opportunity to discuss with either Mr. Baker or Ms. Tomasky, what they mean when they say in their paper that they would do it according to the joint operating agreement.

That's just a technical thing in there in the weeds of this discussion, but it could prove to be important. But I think those are our principal concerns.

We obviously would like to have them in the ICAP market. We also would like to have them in the balancing market. The balancing market, in particular, is a requirement of this Commission's open access transmission tariff, but the LMP is the biggest thing.

Q If I understand your testimony right, your Company's position is that the optimal solution here is to have AEP East completely integrated with PJM and Commonwealth Edison; is that correct?

A Yes.

Q If I understand it right, that would be the solution here that produces the most net benefits for customers; is that right?

A Yes. I believe that it meets the criteria and the findings the Commission would have to make under Section

205 of PURPA, that it enhances reliability coordination between the entities over which this Commission has jurisdiction, and provides a very real reliability benefit.

Q Could you turn to page 4 of your testimony, please? Toward the bottom of this page, you say FERC should direct PJM and MISO to complete and file the joint operating agreement and reliability plan within 30 days. To your knowledge, what is the status of work on those agreements?

A We have not been privy to the discussions that have gone on between the PJM officials and the MISO officials on those documents.

They were working on those documents, they were ready to file them, as I understand it, just before the blackout. I received a call from Mr. Rudika, indicating that they had had to put our integration on hold so that they could be satisfied that they understood the implications of the blackout for that agreement.

I believe that they have had meetings since then between PJM and MISO. I don't know if they have yet completed a review of those documents with an eye toward whether they are sufficient to make the two RTOs comfortable with going forward or not, but they would be reviewed as a part of the NAERC review of our reliability plan, which this Commission has required be concluded satisfactorily before

we do the integration.

That was really ready to go in August. Then it was going to get done in September and now it's again on hold because of the post-blackout review.

Q Could you turn to page 10 of your testimony. Toward the bottom of the page, you're talking about the hold-harmless issue. I just had a couple of procedural questions for you on that.

You say toward the end that Com Ed will propose a resolution of the financial issues as to hold-harmless. One question I have for you is, when do you expect to propose a resolution?

A I think the specifics of when we will make these proposals as to a particular day, is really right now a little bit up in the air because of this hiatus, I guess I'll call it, the stall that we are in.

We have had considerable discussions before an ALJ. Those are obviously privileged discussions, but we are prepared to make a proposal to deal with them when it's the appropriate time. And I don't know when we're going to get that to go. We're stalled.

Q In terms of the vehicle for proposing a resolution, are you envisioning this as some kind of a FERC filing or some kind of proposal within the confines of settlement discussions?

A We are envisioning that it would be a FERC filing, yes. Many of the issues are dealt with in the joint operating plan and reliability agreement and implementation of the white paper that was developed.

We believe that that is the vast majority of what would be necessary to address the hold-harmless concerns.

#### CROSS EXAMINATION

BY MS. FERNANDEZ:

Q Good afternoon, Ms. Moler. I just had a few questions. Currently, does PJM perform any functions for Commonwealth Edison?

A Yes. They are our reliability coordinator. They are administering and calculating ATC and TTC on the Com Ed system, and, of course, for PECO, our other affiliate, was a founder of PJM, and they are fully committed to PJM.

Q Earlier in the discussion with AEP, they mentioned certain other functions that Southwest Power Pool currently has in terms of scheduling and reservations for capacity. Is PJM performing those functions?

A Yes.

(Pause.)

No, I'm sorry. I stand corrected by Mr. Nauman.

(Laughter.)

BY MS. FERNANDEZ:

Q PJM is not currently performing those functions?

A Correct; I was wrong. That is in our dream for when we will join PJM.

Q In terms of changes involving Commonwealth Edison's status in terms of joining PJM, or, I guess, turning over additional functions to PJM, to your knowledge, do you know to what extent that would require changes in the reliability plan that would first require NAERC approval?

A Our plan has been to have the next step be actually joining PJM. And so we've done the steps that we are in the position to do now, and then our next step has been full-fledged operation under the PJM tariff.

So we really haven't contemplated any more interim or baby steps; we're ready to go completely.

Q I'd also like to do a followup to the exchange you had with Mr. Bardee where you were saying that the major concern that you had with AEP's proposed solution was the lack of an LMP congestion management or market-based congestion management.

How do you see, assuming the Commission was to accept AEP's proposal, how do you see the lack of a market-based congestion management system affecting Commonwealth Edison?

A As I indicated earlier, I believe the major impact will be the fact that we would not have free-flowing ties to the AEP system, and we wouldn't have the kind of --



we would have TLRs, in other words, interrupting transactions that ought to happen if you had LMP on a much more frequent basis across AEP, and presumably others in the region would experience that same problem as well, just as we do today.

I think that's the biggest problem. It inhibits free-flowing transactions across the AEP system that a properly designed congestion management system would facilitate and make happen.

Q Do you see that if AEP's proposed solution in their testimony, would that make it easier for Commonwealth Edison to join PJM, or would it be basically the same situation as if AEP had not joined PJM?

A I do not see that it is a great leap forward without dealing with the congestion management. The Commission has already addressed many of the rate implications in its Order, so we are de-pancaking in the Midwest and the Mid Atlantic states.

This is not just the Midwest; it's the Midwest and Mid Atlantic, so we're already dealing with the pancake issue. I'm really not certain, what would happen with redispatch under the AEP proposal.

There was some brief conversation of that with Mr. Baker this morning when he said that PJM could require redispatch. I'm not certain if they mean just for

reliability purposes or if they mean for economic purposes.

Frankly, at lunch, we had a different impression amongst those of us who were sitting at my table as to what they meant.

I think we certainly have heard from generators in the Com Ed service territory, that they are most anxious to have Com Ed and AEP integration happen simultaneously. They would be much comforted by that.

Q Actually sort of the final line when you talk about generation in Commonwealth Edison's territory, how much of that generation does Commonwealth Edison now own?

A We own a lot of it. However, I think we've added 9,000 megawatts, an order of magnitude to 10,000, oh, excuse me, Exelon Generation. I stand corrected. Exelon Generation owns that. Our affiliate owns it. In fact, if you put on my Exelon hat, as opposed to my Com Ed hat, we own the majority of it.

I would be happy to but there is substantial development by independent and affiliated power producers in Illinois. We also own, there's also capacity in neighboring areas that would be affected by all this as well. I'd be happy to apply the specifics as to the Exelon Generation, owned generation, in the Com Ed service territory, as well as other companies' owned generation in Com Ed service territory.

Q Could you supply that? And I understand that certain of the generation was divested under the Illinois restructuring. What amounts have been divested?

A Yes.

Q Could you just supply that for the record?

A I'd be glad to.

PRESIDING JUDGE: Anything further?

MR. McLAUGHLIN: Yes, if I could?

CROSS EXAMINATION

BY MR. McLAUGHLIN:

Q Ms. Moler, I just have a couple of questions, if I could, to try to understand the Illinois Power transmission assets, if I could. You announced earlier that you are in discussions with Dynergy to purchase the Illinois Power Transmission Company assets.

A Not just the transmission assets, the Illinois Power and transmission and distribution systems.

Q And, if successful in that transaction, you would plan to take those to PJM, is that correct?

A Yes sir.

Q Could you give me some time line or some idea, if you were successful, how that would occur?

A Mr. McGlaughlin, I really can't give you specifics about that now. We would obviously file an application to do the acquisition with this Commission. We are very circumscribed in what we are describing publicly right now. There's a press release. Mr. Altenbaumer will be appearing later. He has copies of the press release I believe he will submit for the Commission's record in this

case.

But our goal would be to accomplish it as soon as we possibly could, obviously.

Q I was curious and you may not be able to answer this, but I was curious, you stated that Exelon or Commonwealth Edison is ready to go. I just wasn't sure of the state of affairs with Illinois Power and I plan on asking them, but since Exelon may be the new owner, I thought I would at least ask.

A Our goal would be as I said, to integrate Illinois Power, if the transaction, if satisfactory agreement is reached, and we get the necessary approvals from the Illinois officials and it may not only involve the Illinois Commerce Commission, as well as potentially the Illinois legislature, then our goal would be to integrate Illinois Power as quickly as possible.

Q Would it be fair to assume, I think you stated the Commonwealth Edison transmission assets, you would plan on March 1 now of 2004. Do you have any idea, assuming you would be successful? I think you stated you had a 45 day period in which to negotiate now.

A I am sorely tempted to give a date but it would simply be a plugged date. I could call it something else but I'm not in a position to say how quickly that would occur. It would depend on how quickly the Illinois Commerce

Commission acts, how long it takes us to do definitive agreements between the two companies, how soon the ICC acts, how soon the Illinois legislature acts, quickly, importantly, how soon this Commission acts as well.

Q So I shouldn't necessarily assume much other than the March 1 date or any other date at this time?

A Not yet. We would be delighted to give you an update as soon as we have one.

MR. McLAUGHLIN: Nothing further.

MS. MARLETTE: One question.

#### CROSS EXAMINATION

BY MS. MARLETTE:

Q Ms. Moler, you made very clear in your testimony that you were opposed to AEP's compromise proposal primarily because it won't provide for market based congestion management. Would you be as opposed if the proposal were not adopted by the Commission as an end-state but rather as an interim proposal?

A I think that would depend on the length of the interim period. I was very interested in the suggestion that Mr. Kelly made in the earlier questioning where potentially you could go ahead and this Commission could require, after consultation with appropriate state officials and stakeholders, AEP to join PJM in order to satisfy the merger condition and then there could be something that, a

commitment that AEP could make to the Commonwealth of Virginia that might perhaps hopefully alleviate some of their concerns. But that, to me has perhaps greater potential and would be preferable rather than the interim solution.

PRESIDING JUDGE: Mr. Kelly, you may proceed.

CROSS EXAMINATION

BY MR. KELLY:

Q Just a question of clarification on your testimony. Are you asking the Commission to direct AEP to join PJM, essentially today? Or after some period of negotiation with the state, such as AEP proposes and, if directing immediately, would there be an opportunity for discussions on how to allocate the costs of PJM or AEP joining PJM among the states, particularly those without retail access?

A Mr. Kelly, we made a judgment after the Virginia legislature, excuse me, general assembly, enacted a statute. We made a judgment that this Commission would have to resolve in this vital instance, question of who's in charge here.

I genuinely fear that the Virginia legislature's action could well be the beginning of the end for further RTO development in this country and that grieves me and I believe that because I believe that there are other states

who will seize upon that enactment and see an opportunity for them to just say no, as well, and indeed I heard one state commission chairman gleefully expounding about that possibility in a conversation shortly after the Virginia legislature was doing it's thing at a NARUC meeting.

I believe that Congress contemplated that this Commission is in charge of interstate commerce. I do not believe that Congress contemplated that the Virginia General Assembly should effectively impact the disposition of transmission assets in Illinois or in Ohio or in Michigan. I believe that is this Commission's role and responsibility and I really worry about further development of competitive wholesale markets if this Commission tolerates that.



My choice would be for the Commission to use the authority Congress gave it to do what it's supposed to do.

MR. KELLY: Thank you.

PRESIDING JUDGE: Anything else from staff?

MR. BARDEE: That's all the questions we have, Your Honor. We had asked a couple of factual matters that they said they could provide later. We could talk later with the company, they're rather straightforward questions. Perhaps the company could state now that, within a week, they'd provide i.

PRESIDING JUDGE: Is that an acceptable time frame to provide the answers to those questions within a week?

MR. KELLY: Yes, Your Honor.

PRESIDING JUDGE: We'll do that.

Mr. Chairman?

CHAIRMAN WOOD: Ms. Moler, what aspects of the joint and common market, that phrase has kind of morphed, I guess, over the past eight months or so. What does it mean to you and to Exelon?

THE WITNESS: For us it means compatible systems for transacting across the seam or multiple seams, admittedly involving the companies in the mid-Atlantic and the Midwest, so that the rules will be one and the same, even though two regional transmission organizations would

have the transactional responsibility. That's the big picture now. There's a whole lot.

CHAIRMAN WOOD: Is there some distinguishing between that and the common market?

THE WITNESS: I believe "joint and common market" was the phrase that this Commission used.

CHAIRMAN WOOD: I just wanted to make sure it hadn't morphed on. I'll ask MISO and PJM about that later on.

But Mr. Kelly asked an interesting question and I want to ask if you could kind of go a little deeper into your last response about interposing of a negotiation or discussion opportunity with states. Is that fruitless or is that?

THE WITNESS: I don't know if it's fruitless or not. I had spent roughly five years working on this in private practice and now as an executive with Unicom Corporation and now as an executive with Exelon Corporation.

There's always an opportunity to talk. I find it, I cannot obviously speak for the Virginia Corporation Commission. I don't know if they feel they can do under their statute. I did read their recent filing. I am not optimistic that settlement discussions and talk will prove to be fruitful. If you choose to pursue that course, I'll be here and committed to working hard to get something

accomplished. That's what we're trying to do.

But I believe the time has come for decisive action. I should maybe say it more straightforward.

CHAIRMAN WOOD: I got that the first time.

(Laughter.)

PRESIDING JUDGE: Commissioner Massey, do you have anything?

COMMISSIONER MASSEY: I was just looking at Section 205 of PURPA as you were testifying. The Commission may exempt electric utilities in whole or in part from any provision of state law or from any state rule or regulation which prohibits or prevents the voluntary coordination of electric utilities.

It seems to me you could argue that Congress has already expressly authorized the Commission to take the steps that you're suggesting.

THE WITNESS: I believe it has, too. I think it's quite remarkable that they did so. I actually worked on PURPA in 1978. I don't remember that part of the statute but it was a brilliant person who put it in there.

(Laughter.)

THE WITNESS: This is an interesting system. This is interstate commerce. Congress was prescient when it recognized that there may be actions of an individual state that would louse up the free flow of goods in interstate

commerce and I believe that it's an appropriate action for this Commission to take and I think it's almost easy for this Commission to issue an order invoking its authority under that section of the code and directing AEP to join and we said so in our filing.

COMMISSIONER MASSEY: So you believe we've had enough process?

THE WITNESS: You've had a whole lot of process. Yes, I do.

(Laughter.)

COMMISSIONER MASSEY: Do you believe that there will be reliability benefits associated with both Exelon and AEP being full participants in the PGAM system?

THE WITNESS: Yes I do.

COMMISSIONER MASSEY: What would those be?

THE WITNESS: Those reliability benefits are laid out in some sense in my testimony.

Further, in the filing that we made in March with this Commission, where we made a motion requesting the Commission to expedite its decision on which RTO the former Alliance Companies could join. We see better security coordination. We see improvements in terms of the conversations and the communications if you have RTOs, in being that half the responsibility of doing the security coordination, directing redispatch, directing generators, to

go off-line if necessary, we see definite plusses for generators in our region, selling into PJM and vice versa.

In the case of Commonwealth Edison, when we have had difficulties in the Commonwealth Edison control area, and have had to turn to external resource to serve our customers' load, we have turned to generators east of Illinois, particularly in AEP and PJM.

I believe in having all of those under the same PJM control would definitely enhance the reliability in the region.

COMMISSIONER MASSEY: Is your opinion in this respect influenced in any way by the August 14 blackout?

THE WITNESS: Commissioner Massey, I fly on airplanes a lot. More than I did when I was here and I recently flew to Austin, Texas, for the day and back, because the hurricane was coming. I had in my briefcase, did not get a chance to enjoy Austin, I had in my briefcase the transcripts that the House Committee on Energy and Commerce released of the conversations particularly between those in MISO, Cynery and Allegheny.

I was very upset when I read those transcripts. I believe that the system operators, now this is just Betsy reading transcripts. This is not NAERC and DOE and the Canadians doing their formal review, but I do not have a positive impression of what happened that day because it was

not clear that decisive measures were taken.

There were operators who were moaning and groaning about whether they have authority to require redispatch. There were operators who were moaning and groaning about maybe they should perhaps tell a generator not to put more generation on their operators, who were discussing whether they have authority to make entities abide by the voluntary NAERC guidelines. I was appalled.

I am talking to Ms. Ivy about having our operators read that transcript and saying no discussion. Wrong answer, right answer, for our own operation.

I was really upset. I believe that that experience, maybe it's just Betsy and not something that DOE will conclude, we need to have someone in charge. We need to have a much better picture of the big picture.

You need the kind of automatic systems that will go on that is contemplated between MISO and PJM and this has got to happen. MISO has to seek, as they have had under discussion additional authority to do redispatch, to meet their OATT obligations. This was thoroughly discussed, again without benefit of the definitive conclusions on the study that's ongoing at the House Committee on Energy and Commerce, where Chairman Wood testified as well. It's a huge, important initiative.

COMMISSIONER MASSEY: Thank you.

CHAIRMAN WOOD: Let me ask a follow up on that.

The prior witness, who was from AEP, seemed to say that that reliability issue was something distinct from RTOs. What's your response to that? Could that be dealt with outside of an RTO?

THE WITNESS: It could be dealt with outside an RTO, certainly. It's dealt with today outside an RTO. We have a reliable system. They have a reliable system. I think the relevant question for this Commission is whether an RTO will enhance reliability, and I believe the answer to that is yes.

CHAIRMAN WOOD: Thank you.

PRESIDING JUDGE: Commissioner?

(No response.)

PRESIDING JUDGE: Thank you very much for your testimony, MS. Molar. You are excused.

(Witness excused.)

PRESIDING JUDGE: I'm going to take out of order Illinois Power next, in light of the announcement that was just made. Mr. Palmer, are you here?

Whereupon,

LARRY F. ALTENBAUMER,

a witness, having been called for examination, and, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. PALMER:

Q Mr. Altenbaumer, state your name, business address and title for the record, please?

A My name is Larry F. Altenbaumer. I am president of Illinois Power Company and executive vice president of the Regulated Energy Delivered Business Group of Dynergy, Inc.

Our business address is 500 South 27th Street, Decatur, Illinois, 60521.

Q Mr. Altenbaumer, did you cause to be filed in this proceeding your prepared direct testimony?

A Yes I did.

Q I had previously submitted to the court reporter a copy of your testimony that's marked Exhibit IP-1. Did your testimony consist of seven pages, including the cover page?

A Yes it did.

Q Before I ask you to summarize your testimony, are there any changes or corrections that you would like to make to your prepared direct testimony at this time?

A Yes, there is, in light of the public announcements that were made on Friday by Dynergy and Exelon regarding discussions relating to the possible sale of Illinois Power to Dynergy.



We will modify our activities with regard to RTO participation to take into consideration developments related to those discussions.

Consequently I want to amend my testimony on page 6 by stating that Illinois Power will continue to position itself to move forward with RTO membership as expeditiously as possible in a manner that is appropriately consistent with developments related to the Dynergy-Exelon discussions.

For example, we expect to continue to participate in discussions with other transmission owners regarding the filing of a revenue neutrality mechanism and to participate in such a filing if determined to be appropriate under the circumstances, as it may exist at the time that the other transmission owners decide to make such a filing.

Q Mr. Altenbaumer, are there any other changes or corrections that you would like to make to your prepared testimony at this time?

A No there is not.

Q As you have amended it here today, is your pre-file testimony in this proceeding true and correct to the best of your ability and knowledge?

A Yes it is.

Q Mr. Altenbaumer, would you summarize your pre-file testimony as you have submitted it here today?

A The testimony itself is relatively brief. Let me

try to summarize what I think is the general theme and backdrop in terms of why Illinois Power is where it's at today and not currently a member of an approved RTO.

Despite that fact, I believe that Illinois Power has been actively pursuing a number of activities that we have believed to be consistent with the Commission's policy regarding the development and the advancement of a more effective transmission system including participation in RTO structures.

For us, these efforts began in 1996 when Illinois Power participated in efforts to form the Midwest Independent System Operator. This was an advance RA requirement to join such an organization that was stipulated in the 1997 Illinois electric restructuring legislation.

In efforts in early 2001, Illinois Power sought and gained approval to withdraw from the Midwest Independent System Operator and gained approval to withdraw from the Midwest Independent System Operator in order to participate in the formation of the Alliance RTO.

This was an entity that we genuinely believed was consistent with the desired objectives of the Commission and in the interests of the consumers in parts of the 10 states represented by Alliance members.

We saw the Alliance RTO as a way to expedite these objectives, following the Commission's decision in

December 2001, denying approval of the Alliance RTO. We began efforts to join PJM. This decision was based primarily on the fact that we felt PJM was more advanced in its operational and market capabilities than other choices available at that time.

In another effort that we also believe to be generally consistent with Commission objectives, Illinois Power reached agreement in the fourth quarter of 2002 to sell its transmission assets to TransElect.

As part of this agreement, and in deference to the desire of Transelect, we agreed to the process that would have placed Illinois Power's transmission assets back in the MISO RTO. That transaction, however, was not completed by the required July closing date, July of this year.

Correspondingly, during the period in the middle of this year, we have considered appropriate next steps related to IPE's transmission system. These considerations included simply joining an approved RTO, in a renewed effort to sell the transmission assets and, as announced Friday, a consideration for the sale of all of Illinois Power, including its transmission assets.

Clearly the decisions and actions taken by Illinois Power to become part of an approved RTO must be subordinated to other corporate decisions relating to all of

Illinois Power company.

Nonetheless, we believe that, since 1996, Illinois Power has consistently taken steps that we have believed to be consistent with Commission objectives.

One last point that is addressed in my testimony relates to the remaining impediments that Illinois Power sees standing in the way of its voluntary participation in either the Midwest ISO or PJM. I think one of the most significant impediments today is the absence of an approved mechanism to assure that Illinois Power remains revenue-neutral once it becomes a member of an RTO.

We continue to support current efforts to define and implement a revenue neutrality mechanism for a transitional period that minimizes shifting of costs back to the Illinois Power zone. We believe and expect that there is a very good opportunity, that these current efforts can be successful.

MR. PALMER: Your Honor, at this time I would move the admission of Exhibit No. IP-1, and tender the witness for cross examination.

PRESIDING JUDGE: Thank you, Mr. Palmer. Any objection to receiving this exhibit into evidence?

(No response.)

PRESIDING JUDGE: The aforementioned exhibit will be received.

(Exhibit Number IP-1 was marked for identification and received in evidence.)

PRESIDING JUDGE: Staff, you may proceed with questions.

MR. BARDEE: Thank you, Your Honor. Mr. McLaughlin will start the questioning for Staff.

PRESIDING JUDGE: Mr. McLaughlin, you may proceed.

#### CROSS EXAMINATION

BY MR. McLAUGHLIN:

Q I'm going to ask you a few questions about your RTO participation and a little bit about your proposed sale of the Company to Exelon. If I get into a point in talking about the proposed sale or something along those lines that is proprietary, please let me know, so that we don't tread on that territory.

A I will.

Q You state on page 5 that you were going to update the Commission today on your perspective RTO participation. I take it from the press release on Friday that now you're focusing on selling the Company to Exelon and Exelon then moving forward on RTO participation; is that correct?

A That is effectively correct, yes.

Q If you engage in the sale, am I correct that the Illinois Commerce Commission -- I think Ms. Moler testified that the Illinois Commerce Commission and potentially the Illinois Legislature would be required?

A Clearly, there's a series of regulatory approvals that include the Illinois Commerce Commission, that include this Commission, that include the SEC, and I believe would include also the Department of Justice.

It is possible, depending on the nature of any transaction, that the Illinois Legislature may also be required to take action.

Q It's been a long time since I have been on the staff of the Illinois Commerce Commission. Could you give me some idea of the timeframe that you expect action out of the Commission?

A Using previous transactions as a guide, once a filing has been made with the Commission, the Illinois Commission has been able to complete approval of such

transactions in a period of around six months.

By statute, they would have 11 months and could, under statute, request, I think, an additional three months, depending upon any motions that might be made with respect to a state order.

Q Thank you. In regard to your RTO participation, I know that originally last year, I believe in July, it was Illinois Power's position that they proposed to join PJM. Has Illinois Power been working on that since then to participate, or what's the state of affairs with Illinois Power in its movement toward participation in PJM?

A Subsequent to the announced transaction in October of last year for Illinois Power to sell its transmission assets to Transelect, most of the efforts that we expended were in coordination with Transelect and its desires for moving the Illinois Power assets to the MISO.

It was only a little bit earlier this year when the Transelect transaction failed to close by the July contract date, that Illinois Power began to reexamine and renew discussions with both PJM and MISO with respect to Illinois Power's RTO participation.

(Pause.)

Q I take it that it's fair to assume that you have had some conversations with PJM?

A We've had conversations with both PJM and the

Midwest ISO. Obviously, because of the areas where we have been with Transelect, we've had more conversations recently with the Midwest ISO than with PJM.

Q The last question I would have is, I take it, given that you are now in discussions with Exelon, that the Company's focus will mainly be on those discussions and trying to deal with those arrangements, as opposed to any short-term RTO participation activity; is that correct?

Could you kind of give me an understanding of what's going to be going on over the next few months?

A As I mentioned in my opening comments, my belief is that any action that Illinois Power might consider with respect to RTO participation, will be subordinated in terms of where things turn out at the corporate level as it relates to Illinois Power Company.

That does not mean that we will abandon or that we will sit by idly while that process continues. I anticipate that we will continue to evaluate our RTO participation, in the event that there is no transaction with Exelon or any other party.

So we don't view this as an excuse to not do anything. We want to continue, as I said in my comments, to position ourselves so that, depending upon what the outcome of those discussions happens to be, we'll be able to expeditiously move forward, either as part of an Exelon



transaction, part of some other transaction, or with Illinois Power on its own in terms of RTO participation.

Q That kind of led to one more question. I take it, in that regard, one of those areas that you will be continuing to work on as Illinois Power, will be the through- and out-rate proceedings and trying to address revenue neutrality that you talked about earlier?

A Absolutely.

MR. McLAUGHLIN: Thank you, sir.

PRESIDING JUDGE: Any other questions from Staff of the witness?

MR. BARDEE: No, Your Honor.

PRESIDING JUDGE: Do any of the Commissioners have questions?

(No response.)

PRESIDING JUDGE: Thank you very much, Mr. Altenbaum. You're excused.

(Witness Altenbaum excused.)

PRESIDING JUDGE: We're next going to turn to Dayton Power and Light. Ms. Bruner, you may proceed with your witness.

MS. BRUNER: Your Honor, Dayton Power and Light would call Patricia K. Swanke.

PRESIDING JUDGE: You've been previously sworn and remain under oath.

Whereupon,

PATRICIA K. SWANKE,

a witness, having been called for examination, and, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MS. BRUNER:

Q Ms. Swanke, please state your name, your title, and your business address, for the record.

PRESIDING JUDGE: Ms. Bruner, you're going to need to stay close to a microphone when you're asking questions.

THE WITNESS: Patricia K. Swanke. My title is Vice President of Operations; my business address is 1065 Whitman Drive, Dayton, Ohio, 45432.

BY MS. BRUNER:

Q Ms. Swanke, do you have before you a copy of the prefiled testimony you submitted in this proceeding?

A Yes, I do.

Q If I asked you the same questions today, would your answers be the same?

A Yes, they would.

Q Please give us a summary of your testimony.

A Judge Cowan, Chairman Wood, Commissioner Brownell, Commissioner Massey, I appreciate the opportunity

to testify before you today regarding DP&L's proposed efforts to join the RTO of its choice, the impediments we have faced in these efforts, and proposed solutions to those impediments.

DP&L has made significant progress in its efforts to join the RTO of our choice, PJM. Over the past year, we have signed the PJM West Transmission Owners Agreement and numerous other agreements to facilitate a smooth integration into PJM, as well as initiated the necessary filings at the Commission to become a member of PJM.

We have thus far spent over \$3.5 million, so that PJM can establish the appropriate systems and infrastructure to fully integrate DP&L into PJM. DP&L had released PJM OASIS management responsibility for ATC calculations, scheduling, reliability coordination, and market monitoring, so that customers can be assured they are receiving nondiscriminatory, one-stop shopping for transmission service through an independent party.

We have devoted many hours participating in working group meetings and training sessions so that our employees will be ready when DP&L is fully integrated into PJM.

The timing of DP&L's full integration into PJM has been delayed, pending resolution of issues beyond our control. We appreciate the Commission providing this forum

to discuss these matters.

The legal and regulatory delays that DP&L has encountered in its efforts to join PJM have, in turn, delayed DP&L's efforts to join PJM. DP&L's physical connection to PJM is through AEP, and PJM plans to integrate the two companies on the same date as one control area.

AEP's testimony contains a new proposal which DP&L understands would involve DP&L joining PJM in all respects, except for market integration. For DP&L to take a firm position in response to AEP'S proposal would require more time and analysis than was available prior to our discussion today.

Prior to AEP's testimony this morning, it was unclear as to whether they were proposing it as an interim solution, or whether they envisioned this arrangement as permanent. DP&L is concerned that the effects of AEP's new proposal would take away much of the intended benefit from full participation in the PJM market.

DP&L desires to be integrated into the PJM market as early as is feasible, however, DP&L is concerned that without AEP in the market, DP&L would essentially be its own tiny market, effectively isolated from the rest of the PJM market.

It is DP&L's intention to join the PJM market, along with AEP in the Fall of 2004. However, if the FERC

accepts AEP's recent proposal to join PJM without a market, DP&L will require additional information and adequate time to fully evaluate its options.

Second, the myriad of interrelated dockets in front of the Commission regarding this matter has made movement forward extremely difficult. DP&L suggests that the Commission continue an ongoing dialogue between itself and stakeholders by providing clear and consistent direction on an expedited basis.

Finally, decisions in case management coordination will assist in the resolution of many key issues.

Third, to implement the Commission's directive to create a seamless market between PJM and MISO, a regional rate solution must be in place. If the Commission expect parties to voluntarily participate in an RTO and feel they have incentives to make further transmission investments, the Commission cannot eliminate transmission owners through- and out-rates without simultaneously replacing them with a fair, compensatory, and revenue-neutral rate solution.

Further regional rate solutions that carry out the FERC directives to eliminate the rate seams, must include all parties in the region. To allow certain parties to opt out will destroy the carefully balanced revenue-neutral rate design.

To resolve the impediments that have delayed the formation of a successful joint and common market, DP&L respectfully requests that the Commission continue to work towards resolving issues and concerns of the states concerning RTO integration, allow time for affected stakeholders to analyze AEP's new proposal, implement a case management policy for all the interrelated RTO dockets, so there is a clear path toward resolving regulatory and rate filings, and, finally, direct all parties within the Midwest footprint to implement the SECA as a regional rate mechanism to resolve the rate seams issues in the event the Commission eliminates the individual companies' through- and out-rates.

DP&L and I appreciate the Commission providing the opportunity to testify before you today to discuss the best way to advance with RTO integration.

MS. BRUNER: Your Honor, I move for admission of Ms. Swanke's testimony, which has been marked as DPL-1.

PRESIDING JUDGE: Any objection to receiving DPL-1 into evidence?

(No response.)

PRESIDING JUDGE: We'll receive that into evidence. You may proceed when ready, Mr. Bardee.

(Exhibit Number DPL-1 was marked for identification and received in evidence.)

PRESIDING JUDGE: You may proceed when ready, Mr. Bardee.

MR. BARDEE: Ms. Fernandez will start the questions.

CROSS EXAMINATION

BY MS. FERNANDEZ:

Q Good afternoon. Let me just clarify up front, what DP&L's position is. DP&L's objective is full integration into PJM, including the energy markets as soon as possible?

A Yes, it is, as soon as possible, assuming the conditions we've stated in previous filings are met, revenue neutrality mechanisms and all the other things -- yes.

Q When you're saying "all the other things," --

A Revenue neutrality, we're contingent on AEP being in the market; those general conditions have to be present for us.

Q Basically, it's your position that DP&L cannot join PJM's markets unless AEP is in those markets?

A I don't know if I would say "cannot." It was our intention to join with AEP, and that's the path we're heading down.

Q But you haven't had the time to study the interim proposal to see if that would also be a possibility?

A Right.

Q Have you done any cost-benefit analyses for DP&L in terms of joining PJM?

A No, we have not.

Q Were there ones prepared by PJM for DP&L?

A I'm not aware of any; I don't believe there were.

Q On page 11 of your testimony, you state that Dayton had received authorization from the Public Utilities Commission of Ohio to turn over certain key functions to PJM. I take it those are functions that are specified in your testimony?

A That is correct.

Q Does Dayton have all the state authorization it needs to fully join PJM?

A Yes, we do.

Q So when it becomes technically or operationally possible, DP&L could join PJM?

A Yes, ma'am.

Q One possibility has also been discussed at points today, that has been a sort of partial integration, maybe of parts of AEP's system into PJM and certain operating companies or states that oppose it, would not be integrated into PJM.

Does DP&L have a position on this, as to whether this would be acceptable to DP&L or not?



A Provided someone can prove to us that there won't be any adverse reliability or cost impacts. Those would be the main conditions, any impacts on DP&L for our shareholders, our customers.

I would agree that AEP has some, I think, pretty compelling reasons for why that might not be a good solution. I think we would agree that that appears to be costly. I think there would be a temptation to try to socialize those costs and we would not be in favor of having to subsidize that in any way.

Q In terms of the interim solution that's been put forward by AEP, I know you said that it's something you are still looking at. You did mention you had some concern, in your summary of the testimony. Could you explain what those concerns are?

A If you just look geographically where DP&L would be located, we'd essentially be an island, because of the way we're contiguous with PJM is through AEP, so if they are not in the market, that really takes away a lot of the benefit of DP&L being in the market, either.

I'm not saying that that's a decision we've made, but our initial reaction is we'd have to thoroughly evaluate that and decide whether it make sense,if the Commission supports AEP proceeding that way, for us to try to be in the market or to wait till some later date and join the market

when, hopefully, AEP did.

Q Does DP&L have any point-to-point firm transmission agreements through AEP that would connect with PJM?

A No, we do not.

MS. FERNANDEZ: For now, those are all the questions I have.

PRESIDING JUDGE: Anything else from Staff?

(No response.)

PRESIDING JUDGE: Do any of the Commissioners have questions of this witness?

COMMISSIONER BROWNELL: You commented that you really hadn't had a chance to look at the AEP interim proposal, and a number of other people have said the same. Would you be able to give us comments in, say, 10 days and perhaps ask the rest of the participants to do the same?

Because I think it's only equitable if my colleagues agree that we really get a chance to respond. I don't think we need a long time to do that.

THE WITNESS: Yes, we'd be happy to do that.

COMMISSIONER BROWNELL: If we could ask the other participants to comment on that interim proposal, Judge Cowen.

PRESIDING JUDGE: Within 10 days.

COMMISSIONER BROWNELL: Yes.

PRESIDING JUDGE: You all have heard that direction. I expect you to comply, comments on AEP's interim proposal within 10 days. And I guess that's all.

You're excused. Thank you very much, Ms. Swanke.

(Witness excused.)

PRESIDING JUDGE: Ms. Thompson, you may proceed with the witness for Ameren Services.

MS. THOMPSON: Thank you. I call David Whiteley to the stand.

Whereupon,

DAVID A. WHITELEY

was called as a witness and, having first been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MS. THOMPSON:

Q Mr. Whiteley, please state your name, position, and business address for the record.

A (Whiteley) David Whiteley, Senior Vice President, Ameren Services. My business address is 1901 Chouteau Avenue, St. Louis Missouri, 63103.

Q Mr. Whiteley, did you file testimony on September 23rd in response to this Commission's September 12th order announcing this inquiry?

A (Whiteley) I did.

Q Mr. Whiteley, do you have a copy of the testimony with you on the stand?

A (Whiteley) I do.

MR. THOMPSON: I have given two copies of Exhibit ASC-1 to the Court Reporter.

BY MR. THOMPSON:

Q Mr. Whiteley, we've been in this hearing room since the inquiry began this morning so you're aware that I would now ask you to summarize your testimony.

A (Whiteley) Thank you, I will. On behalf of Ameren, first I would like to thank the Commission for the opportunity to share Ameren's views regarding RTO formation in the Midwest and to respond to the Commission's September 12th order announcing this inquiry.

In December 2001, this Commission denied RTO status to the proposed Alliance RTO. In response Ameren declared its intention to form an independent transmission company, the Grid America ITC, with two other former Alliance members, FirstEnergy Corp. and Northern Indiana Public Service Company and to integrate the Grid America ITC in the Midwest ISO. The Grid America Company selected National Grid USA as the independent managing member.

Grid America, including Ameren, cooperated, negotiated and compromised with the Midwest and the various Midwest ISO stakeholders in various proceedings to secure FERC authorization for Grid America and its role as an ITC in the Midwest ISO. Grid America and Ameren met every deadline and every condition and now have the necessary authorization.

The only open issue before this Commission with respect to the Grid America ITC is the zonal transmission

rates for the Grid America zones within the Midwest ISO, but the rates were filed and will become effective October 1st subject to refund and therefore are no barrier to Grid America's going live. FirstEnergy and NIPSCO will do so this Wednesday October 1st.

Ameren, however, must still secure authorization to join the Midwest ISO through participation in Grid America through another of its regulators, the Missouri Public Service Commission. The Missouri proceeding is in active settlement discussions, If course, I can guarantee nothing, but I am optimistic that a settlement will be reached. I point out in my testimony that this Commission will need to act to address the concerns of the Missouri parties. First, we anticipate this Commission will be asked to approve a service agreement between the Midwest ISO and Ameren that memorializes the commitment that this Commission made in its April 8th white paper. That's the respective state commissions shall retain jurisdiction over the transmission component of bundled retail rates.

Second, the Missouri parties are particularly concerned that the firm transmission rates, the FTRs, allocated to Ameren UE must be adequate to protect Missouri bundled retail load from congestion charge. A Missouri commission will make an independent assessment of the adequacy of the FTRs after the Midwest ISO completely the

allocation process.

Finally, assuming there are no problems with the service agreement or FTRs, any Missouri approval will still be interim and conditional and Ameren will have to undertake a cost/benefit analysis as to its Grid America/Midwest ISO participation for review by the Missouri Commission prior to the end of Ameren's current retail rate freeze in Missouri. That is, by June 2006.

I urge the Commission to do nothing precipitous with respect to Ameren. Ameren has addressed the concerned and security the approval of this Commission. It needs time to address these legitimate concerns of the Missouri Commission and hopefully secure its approval also. Indeed, Ameren believe that its efforts in working with the Missouri PSC can serve as a model to pro-actively address issues raised by interested rates regarding the RTO development and implementation process which we believe will ultimately result in long-term constructive solutions. That said, I would like to take this opportunity to provide a more focused assessment of Ameren's views on the appropriate scope and configuration for any Midwest RTO.

A significant portion of Ameren's service territory is situation between territories served by Commonwealth Edison and the Illinois Power Company. While Ameren would have preferred to have its neighbors join the

Midwest ISO, it has not yet protested the choices of ConEd and Illinois Power. Why? Because Ameren believes that the conditions that this Commission placed on the proposed PJM/Midwest ISO configuration would result in any reliability or market fragmentation issues.

Notably, the promise of a joint PJM/Midwest ISO operational plan, a reliability plan approved by NERC, and the promise of a joint and common market without pancaked rates has promise for alleviating any operational and financial concerns that Ameren may have had. Additionally, in late 2002, Illinois Power announced an intention to join the Midwest ISO rather than PJM.

\*(Check tape) portion of the seams on Ameren's borders. We now believe, however, that it's appropriate to reassess the state of affairs in this region given new and important developments, most notably the announcement by Ms. Moeller today that affects a lot of (inaudible) IP. It intends to take IP into PJM. This is a reversal of IPs previously stated intention to join the Midwest ISO.

Let me start by saying I remain confident that the market and rate issues will be resolved within a reasonable time frame. What, then, has changed to cause the need for a fresh assessment?

\*Has now publicly stated that it intends to take IP into PJM at the 11th hour. This is a significantly



destabilizing event at this time. The impact of this RTO membership change is exacerbated by two additional factors. First, the joint PJM/Midwest ISO operational plan has not yet been filed and, perhaps more significantly, NERC has not approved a reliability plan.

Second, the August 14th blackout affecting 50 million people over a huge swath of the eastern interconnection requires the Commission to take action now, which will ensure to the greatest possible extent that such an event will not happen again. Based on initial indications, the August 14th blackout seems to highlight the fact that reliability will not be enhanced but may be significantly hindered by having an intertwined PJM and MISO configuration. Even if a reliability plan can be devised and approved by NERC, isn't the point of RTO formation to enhance reliability and make coordination less complicated?

The aforementioned developments or lack of developments in the case of the NERC reliability plan, taken together, present Ameren with a reality of being sandwiched between two PJM members within the State of Illinois. We cannot responsibly institutionalize these reliability seams on the heels of the largest blackout of the nation's history. And certainly, given these developments, Ameren cannot expeditiously proceed to settlement in the Missouri proceeding. Ameren's preference, frankly, would be to have

the entire State of Illinois in the Midwest ISO. Having said that, ConEd has remained steadfast in its insistence in joining PJM and Ameren could live with that choice.

Unfortunately, if ConEd and Illinois Power were to join PJM, Ameren would have to reassess its RTO decisions. To do otherwise would be irresponsible from a reliability perspective.

The Commission should therefore at least call on Illinois Power to reaffirm its commitment to join the Midwest ISO, regardless of the results of \*(inaudible-Exelon) and Dynegy's discussions regarding the acquisition of IP. Once this commitment has been reaffirmed, a timetable for expeditious integration should be constructed.

In addition, I would note for this Commission that under the terms of the Midwest ISO agreement, that if IP were to join the Midwest ISO now, Exelon would be able to remove IP from the Midwest ISO once its acquisition had closed. Since Ameren is looking for long-term solutions to the RGO progress, we would respectfully request that IP and Exelon make a long-term commitment for IP to remain in the Midwest ISO regardless of the outcome of their NMA activities. Since Ameren's election in May of 2002 to join the Midwest ISO, Ameren has done everything asked of it by the Commission and has diligently sought to fulfill its

voluntary commitment to participate in an RTO. Ameren has even refrained from protecting the RTO choices of its neighbors, even if that may have proved to be problematic.

Ameren cannot refrain from protesting any longer. The stakes are too high. Therefore, Ameren respectfully requests that the Commission use this forum to confirm Illinois Power's commitment to join the Midwest ISO, regardless of the subsequent ownership of IT. We believe this is in the public interest. Otherwise, Ameren may be forced to reassess its own good-faith RTO commitments and unfortunately this reassessment would be as a direct result of the action of other Illinois utilities.

Ameren wishes to clarify that this statement here today should not be construed in any way by the Commission as an attempt to delay joining an RTO. Nothing could be further from the truth. Ameren remains committed to RTO membership and joining an RTO as expeditiously as possible.

In sum, however, significant changes have recently occurred. Ensuring that Illinois Power joins the Midwest ISO, as well as continued progress on the other conditions required by the Commission in an expeditious manner should clear the way for Ameren's prompt integration into the Midwest ISO.

MR. THOMPSON: Thank you, Mr. Whiteley.

I'd like to move for the admission, your Honor,

of ASC-1 into evidence.

PRESIDING JUDGE: Any objection to receiving ASC-1?

(No response.)

PRESIDING JUDGE: That will be received in evidence.

(Exhibit ASC-1 was identified and received in evidence.)

PRESIDING JUDGE: Staff may proceed with their questions.

#### CROSS-EXAMINATION

BY MR. MC LAUGHLIN:

Q Good afternoon, Mr. Whiteley.

A (Whiteley) How are you?

Q Doing good. Yourself?

A (Whiteley) Doing fine. Thank you.

(Laughter.)

Q I'd like to ask a couple of questions if I could, just about Ameren itself and get an understanding of the three electric affiliates, if I could?

Do I understand you have an electric affiliate in Missouri, Union Electric, and two in Illinois?

A (Whiteley) Yes, that's correct. Ameren operates three utility companies: Ameren UE, which is Union

Electric, doing business as Ameren UE, Central Illinois Public Service Company, doing business as Ameren CIPS, and Central Illinois Light Company, doing business as Ameren CILCO.

Q It's my understanding that Ameren CILCO is currently a member of the Midwest ISO?

A (Whiteley) It is.

Q Could you give me an idea of the relatively size of each of those three electric utilities transmission investments?

A (Whiteley) Transmission investments. I don't know off the top of my head. Rough size-wise Ameren UE is roughly two-thirds of Ameren. Central Illinois Public Service is most the remaining one-third because Ameren CILCO is much smaller. But I don't have the exact ratios. We can certainly get that information for you.

Q If you could just supply it for the record, I would appreciate it.

I'm correct that Ameren Service Company is the agent for all three utilities?

A (Whiteley) It is.

Q In your testimony on page 20 you talk about the Missouri proceedings and the progress being made there and that you're optimistic of reaching resolution in that case.

In your testimony and then today you briefly

recapped the issues that are being addressed there. Do you have some estimate of the time frame for which resolution may be reached assuming a settlement?

A (Whiteley) That's always difficult given the nature of settlement discussions. But we've made significant progress over the last couple of months. I would estimate that if settlement can be reached, it would be reached within the next month. Then the stipulation of settlement would go to the Missouri Public Service Commission for their action.

Q I'm not familiar with the Missouri Commission's process, but I assume they would have a certain amount of time or they would generally take a certain amount of time to act on that?

A (Whiteley) I'm not sure if the statute actually sets a time limit. I believe the Missouri Commission would act expeditiously on that stipulation.

Q Once the Missouri Commission acts on the stipulation, assuming there is one reached and it's approved, how much longer -- or is there any other authorizations required for Ameren to join the Midwest ISO as a member of Grid America?

A (Whiteley) As I explained in my testimony, there's two other sets of approvals that would be required. First from this Commission, the approval of a service agreement between the Midwest ISO and Ameren UE regarding the transmission component of bundled retail rates. There would also be changes from the stipulation that says \*it in the Grid America agreements that are approved by this Commission, most notably, the length of time that Ameren would be required to remain in Grid America.

Here what we anticipate -- and again this is characterizing the present state of the settlement discussions and assuming that they continue in the direction that they are, the Missouri Commission is concerned about

the FTR allocation process and the possibility of congestion charges on Missouri customers. Therefore, at present the settlement discussions indicate that if a portfolio of FTRs cannot be properly allocated to hold the bundled retail customers harmless, then the Missouri Commission would have the right to cause Ameren to withdraw from Grid America and the Midwest ISO. Those two items would require some action by this Commission.

We would also need some action by the Illinois Commerce Commission due to our activity in the CILCO acquisition. That calls for Ameren to be in that RTO by the end of 2004 and remain in an RTO by the end of 2008. Obviously the aforementioned condition that the Missouri Commission would have would impact that time frame and so we believe in Illinois permission is also required.

Q Concerning the merger commitment that you made in the Illinois Commerce Commission and the fact that at least the current discussions going on in Missouri may impact that in some way, is the Illinois Commerce Commission participating or any Illinois officials participating in the Missouri proceeding?

A (Whiteley) They're not participating in the Missouri proceeding, no.

Q I'd like to explore kind of a line of questions just to see if you had thought about potentially freezing



participation in the Midwest ISO. With the Central Illinois Public Service Company or Ameren CIPS joining and then later Ameren UE joining. As you noted previously, Ameren CILCO is currently a member of the Midwest ISO.

Have you explored the idea of a phased approach to joining the Midwest ISO?

A (Whiteley) We've thought about it but not for long is the answer. I did hear the testimony of AEP this morning. For all of the reasons, not surprisingly, that AEP cited as to why separating a system that's presently operated as one control area with a joint dispatch agreement for its generating units and the efficiencies that that creates, separating that into what would be necessary for two control areas doesn't make a whole lot of sense. So all of those arguments, which have been well stated, I think, would apply in our situation. In fact, Ameren looks a lot like AEP only about half their size, so we have many of the same issues and concerns.

That said, there are two unique things. First off, if Ameren CIPS were to join the Midwest ISO ahead of Ameren UE, there would be very little benefit to the Midwest ISO in terms of connectivity. The connectivity that is the cornerstone of Ameren's participation, that I believe the Midwest ISO has tried to achieve for several months now, is only achieved if Ameren UE is a member as well.

The other thing is we are very close to a settlement in Missouri. And to go to the time and expense of splitting a system when literally we believe we are months or less away from a settlement seems to not be a very good judgment.

Q I was really looking at it more from the perspective and the assumption that ultimately three or four months down the road you come to some conclusion that a settlement would not be achievable and you would end up in some further process in Missouri.

A (Whiteley) That's fair. At that time, we would certainly want to reassess that option that we haven't given a whole lot of thought to right now simply because of the circumstances.

Q When you refer to the Missouri proceedings in your testimony, you're talking about in terms of Ameren? It is Ameren or Ameren UE that's really the issue in the Missouri proceeding? When you were talking about FTR allocation, I wasn't clear really who was the focus?

A (Whiteley) It's picked up as a footnote in my testimony. We refer to "Ameren" throughout the testimony. But with respect to the Missouri proceeding, the applicant is Ameren UE, the regulated utility within Missouri.

Q Thank you.

You stated earlier that, given Illinois Power's

decision to engage in discussions with Exelon, if ultimately that was fruitful and Exelon proposed to take Illinois Power to PJM, you'd have to reconsider your choices.

I take it that it's too soon to speculate on what choices you would have to reconsider? Can you give me some idea?

A (Whiteley) I believe I said we'd need to reassess our RTO options. Yes, indeed, it is very early to understand what that would be.

What I could assure you is that all options would be reassessed. It doesn't necessarily mean there would be a chance in our direction, but it could.

Q Then kind of just to summarize, do I understand correctly that right now with any luck, if all things go well, you should know within a month or two if you can reach an agreement within the Missouri proceeding. And then at that point, assuming that was successful, you'd need further authorization from the Illinois Commerce Commission at the FERC and, also during that period of time, I assume you would be assessing the situation with Illinois Power so that you could make a decision relative to moving forward with Grid America.

Is that a fair kind of summation?

A (Whiteley) I believe that's a fair summation, with one exception. Given the announcements today and what

we believe is the significant aspect that they cause in destabilizing the RTO footprints in the Midwest, we may not even be able to sign the Missouri stipulation, which would indeed hold up the process and necessarily delay it.

MR. MC LAUGHLIN: Thank you.

That's all I have.

PRESIDING JUDGE: Any other questions from Commission Staff?

#### CROSS-EXAMINATION

BY MS. FERNANDEZ:

Q I'd like to start with Illinois Power. When the Commission basically found that the Alliance companies -- that that was not a sufficient RTO, did Illinois Power elect to go to MISO or PJM?

A (Whiteley) The first election was to PJM. That was in the late spring-early summer of 2002 and before any of the conditions which this Commission correctly placed on those choices. Before any of those conditions could be met, Illinois Power changed direction and said they would join the Midwest ISO. That is the direction that they have held since late 2002.

MS. FERNANDEZ: Thank you.

PRESIDING JUDGE: Proceed.

CROSS EXAMINATION

BY MR. LARCAMP:

Q One question: Ameren is responsible for the contract path by which AEP West and AEP East integrate; is that correct?

A That's correct.

Q Have you in the system -- when the system merger has been consummated, is that operation sort of two different zones of a company through another company creating any reliability problems from your perspective?

A I don't believe so. We treat it as a transmission service request. It's a long-term request for firm service. It's scheduled as the party desires it to be scheduled, and it's treated like any other transmission service.

MR. LARCAMP: Thank you.

PRESIDING JUDGE: Anything else?

(No response.)

PRESIDING JUDGE: Do any Commissioners have any questions of this witness?

(No response.)

PRESIDING JUDGE: Thank you very much for your testimony.

(Witness excused.)

PRESIDING JUDGE: We're going to take a break and be back at 4:00.

(Recess.)

PRESIDING JUDGE: We're back on the record. The next order of business is the receipt of testimony of the Michigan Public Service Commission, Commissioner Chappelle. Mr. D'Allesandro?

Whereupon,

LAURA CHAPPELLE,

a witness, having been called for examination, and, having been first duly sworn, was examined and testified (telephonically) as follows:

DIRECT EXAMINATION

BY MR. D'ALLESANDRO:

Q Commissioner Chappelle, can you hear me?

A Yes, I can.

Q Please state your name, title, and business address, please.

A My name is Laura Chappelle. I'm the current Commissioner of the Michigan Public Service Commission. My business address is 6545 Mercantile Way in Lansing, Michigan.

Q Do you have before you, a copy of the Prepared Direct Testimony of Commissioner Laura Chappelle on Behalf

of the Michigan Public Service Commission?

A Yes, I do.

Q Was that testimony prepared, either by you or under your direct supervision?

A Yes, it was.

Q If today, I'd ask you the same questions that appear in your prepared testimony, would your answers be the same?

A Yes, they would.

Q Please summarize your testimony at this point.

A Yes, I will. I'd like to first take this opportunity to thank the Commission for the opportunity to present the views of the Michigan Public Service Commission. Particularly, I'd like to thank Presiding Law Judge Cowan for allowing me to participate by phone.

The Michigan Public Service Commission has been actively involved for many years in efforts to develop an effective Midwest regional transmission organization. Michigan appreciates all of the efforts and regulatory initiatives to help us achieve this very important goal.

This initiative could not have come at a more crucial time. Identifying impediments to certain utilities joining an RTO and finding solutions to find full membership, is essential to the development of a reliable transmission grid and the implementation of a joint common

market.

Markets with holes do not work; in fact, they hurt reliability. There is mounting evidence that loop flows played a significant role in the recent August 14th blackout.

It is clear that if the former Alliance Companies were either members of the Midwest ISO, or, at the very least, were members of a fully-functional joint and common market, the loop flow problem would have been significantly mitigated, if not outright eliminated.

Assuming the Commission stays with its approval of the new PJM Company's decision to join PJM, it's essential to hold Michigan harmless from loop flow. We must be assured of the same degree of protection from loop flows that we would have enjoyed, had all of the former Alliance Companies joined the Midwest ISO.

It remains to be seen whether a properly structured joint operating agreement can achieve this very important objective. Michigan applauds FERC's elimination of all through- and out-rates as an essential step toward eliminating the irregular seams caused by the choices of a new PJM company.

Notwithstanding the source of those problems, Michigan is not opposed to providing compensation of the resulting lost revenues, provided that Michigan entities do



not have to pay more for their most recent 12-month invoices over a two-year transmission period.

Michigan cannot overstate the importance of the instant initiative to break the RTO logjam. Achieving full RTO membership without seams, is essential for improving the reliability of our transmission grid and implementation of a joint and common competitive market.

To achieve these goals, FERC needs to act promptly under its existing authority to resolve the issues pending before it on Michigan reliability issues, loop flow, and lost revenues, and continue working with the state to resolve the impediments to the utilities joining the RTOs.

Again, thank you very much for our opportunity to participate in this very important hearing today.

MR. D'ALLESANDRO: Thank you, Commissioner Chappelle. At this point, Your Honor, would move into evidence, what's been identified as Exhibit MPSC-1 and MPSC-2. Two copies have been given to the Court Reporter already, Your Honor, and I have one for you, the same one that was filed with the Commission.

PRESIDING JUDGE: Very well, thank you, Mr. D'Allesandro. Any objection to receiving MPSC-1 and 2 into evidence?

(No response.)

PRESIDING JUDGE: If there's no objections, the

aforementioned exhibits will be received into evidence.

(Exhibit Numbered MPSC-1 and MPSC-2 were marked for identification and received in evidence.)

PRESIDING JUDGE: Commissioner Chappelle is available for questioning?

MR. D'ALLESANDRO: Yes, she is, Your Honor.

PRESIDING JUDGE: Does Staff have any questions?

MR. BARDEE: Yes, Your Honor, and Ms. Marlette will start the questioning.

PRESIDING JUDGE: Please, Ms. Marlette, you may proceed.

#### CROSS EXAMINATION

BY MS. MARLETTE:

Q Good afternoon, Commissioner Chappelle. I just have a couple of preliminary clarification questions. On page 12 of your written testimony, you state that Michigan's Legislature enacted a law requiring AEP's Michigan affiliate, Indiana-Michigan Power Company, to either divest itself of its transmission lines or belong to an RTO.

Would you please clarify for the record, is that the legislation that was signed into law in June of 2000, over three years ago?

A Yes, it was. That was Michigan's restructuring law, which is Public Law 141 in 2000.

Q So AEP's Michigan subsidiary currently is in noncompliance with the Michigan law?

A Well, we do have an open docket on that, so I won't give you the finality of an answer to that. We do have an open docket to explore that very issue, and, in fact, ask why they should not be held out of compliance for violating that law.

Q Thank you. You also reference on page 12 of your written testimony, the actions of the Virginia Legislature and the Kentucky Public Service Commission, which prohibit AEP from transferring functional control of transmission facilities located in those states, to PJM.

You also state, and I quote, "Your decision could have an adverse impact upon the competitiveness and reliability of electric service in Michigan, particularly if the actions of one or two states result in prohibiting all AEP operating companies from joining an RTO," end quote.

Would you please elaborate on the potential impacts that these other state actions could have on Michigan customers?

A Particularly with the formation at this very critical time of a functional joint and common market, even with regard to wholesale markets, the fact that we -- as one staff member commented, what appears in the Midwest right now looks like swiss cheese.

The fact that we have real holes in our market and those holes affect seams issues and loop flow issues, it affects the rates and the terms and the availability of service, just even on a wholesale level, are primarily what is important to Michigan.

We do operate -- you may know Michigan is part of the organization of MISO states, a grouping of about 15 regional bodies that have come together to try and address certain transmission issues.

What I particularly like about that organization is that you have some states like Michigan and Illinois, which are retail wheeling states, however, you have other states that are not, Indiana being one of them.

But we can all agree to the importance of a functional wholesale market, and I think, predominantly, that is our biggest concern, is the functionality of the market, the reliability of the market that certainly August 14th has brought to bear.

Just as one state should not force upon other states, pressure to open up their retail markets, other states, directly or indirectly, shouldn't stop reliability improvements and the improvements in wholesale markets from forming, as well.

Q Thank you. This next question will overlap with the one I just asked. I'm going to state it a slightly

different way.

If AEP fails to transfer its facilities to an RTO as a result of the actions of Virginia and Kentucky's governmental entities, will that, in your opinion, negatively affect the economic utilization of facilities and resources in the state of Michigan?

A Yes. I would defer -- I know Detroit Edison and IPC are both there today to present testimony, but certainly we would say, yes, in a very negative manner, we would be affected.

Q Thank you. I don't know if you were able to hear all of the discussion today, but in your testimony, including in your summary of conclusions, you state that all major transmission systems within the Midwest Region must be fully integrated into an RTO, promptly.

Today, AEP, both in its written testimony and in oral discussion here, has proposed an alternative compromise under which AEP would partially integrate the system. It would transfer functional control of facilities to PJM, but would not be integrated into the PJM market and would not participate in PJM's market-based congestion management system.

AEP also refers in its testimony -- or states, excuse me -- that this proposal resembles a solution that had previously been put forward by the Commissions of Ohio,

Michigan, and Pennsylvania. I don't know if you have had time to think about their alternative proposals. Do you have any preliminary views about it?

A I don't think that we would agree, necessarily, that that is our proposal. I would say that, preliminarily, we would have some real concerns with that.

Again, I think the end game -- and the quicker we get there, the better -- has to be a fully-functional, joint and common market. It can't be steps that further perpetuate seams issues, unfair pricing issues.

And, again, what's predominant on Michigan's mind right now is reliability, and it hasn't been shown how that would even help reliability, so with all due respect, I think we would be wanting to get further comment on why, exactly, kind of that half-step approach isn't really the necessary approach that I think needs to be taken for the solution.

Q Just as a reminder, Judge Cowan gave parties ten days to file written comments, so please feel free to do that on that issue.

My last question: It's very clear to all of us in this room that AEP's transmission system is a prime example of a multistate interstate system and that their operation and use of their transmission system can significantly affect interstate commerce. In fact, I think

we're talking 11 states here.

How, in your opinion, can this Commission best resolve the interstate conflicts that have come about from the differing state decisions with regard to AEP's RTO participation? I would welcome both substantive recommendations, as well as any next steps, procedural recommendations.

A I'm going to give a couple thoughts and preface this that these are going to be my personal comments as a Commissioner. Certainly, informally, you do have this association that is well along the way, this organization of MISO states that's attempting very quickly to work out some of these very difficult issues, and so, again, I think, as FERC has reached out to these multistate entities, in response, we are trying to respond by doing what we can to bring multistate approaches to very difficult issues.

I also would agree with those commentators that FERC already has existing legal authority to address interstate transmission issues, and I say that carefully because I have been a strong opponent of exercising that authority over certain states.

I am on many records, opposing FERC preemption, either by way of a backstop or outright preemption of a state's siting authority.

But having said that, again, I think, as an

attorney, I could still note that that authority exists within FERC and on a legal basis, I think that FERC has the option and the legal right to exercise their authority in this regard, to move markets along where it directly impacts interstate commerce.

MS. MARLETTE: Thank you. I don't have any other questions.

PRESIDING JUDGE: Does any other Staff member have questions? Kevin?

#### CROSS EXAMINATION

BY MR. KELLY:

Q Commissioner Chappelle, this is Kevin Kelly. I have just one question.

In your opening remarks, you called on FERC to act promptly, and also to confer with the states. What, exactly, were you asking FERC to do promptly?

A I think we're starting to get at a crossroads of needing some real decisions to be made by FERC. I respect previous parties for various reasons, who need time or are suggesting more time for negotiation, and I certainly respect that.

Certainly FERC has done -- I think I cannot commend FERC enough for listening to states. You've listened to us when we were saying that states had to have a role in these transmission issues, and your response was a



very effective role could be multistate entities. And I think you will see more and more states that are responding.

But to your exact question of what FERC can do promptly: Promptly, what FERC can do, even though, again, as to Michigan, we wouldn't necessarily agree with exactly how these markets are formulated, given our preference, we would have preferred that Com Ed and AEP join MISO.

That does not appear to be the case. It looks now like what we just need is a parent up there in D.C. to start making some of these tough decisions and move the market along to the best of its ability to benefit, as Commissioner Brownell said in the opening, really to put customers first and foremost and to try and look in that regard to start resolving these issues.

MR. KELLY: Thank you.

PRESIDING JUDGE: Anything else from Staff?

(No response.)

PRESIDING JUDGE: Do any of the Commissioners have any questions of Commissioner Chappelle?

CHAIRMAN WOOD: Commissioner Chappelle, it's Pat Wood. I don't have any questions. I just want to thank you for participating today, and appreciate the Commission's interest in our proceeding here.

COMMISSIONER BROWNELL: I would like to add to that the consistency and substance with which the Midwest Commissioners have commented long before we even envisioned RSCs has really added great value to the discussion. We appreciate your leadership and the leadership of your colleagues and hope you'll keep it up. We'll provide that adult supervision.

PRESIDING JUDGE: Very well, thank you for your testimony, Commissioner Chappelle. I have the pleasure of saying you are excused as a witness.

(Witness excused.)

PRESIDING JUDGE: Getting back to the order of witnesses in the proceeding, let me just say that this category that we're in now includes state commissions and state interests. The testimony you just heard from Commissioner Chappelle of the Michigan commission, is the only formal testimonial submission we've received from the states for testimony here today, but we have received comments from the Kentucky Public Service Commission, the Indiana Public Utilities Regulatory Commission, a joint filing by the North Carolina Utilities Commission, the public staff of the North Carolina Public Utilities Commission, and the Attorney-General of North Carolina.

We've also received comments from the Virginia State Corporation Commission and the Missouri Public Service

Commission.

I know that today we also had the Ohio Commission represented in the audience and I believe they intend to file comments after the close of today and tomorrow's proceedings and taking advantage of the 10 days I think that we provided and will include their participation in that time frame.

Are there any other state interests or state parties that wish to be heard at this time? Yes sir?

MR. LEVIN: Your Honor? John Levin from the Pennsylvania Commission. I'd like to note that we filed comments as well.

PRESIDING JUDGE: You did. I apologize for that. I was using an old list and you weren't on there. I do have your comments.

MR. LEVIN: Thank you, Your Honor.

PRESIDING JUDGE: Thank you. Very well.

The next witness, and I think we should proceed, is the PJM Interconnection LLC. I think we have Mr. Spector to present that witness.

Whereupon,

RICHARD A. WODYKA,

A witness having been called for examination, and, having first been duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. SPECTOR:

Q Mr. Wodyka, state your full name and position with PJM.

A Richard Wodyka, senior vice president in charge of RTO coordination and integration.

Q You have before you what's been marked as Exhibit PJM-1, the prepared direct testimony of Richard A. Wodyka on behalf of the PJM Interconnection LLC?

A Yes I do.

Q Was that prepared under your supervision?

A Yes it was.

Q Was it true and accurate to the best of your belief and knowledge?

A Yes it is.

Q Please summarize that testimony.

A Yes, thank you. Judge Cowan, Chairman Wood, Commissioner Brownell, Commissioner Massey, PJM commends the Commission for taking the initiative in this area and appreciates the opportunity to contribute to the record the Commission is developing in this proceeding.

My testimony on behalf of PJM, I update the Commission on PJM's efforts to integrate each of the new companies into the PJM market.

PJM was on schedule to integrate Com Ed into the

PJM market on November 1, 2003, being fully functioning in the market in Northern Illinois. This is predicated on meeting all the Commission's conditions related to getting NAERC approval of PJM's proposed reliability plan that was negotiated with the midwest ISO.

PJM was positioned to receive the MIRC approval of the reliability plan at the end of August, but the blackout of August 14 preempted the MIRC operating committee review at that time. PJM has worked well with the Midwest ISO to arrive at a proposed joint operating agreement and reliability plan and was planning to file this document with the Commission at the end of August.

The joint operating agreement grew out of a super regional congestion management white paper which was jointly issued by PJM and Midwest ISO. This underwent several iterations and extensive stakeholder comments. PJM is now working with the Midwest ISO to incorporate any changes needed in the joint operating agreement and the reliability plan.

As a result of the August 14 blackout, PJM continues to proceed with all other necessary integration work so we will be able to implement and extend the PJM market to Northern Illinois as soon as MIRC approves the reliability plan and the Commission approves the joint operating agreement and other related tariff changes.

PJM will provide the market participants at least three months' advance notice of a new Com Ed integration date, which can be as early as March 1, 2004.

As to AEP in Dayton, PJM continues to work towards a market integration commencement date as of October 1, 2004, for those two transmission owners. As has been previously referred to the Commission, this date was selected with the cooperation of those transmission owners reflecting the restrictions placed on the AEP by the Virginia legislation. PJM's system and infrastructure will be available to integrate AEP and Dayton at any time on or after that date, although PJM could accelerate this date into the Spring of 2004 absent any regulatory restrictions.

It is not advisable that we integrate all the new companies simultaneously or to integrate any of the companies over our summer peak period.

As requested by the September 12 order, my testimony also identifies areas where the Commission action can facilitate integration of the new transmission companies into PJM.

Thank you again for this opportunity to provide you this testimony today.

MR. SPECTOR: I would like to move the admission of Exhibit PJM-1 and offer the witness for cross examination.

PRESIDING JUDGE: Any objection to receiving this exhibit into evidence?

(No response.)

PRESIDING JUDGE: PJM-1 is received into evidence and staff may proceed with any questions they have on cross examination.

MR. BARDEE: Ms. Fernandez will begin cross examination.

(Exhibit Number PJM-1 was marked for identification and received in evidence.)

CROSS EXAMINATION

BY MS. FERNANDEZ:

Q Good afternoon. I guess I'd like to start first with the interim solution that AEP discussed earlier today in their testimony, under which AEP would turn over functional control of its transmission facilities to PJM.

However, AEP would not participate in congestion management system, nor would it participate in the energy markets. Has PJM discussed this proposal with AEP?

A AEP has not consulted with PJM before they put forward the proposal. I did consult with them on Friday in response after having read their testimony, but not beforehand.

Q Does PJM have concerns about this proposal as to

how well it would work within the PJM market? This proposal looks a lot like day one integration.

In PJM, our integration originally included the day one and day two integration. The AEP proposal, while it's not identical, it is very similar to our original plan to take over certain transmission related functions first, then move on to a full integration of the markets a short time later.

This particular proposal, as I said, looks a lot like a day one integration and we would not be opposed to proceeding with a day one integration.

However, the instant reaction of most of the PJM members who called me between the time the testimony was filed and today, expressed significant concerns about not having a day two integration date selected. If they viewed this as the end state, the PJM membership would not view this as a positive move forward.

Q In order to go ahead with these changes you would have to make a number of changes in your original proposal when you had a day one proposal and a day two proposal for the new PJM companies. There were a number of proposed changes to PJM's tariff, I believe also to the operating agreement and also to the reliability agreement.

A That's correct.

Q So all those changes would have to go through the



PJM membership in order to go ahead with AEP's proposal?

A I believe the majority of those changes have already been filed and accepted by the Commission. Again, we haven't dealt into the details of what AEP has proposed. There might be modifications to those changes that were previously filed. We would have to take that and evaluate that.

Q Would you have to go back to the members as you stated before when you made the proposal for day one and day two? The difference between day one and day two was several months.

A That's correct.

Q Until there's full integration, based on your discussions with the members and I guess within the by-laws, would you have to go back to the membership to seek approval for adopting this as a day one solution without a definitive date when there would be a day two for integration of AEP?

A For sure we would review this with all the PJM stakeholders whether we would need their approval to make any agreement changes, it depends on what those agreement changes would be, but for sure, we would go back to our stakeholder process and discuss this with all the stakeholders.

Q Do you have any concerns about how AEP's proposal would operate if it was for more than a few months?

A I do have some concerns that this would be an open ended proposal. It could affect a number of items like our planning process, obviously our congestion management process. There are a number of items that this could impact and we haven't evaluated those since the proposal just came out.

Q How would this affect the planning process?

A Well, I think it was suggested earlier that they would come under the same general authorities that the current PJM transmission owners come under as far as the PJM regional planning process. I would have some concerns whether we could evaluate their system for economic improvements to make the market more efficient if there wasn't a market, for example.

So there would be a mixed bag of our authorities and responsibilities regarding the AEP territory.

Q What about congestion management? What would your concerns be there?

A Just that there wasn't a congestion management system. We would have to implement that as a market to non market integration.

Q How would AEP's proposed solution, how would that, in your opinion, affect the integration of Dayton Power and Light and Commonwealth Edison?

A Commonwealth Edison is very straightforward.

That does not impact that at all. We are prepared to move forward with Commonwealth Edison.

As Betsy Molar testified earlier, both parties were ready, willing and able to proceed. Unfortunately, the August 14 blackout has caused PJM to call a time out to evaluate thoroughly what may have caused this and are there improvements to our reliability plans and our joint operating agreement that effectuate that?

Dayton, unfortunately, because of the topology and geography of the system being embedded basically within AEP, that's a different circumstances, whether a competitive market could be put in there for them, we have not evaluated that scenario.

Q Could you explain why it would be easier to integrate Commonwealth Edison? Is it because?

A They had the firm transmission service available which allows us to connect the marketplaces.

Q And because of that transmission service, there's a path through AEP to PJM?

A That's correct.

Q Whereas there isn't one with Dayton Power and Light?

A That's correct.

Q I'd like to talk now a little bit about the joint operating agreement. What is the status of the joint

operating agreement?

A The joint operating agreement was a very good cooperative effort between PJM and MISO. We had published that to both sets of stakeholders back in August. We had planned to file it at the end of August. Unfortunately the August 14 blackout occurred.

In response to that, both parties agreed that we would call a time out and evaluate were there any additional improvements that we should be making to that joint operating agreement before we moved it forward on to the Commission's approval. We had some meetings. We are preparing that document. We are evaluating from both sides what may need to be changed in that document. We feel very confident that we'll make some improvements in that document and file that early in December for the Commission's review and approval.

Q Have you gone through discussions with their stakeholders in PJM about the joint operating agreement?

A Previously in the August time frame we had solicited comments from both the MISO and the PJM stakeholders. We had received some. We've already begun the process to incorporate those.

The next set of changes in response to what happened on August 14 are the ones we're still evaluating and plan to update the joint operating agreement and

reliability plans to consider those then put those back out for stakeholder review in the November time frame and hope to file that, as I said, in early December.

Q In terms of under the joint operating agreement, there was a contemplation that I believe you would use the white paper to manage congestion between a market to non market situation and a market to market situation?

A That's correct.

Q How would the joint operating agreement apply in a situation such as AEP's proposed solution where they would be part of PJM that would not be under a market solution for congestion management?

A Again, we've not evaluated that. I can only opine at this point that it would be treated as a market to non market solution. We would have to evaluate that.

Q Would adoption of AEP's proposed solution, I guess it might be preliminary to use, whether it would require other changes in the joint operating agreement?

A I don't believe so. I believe, again, we would treat them the same as we would any of our neighbors who do not have markets at this point in time. I don't believe that would necessitate any changes to the joint operating agreement for that.

Q I'd also like to clarify sort of what aspects of the joint operating agreement and I guess changes in PJM

membership, would require changes in the reliability plan that would be subject to NAERC approval? Is it the addition of, I guess we now have the possibility of AEP under either full integration or interim solution? Commonwealth Edison and Dayton Power and Light and potentially Illinois Power, which of those would require NAERC approval?

A Just to set the record straight, there is a reliability plan in existence today. That reliability plan was improved or predicated on the fact that we were going to integrate actually AEP and Dayton last spring. That went through the official NAERC process and received official NAERC approval for that particular reliability plan.

What's missing is the Com Ed part of that, the expansion of the territory to encompass Com Ed. As a result of the configuration of Com Ed joining PJM potentially on a stand alone basis, there are additional changes to accommodate that firm transmission service pathway between Com Ed's territory and the existing PJM territory that necessitated us updating the reliability plan as well as then we had proceeded with significant progress in developing this interregional congestion management protocol that's part of the joint operating agreement. The reliability plan, technically is a subset of the joint operating agreement. The joint operating agreement is the larger document that encompasses more elements than the

reliability plan does.

So the reliability plan is a subset of the joint operating agreement and we do need to take that back to the official NAERC process. We were positioned to do that in August. Again, unfortunately, the August 14 episode happened. We are positioned again to take that back through the NAERC process. We believe the reliability plan on the joint operating agreement as they exist today are superior to any other reliability plan or coordination agreement between neighboring systems. We believe this is a superior documentation that will again improve the reliability, enhance reliability and send us toward the joint and common market. The joint operating agreement is a necessary step to achieving a joint common market between PJM and MISO.

Q If I can clarify, then, you, PJM, does not believe there would be changes needed for the reliability plan that would require NAERC approval to integrate Dayton and AEP?

A We're evaluating that reliability plan in response to the August 14 blackout. That's the only necessity for updating that and if there are additional changes, we've received some comments from the stakeholders on the joint operating agreement. We are evaluating what changes we are going to incorporate as a result of the stakeholders' feedback. We would likely make and update

that reliability plan that is in place today.

Q In terms of the joint and common market development of that, what is the current schedule for developing an actual implementation of the common market, the joint and common market?

A The joint and common markets I believe was in the end of the 2005 - 2006 time frame. If I could just try to put a definition on the table to make sure that all of us are talking about the same thing. When PJM and MISO have talked about a common market, we believe what that represents is essentially the same type of markets being run on both territories, including a security economic constraint, dispatch locational marginal pricing, all the elements that comprise pretty much the PJM marketplace today.

What the joint market was I think originally looking like was a single security constraint dispatch across the entire two territories, so the difference is a security constraint dispatch for PJM and MISO as part of the common market coordination of the seams and actually the joint operating agreement addresses how units on one side of the boundary can be utilized in congestion relief for problems on the other side of the boundary and how those units then get compensated for that.

It's a question whether you have all that in



place for the common market, what then is the value of trying to go to a joint and common market with a single security dispatch across that entire footprint which may have some technology issues associated with it.

Q At what point would MISO and PJM achieve? What's the time line for achieving the coordination across seams?

A That coordination across the seams is part of the joint operating agreement that we plan to file as I said, in December. Once that gets approved, there are provisions in there even on a market to non market basis for utilizing generation on one side of the border to help relieve problems on the other side.

Q But that's for the end state of going to a market to market?

A Ultimately with a market to market, correct.

Q The market to market is envisioned to take place when?

A MISO just republished their market schedule. I'm not totally familiar with it other than the original plan of implementing the full market in next spring has been delayed, I understand.

Q How does the uncertainty regarding the status of AEP affect the time line for the development of the coordination between MISO and PJM?

A It does not affect it because, again, the joint

operating agreement allows for a market to non market interface. One of the things that is necessary, though, is the coordination agreement between MISO, AEP and PJM absent AEP belonging to an RTO. We've had discussions with AEP on that matter. We expect to have a coordination agreement. It's necessary if that is how the system is configured at that point in time. So when we integrate Com Ed, if AEP is not in either PJM or MISO, then there has to be a coordination agreement between MISO, AEP and PJM.

Q When you're saying "not in PJM," do you mean short of a full integration into PJM?

A Correct. Just as a transition step. If we move forward with Com Ed we still need a coordination agreement with AEP and we have been working on that.

But again, in light of the August 14th, we needed to re-evaluate that. We needed to bring MISO into those discussions, which we are in the process of doing. It needs to be a three-way agreement between PJM, MISO and AEP.

Q Would the coordination agreement affect the reliability plans?

A I don't believe they will. I believe those reliability plans, again, are more affected by the August 14th evaluation and stakeholder input we've already received.

Q Again, this is something where you don't believe

you can move forward with the coordination agreement until you sort of see the outcome of the August 14th investigation?

A Well, I wouldn't say we're waiting totally on the August 14th investigation. We anticipate getting some preliminary findings in the next month or so and we're very much a part of those discussions as we find things out.

We're trying to update things as we go down the path. We're not waiting until the final report.

Q Are there elements that require approval by NAERC before you could move forward on them?

A I don't believe so.

Q In AEP's proposal, they say they would participate in the markets through bilateral arrangements. Do you see any benefits to that type of participation?

A That's no different than they have the ability to do today.

Q In terms of their proposal do you see benefits for the competitiveness of the market or integration?

A Not from that perspective. They have the ability to bid into PJM's marketplace today on a bilateral basis. They would not bring the true value of an entire marketplace that encompasses Com Ed, AEP, Dayton, by them participating in that now.

Q One final series of questions in terms of cost

benefit analyses. Has PJM done cost benefit analyses that sort out the benefits of all the new PJM companies integrating into PJM?

A Just to clarify, we don't do cost benefit analysis. What we try to provide the joining members is a market analysis. That market analysis evaluates a single security constraint to dispatch across the new territory and how that from a production cost basis then could provide value to the customers of that expanded territory, as well as the existing customers in PJM today. We have provided that analysis in different instances to several RTOs.

Q Have you done that separately for each of the new PJM companies?

A I believe we have done that separately for each of them except I don't believe we did one for Dayton. That's my best recollection.

Q Could you provide those for the record?

A Sure.

MS. FERNANDEZ: Thank you. I don't have any more questions.

PRESIDING JUDGE: Does any other staff member have any questions?

(No response.)

PRESIDING JUDGE: Chairman Wood?

CHAIRMAN WOOD: I'm okay.

PRESIDING JUDGE: All set?

(No response.)

PRESIDING JUDGE: Thank you very much for your testimony, Mr. Wodyka.

(Witness excused.)

PRESIDING JUDGE: I think we're going to call it a day. Thank you very much for your participation. We'll look forward to seeing you at 9:00 a.m. tomorrow morning, same place, same station. We'll pick it up from there. It's ten to five. We are recessed until nine tomorrow.

(Whereupon, at 4:50 p.m., the hearing was recessed, to reconvene at 9:00 a.m., Tuesday, September 30, 2003.)

C O N T E N T S

WITNESS	DIRECT	CROSS	REDIRECT	RECROSS
E. LINN DRAPER, JR.				
by Mr. Duffy	29			
by Mr. Larcamp		37		
by Mr. Bardee		44		
by Mr. Larcamp		47		
by Mr. Kelly		48		
by Mr. Bardee		49		
SUSAN TOMASKY				
by Mr. Duffy	54			
by Mr. Bardee		52		
by Ms. Fernandez		93		
by Mr. Larcamp		103		
by Mr. Kelly		119		
JERRY CRAIG BAKER				
by Ms. Fernandez		93		
by Mr. Larcamp		103		
by Mr. Kelly		119		

(FERC - THE NEW PJM COMPANIES DOCKET NUMBERS  
ER03-262-001 ET AL.; WASHINGTON, D.C.; VOLUME 1;  
MONDAY, SEPTEMBER 29, 2003.)

C O N T E N T S -- continued

WITNESS	DIRECT	CROSS	REDIRECT	RECROSS
ELIZABETH ANNE MOLER				
by Ms. Hill	142			
by Mr. Bardee		148		
by Ms. Fernandez		158		
by Mr. McLaughlin		163		
by Ms. Marlette		165		
by Mr. Kelly		166		
LARRY F. ALTENBAUMER				
by Mr. Palmer	175			
by Mr. McLaughlin		180		
PATRICIA K. SWANKE				
by Ms. Bruner	185			
by Ms. Fernandez		190		
DAVID A. WHITELEY				
by Ms. Thompson	195			
by Mr. McLaughlin		203		
by Ms. Fernandez		211		
by Mr. Larcamp		212		

(FERC - THE NEW PJM COMPANIES DOCKET NUMBERS  
ER03-262-001 ET AL.; WASHINGTON, D.C.; VOLUME 1;  
MONDAY, SEPTEMBER 29, 2003.)

C O N T E N T S -- continued

LAURA CHAPPELLE

by Mr. D'Alesandro	213
by Ms. Marlette	217
by Mr. Kelly	223

RICHARD A. WODYKA

by Mr. Spector	227
by Ms. Fernandez	230

RECESSES: A.M. - 82  
          NOON - 136  
          P.M. - 244



(FERC - THE NEW PJM COMPANIES DOCKET NUMBERS  
ER03-262-001 ET AL.; WASHINGTON, D.C.; VOLUME 1;  
MONDAY, SEPTEMBER 29, 2003.)

E X H I B I T S

NUMBER	DESCRIPTION	IDENTIFIED	RECEIVED
AEP-1	Draper direct testimony	27	27
AEP-2	Direct testimony of Susan Tomasky & J. Craig Baker	52	52
AEP-3		52	52
AEP-4		52	52
AEP-5		52	52
S-1	12/3/02 Duffy letter to Salas	119	119
C-1	Moler prefiled testimony	142	148
IP-1	Altenbaumer direct testimony	176	176
DPL-1	Swanke direct testimony	189	189
ASC-1	Whiteley direct testimony	203	203
PJM-1	Wodyka direct testimony	226	226
MPSC-1	Chappelle direct testimony	217	217
MPSC-2	Midwest ISO footprint	217	217