

**UNITED STATES OF AMERICA 106 FERC ¶ 63,029  
FEDERAL ENERGY REGULATORY COMMISSION**

The New PJM Companies  
American Electric Power Service Corp.  
Commonwealth Edison Co.,  
Dayton Power and Light Co.  
and  
PJM Interconnection, LLC

Docket No. ER03-262-009

**INITIAL DECISION**

**(Issued March 12, 2004)**

**Appearances**

*Kevin F. Duffy, Esq., Edward J. Brady, Esq., Steven J. Ross, Esq., Samuel T. Perkins, Esq., J.A. Bouknight Jr., Esq., and Douglas G. Green, Esq.* on behalf of American Electric Power Service Corp.

*Barry S. Spector, Esq., Paul M. Flynn, Esq., and Andrew T. Swers, Esq.* on behalf of PJM Interconnection, L.L.C.

*Steven Teichler, Esq., Stephanie A. Conaghan, Esq., and Stephen G. Cozey, Esq.* on behalf of Midwest Independent Transmission System Operator, Inc.

*John N. Estes, Esq., A. Karen Hill, Esq., David J. Hill, Esq., William R. Holloway, Esq., and John Lee Shepherd, Esq.* on behalf of Exelon Corporation

*John S. Moot, Esq., Noel Symons, Esq., Cheryl Foley, Esq., and Eve R. Runyon, Esq.* on behalf of Cinergy Services, Inc.

*Earle H. O'Donnell, Esq. and Andrew B. Young, Esq.* on behalf of Edison Mission Energy, Edison Mission Marketing & Trading, Inc. and Midwest Generation EME, LLC.

*Robert A. Weishaar, Jr., Esq., Samuel C. Randazzo, Esq., David M. Kleppinger, Esq., and Vasili Karandrikas Esq.,* on behalf of the Coalition of Midwest Transmission Customers, PJM Industrial Customer Coalition, American Forest & Paper Association, and Electricity Consumers Resource Council

*Robert L. Daileader, Jr., Esq., and Elizabeth W. Whittle, Esq.,* on behalf of Wisconsin Public Service Corporation and Upper Peninsula Power Company

*Kenneth R. Carretta, Esq., and Jason A. Lewis, Esq.,* on behalf of PSEG Energy Resources & Trade LLC, and Public Service Electric and Gas Company

*S. Cathy Fogel, Esq., and Emma F. Hand, Esq.,* on behalf of Ormet Primary Aluminum Corporation

*Michael Briggs, Esq.* on behalf of Reliant Resources

*Michael C. Regulinski Esq.,* on behalf of Dominion Resources

*Gary D. Buchman, Esq., Arthur W. Iler, Esq., and Evan C. Reese, Esq.,* on behalf of Wisconsin Electric Power Company

*Heidi M. Werntz, Esq., and Donald A. Kaplan, Esq.* on behalf of PPL Electric Utilities Corporation

*D. Cameron Press, Esq.* on behalf of Consumers Energy Company

*James L. Blasiak, Esq.* on behalf of International Transmission Company

*William R. Derasmo, Esq.* on behalf of The Detroit Edison Company

*G. Philip Nowak, Esq.* on behalf of First Energy Corporation

*Gary L. Newell, Esq. David Pomperl, Esq., and Pablo O. Nuesch, Esq.* on behalf of the Coalition of Municipal and Cooperative Users of New PJM Companies' Transmission

*Julie Simon, Esq., Larry F. Eisenstat, Esq., Robert C. Fallon, Esq., and Carrie M. Safford, Esq.* on behalf of Electric Power Supply Association

*Robert Weinberg, Esq., Eli D. Eilbott, Esq., Kathleen Mazure, Esq., Tanja M. Shonkwiler, Esq., William H. Chambliss, Esq., and Arlen K. Bolstad, Esq.,* on behalf of the Virginia State Corporation Commission

*C. Meade Browder, Jr., Esq., D. Mathias Roussy, Jr., Esq.,* on behalf of the Virginia Office of Attorney General

*A. W. Turner, Jr., Esq., Rebecca W. Goodman, Esq., Deborah T. Eversole, Esq., Robert Weinberg, Esq., Eli D. Eilbott, Esq., Tanja Shonkwiler, Esq., and Kathleen L. Mazure, Esq.* on behalf of the Public Service Commission of Kentucky

*Mary W. Cochran, Esq., and Randolph Hightower, Esq.,* on behalf of the Arkansas Public Service Commission

*Michael R. Fontham, Esq., Paul L. Zimmerman, Esq., Noel J. Darce, Esq., Dana M. Shelton, Esq., Walter F. Wolf, III, Esq., and Daria Burgess Diaz, Esq.* on behalf of the Louisiana Public Service Commission

*George M. Fleming, Esq.* on behalf of the Mississippi Public Service Commission

*G. Scott Morris, Esq.*, on behalf of the Alabama Public Service Commission

*Thomas W. McNamee, Esq.* on behalf of the Public Utilities Commission of Ohio

*Sandra Hall, Esq.*, on behalf of the Maryland Public Service Commission

*Richard Beverly, Esq.*, on behalf of the Public Service Commission of the District of Columbia

*Peter C. Harvey, Esq., and Helene Wallenstein, Esq.* on behalf of the New Jersey Board of Public Utilities

*Phillip A. Casey, Esq.*, on behalf of the Illinois Commerce Commission

*Eric A. Eisen, Esq.*, on behalf of the Indiana Utility Regulatory Commission

*Michael A. Cox, Esq., David A. Voges, Esq., Steven D. Hughey, Esq., Patricia S. Barone, Esq., Denise Zosa, Esq. and David D. D'Allessandro, Esq.*, on behalf of the Michigan Public Service Commission and the State of Michigan

*John A. Levin, Esq., Bohdan R. Pankiw, Esq., and Robert Young, Esq.*, on behalf of the Pennsylvania Public Utility Commission

*Leonard G. Green, Esq., Louis S. Watson, Jr., Esq., and Gisele L. Rankin, Esq.*, on behalf of the North Carolina Department of Justice, the North Carolina Utilities Commission and the Public Staff- North Carolina Utilities Commission; and

*William W. Bennett, Esq. and Felix M. Khalatnikov, Esq.* on behalf of the Trial Staff of the Federal Energy Regulatory Commission

**WILLIAM J. COWAN, Presiding Administrative Law Judge**

## PROCEDURAL HISTORY

1. By order issued November 25, 2003 (“the November 25 Order”), the Commission made certain preliminary findings, described below, gave public notice, and set for hearing certain matters under the provisions of Section 205(a) of the Public Utility Regulatory Policies Act of 1978 (“PURPA”).<sup>1</sup> The Commission also, pursuant to Section 203(b) of the Federal Power Act,<sup>2</sup> supplemented its orders approving the merger of American Electric Power Company (“AEP”) with Central and South West Corporation (“CSW”), finding that AEP must fulfill its voluntary commitment to join PJM Interconnection, LLC (“PJM”), a Regional Transmission Organization (“RTO”), in order to secure the maintenance of adequate service and the coordination of facilities subject to the jurisdiction of the Commission.<sup>3</sup>
2. In the November 25 Order, the Commission made the following preliminary findings:
  - AEP’s voluntary commitment to join PJM is designed to obtain economical utilization of facilities and resources in the Midwest and Mid-Atlantic areas, as set forth in Section 205(a) of PURPA.
  - The laws, rules or regulations of Virginia and Kentucky are preventing AEP from fulfilling both its voluntary commitment in 1999, as part of merger proceedings, to join an RTO, and its application to join an RTO pursuant to Commission Order No. 2000.<sup>4</sup>
  - The aforementioned provisions of Kentucky or Virginia law or rule or regulation are neither (1) required by any authority of Federal Law, nor (2) designed to protect public health, safety or welfare, or the environment or conserve energy or are designed to mitigate the effects of emergencies resulting from fuel shortages, such that the Commission may exempt AEP from those provisions of Kentucky and Virginia law or rule or regulation.
3. The Commission further provided public notice and notice to the Governors of the states within the so-called Eastern Interconnection,<sup>5</sup> and set for hearing the preliminary

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<sup>1</sup> 16 U.S.C. § 824a-1(a) (2000).

<sup>2</sup> 16 U.S.C. § 824(b) (2000).

<sup>3</sup> *The New PJM Companies, et al.*, 105 FERC ¶ 61,251 (November 25, 2003).

<sup>4</sup> *Regional Transmission Organizations, Order No. 2000*, 65 Fed. Reg. 809 (Jan. 6, 2000), *FERC Stats. & Regs.* ¶ 31,089, *order on reh’g, Order No. 2000-A*, 65 Fed. Reg. 12,088 (Feb. 25, 2000), *FERC Stats. & Regs.* ¶ 31,092, *petitions for review dismissed, Public Utility District No. 1 of Snohomish County, Washington v. FERC*, 272 F.3d 607 (D.C. Cir. 2001)

<sup>5</sup> Exh. S-8.

findings described immediately above. The Commission further returned this matter to the undersigned and directed that an initial decision be rendered by March 15, 2004.<sup>6</sup>

4. A prehearing conference was held on December 2, 2003, to establish a procedural schedule and to set rules for the case that would ensure that the Commission's directives were met and that the parties had a sufficient opportunity to present their evidence and argument on the issues set by the Commission for hearing. A procedural schedule and rules for the case were adopted in my Order Establishing Procedural Schedule and Rules for the Case, issued December 3, 2003. In my judgment, the schedule adopted provided an adequate opportunity for discovery, the development of evidentiary submissions, rebuttal presentations, and also provided two briefing opportunities for the parties to argue their cases. In addition, an oral argument was scheduled and held in lieu of post-hearing reply briefs to give the parties an opportunity to respond to arguments in the post-hearing initial briefs.

5. At the prehearing conference, counsel for the Virginia State Corporation Commission ("VSCC") expressed what he described as a fundamental concern that the Commission's order does not provide an adequate amount of time for meaningful due process in this case, but agreed that a schedule offered by PJM at the conference, which largely formed the basis for the schedule that I adopted, was one he could work with, with some modifications, given the deadline established by the Commission for an Initial Decision. Counsel for the Commonwealth of Kentucky ("Kentucky") agreed with the position of VSCC, and suggested that he would be petitioning the Commission concerning the March 15, 2004 deadline.

6. On December 10, 2003, the VSCC and the Kentucky Public Service Commission ("KPSC") filed with the Commission and Chief Administrative Law Judge an Emergency Motion to Extend the Date for an Initial Decision and requested a shortened response time and expedited consideration. That Emergency Motion was denied by the Chief Administrative Law Judge in an order issued December 17, 2003.<sup>7</sup> Thereafter, the moving parties filed with the Commission a Request for Rehearing of the Chief Judge's Order. That request was denied by the Commission on procedural grounds in an Order Dismissing Rehearing, issued December 31, 2003. VSCC and KPSC, joined in a separate pleading by certain North Carolina Parties, requested rehearing of the Commission's Order Dismissing Rehearing, or in the alternative, leave to file an interlocutory appeal of the Order of the Chief Judge denying the emergency motion to extend the date for an initial decision. The Chief Judge denied the motions for interlocutory appeal in an order issued January 7, 2004.

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<sup>6</sup> I had presided, with the Commissioners, over the Inquiry into RTO Issues related to the Midwest Independent System Operator ("MISO") and PJM, convened September 29-30, 2003.

<sup>7</sup> *Order of Chief Judge Denying Emergency Motion of the Virginia State Corporation Commission and the Kentucky Public Service Commission to Extend the Date for Initial Decision*, Issued December 17, 2003 in this docket.

Subsequently, VSCC, KPSC and the North Carolina Utilities Commission sought interlocutory review of that determination. Interlocutory review was denied by the Chairman, acting as Motions Commissioner, on January 16, 2004.

Pre-filed testimony was filed by the following entities on January 7, 2004:

- American Electric Power System (“AEP”)
- Exelon Corporation (“Exelon”)
- Cinergy Services, Inc. (“Cinergy”)
- PSEG Energy Resources & Trade LLC and Public Service Electric and Gas Company (“PSE&G”)
- Edison Mission Energy, Edison Mission Marketing & Trading, Inc. and Midwest Generation EME, LLC (“EME”)
- PJM Interconnection, L.L.C. (“PJM”)
- Midwest Independent Transmission System Operator, Inc. (“MISO”)
- Coalition of Municipal and Cooperative Users of New PJM Companies’ Transmission (“Muni-Coop Coalition”)<sup>8</sup>
- Coalition of Midwest Transmission Customers and PJM Industrial Customer Coalition (“CMTC/PJMICC”)
- VSCC State Corporation Commission (“VSCC”), and
- Kentucky Public Service Commission (“KPSC”)

7. Pre-trial briefs were filed on January 20, 2004, by the above entities, and also by the Trial Staff of the Federal Energy Regulatory Commission (“Staff”) and by the Public Utilities Commission of Ohio (“PUC Ohio”). A public hearing was held, beginning on January 26, 2004, and continuing until February 2, 2004. The following exhibits were received into evidence: AEP 1-8; PJM 1-7; EXE 1-20, 30-33, 40,<sup>9</sup> 50-72, 80-82, 90-97, 100, 110, 120, and 130<sup>10</sup>; EME 1A, 1-9, 10A, 10-19, and 21-22; CIN 1-8; PS 1-4<sup>11</sup>; VCC 1-31,

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<sup>8</sup> In lieu of submitting pre-filed direct testimony, Muni-Coop filed rebuttal testimony on January 22, 2004.

<sup>9</sup> The transcript at p. 330, line 10, should reflect the admission of Exhibits EXE-40 and EXE-110, as shown on Tr. at p. 261, line 16.

<sup>10</sup> Exhibits EXE- 50, 58, 59, 61, 62, 63, 64, 65, 66, 67, 68, 70, 71, 72, and 80 were

34-43, 45-46; KYC 1-8; MIS 1; IND 1-2; MCC 1-19; and S 1-10. In addition, the parties filed two stipulations, which will be received into evidence. The first, which I hereby designate Exh. No. ALJ-1, is a Stipulated List of Issues around which briefs and this decision are organized. The second stipulation, which I hereby designate Exh. No. ALJ-2, is a stipulated timeline or chronology of events which the parties agreed would be useful to the decisionmakers, but not as an evidentiary submission. It will be received for that limited purpose. By letter dated February 26, 2004, counsel for Exelon supplied copies of the text of certain visual displays he used during oral argument. I will identify these (three pages headed "Section 205(a)") as Exh. ALJ- 3, and this exhibit will be received for the limited purpose of aiding any discussion of the oral argument. The hearing transcript consists of 1,116 pages. The transcript of the oral argument, which will be treated as a pleading in lieu of reply briefs, runs from pages 1,117 to 1,259.

8. Post-hearing briefs were filed on February 12, 2004, by PUC Ohio; jointly by the District of Columbia Public Service Commission, the Illinois Commerce Commission, the Indiana Utility Regulatory Commission, the Michigan Public Service Commission and the Pennsylvania Public Utility Commission ("Joint Midwest and Mid-Atlantic Commissions")<sup>12</sup>; jointly by the Arkansas Public Service Commission, the Mississippi Public Service Commission, the Alabama Public Service Commission, and the Louisiana Public Service Commission ("Joint Southern Commissions"); jointly by the VSCC and the Commonwealth of VSCC, by its Governor Mark M. Warner, and Attorney General Jerry W. Kilgore; jointly by the Washington Utilities and Transportation Commission and the New Mexico Attorney General ("WUTC/NMAG"); jointly by the North Carolina Utilities Commission, the Public Staff-North Carolina Utilities Commission, and the Attorney General of the State of North Carolina ("North Carolina Parties"); KPSC; AEP; CMTC/PJMICC; Electric Power Supply Association ("EPSA"); jointly by the Wisconsin Public Service Corporation and Upper Peninsula Power Company ("WPSC/UPPC"); Exelon; Cinergy; Muni-Coop Coalition; PSE&G; EME; PJM; MISO; Ormet Primary Aluminum Company ("Ormet"); and Staff.<sup>13</sup> An oral argument in lieu of reply briefs was convened on February 24, 2004.

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submitted in protected status because some information in them was derived from protected data responses. By letter dated February 26, 2004, counsel for Exelon advised that the parties providing the protected material have agreed that the exhibits no longer require protected status.

<sup>11</sup> The transcript at p. 330 should reflect the admission into evidence of Exhibits PS-1 through PS- 4. Tr. at p. 324. Exhibits PS- 3 and PS- 4 contain protected material.

<sup>12</sup> The Commissions' motion for late intervention was granted and their statements of position were accepted as a pleading, but not received into evidence. *Order Confirming Rulings on Motions*, issued February 3, 2004 in Docket No. ER03-262-009.

<sup>13</sup> Comments were filed by Reliant Resources, Inc. in support of the Commission's November 25 Order; however, there is no provision for such a filing. I

## BACKGROUND

9. As noted by several parties, it is necessary to put the issues here in perspective. This case presents a dispute between conflicting views of different groups of states, and between certain of those states and the Commission, concerning the need for full and prompt integration of AEP into PJM. Numerous utility regulatory commissions in the region under study, namely, those in Michigan, Indiana, Illinois, Pennsylvania, New Jersey, and the District of Columbia, favor the prompt initiation of coordinated regional operations and look forward to the attendant benefits they believe will ensue from integration of AEP into PJM. These parties contend that the benefits have been long delayed and frustrated, in part by actions of other states. They are joined by the Public Utility Commission of Texas (“Texas Commission”), which, although not directly affected by this proceeding, indicated its support for the Commission’s November 25 Order, and for the concept of regional transmission organizations, which it suggests are a critical element for vibrant wholesale competition. The Texas Commission sees the issues here as “super-regional” in scope, and, as such, it believes that they require regional and multi-regional solutions beyond the reach of individual state commissions. While professing a general concern about the Commission preempting the orders of states, the Texas Commission argues that the Virginia and Kentucky actions here may effectively preempt other states from enforcing their own orders, which would frustrate state initiatives designed to achieve the benefits of regional coordination.

10. The states of Virginia and Kentucky have raised legal and procedural obstacles to integration of AEP into PJM, primarily due to a perceived loss of local control, expected loss of cost advantages which they believe would be sacrificed in the name of regional benefits, and a concern about federal market structure initiatives. They have been joined by public entities in North Carolina and the Public Service Commissions of Arkansas, Mississippi, Alabama, and Louisiana. Because of state sensitivity generally to issues of federal over-ride of state actions, other states outside of the region have voiced negative opinions about the propriety of federal action here under PURPA Section 205(a). These include the Washington Utilities and Transportation Commission, the New Mexico Attorney General, and most recently California, by its Public Utilities Commission.

11. Therefore, as we proceed to analyze the record and reach decisions on the important issues raised by the Commission, it is important to appreciate that this is not a case where two states are being pressured by a federal agency to comply with a federal scheme that might prove disadvantageous to them. It is, instead, one that is attempting to decide whether the legal actions of two states are impeding and frustrating the desires of other states in a particular region, under the guiding influence of the Commission, to improve regional coordination for the benefit of the entire region. It requires that we look at what the authority

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will, however, treat it as a pleading similar to the statements made in support of the November 25 Order by the Joint Midwest and Mid-Atlantic Commissions in their petition for late intervention.

provided to the Commission under Section 205(a) entails and whether the prerequisites for its exercise have been established. A review of the background of this issue will be helpful to set the stage for a discussion of these issues.

12. This matter began on April 30, 1998, with the filing by AEP and CSW of an application with the Commission for approval of a proposed merger. Exh. AEP-1 at p. 4. On November 10, 1998, the Commission set for hearing a number of issues to determine whether the proposed merger was consistent with the public interest. *American Electric Power Company and Central Southwest Corporation*, 85 FERC ¶ 61,201 (1998). In that hearing order, the Commission acknowledged that “[m]any intervenors urge the Commission to dismiss the merger application, without prejudice, since Applicants have not made a meaningful commitment to join an ISO of sufficient size and scope to mitigate their market power.” *Id.* at 61,818.<sup>14</sup> AEP and Staff subsequently entered into a stipulation on May 24, 1999, in which AEP agreed to file with the Commission a proposal to transfer to an RTO the operation and control of the bulk transmission facilities in its east zone (the historic AEP system) and west zone (the former CSW system). Exh. AEP-1 at p. 5; Exh. EXE-4 at p. 2. On June 3, 1999, AEP and other applicants (“Alliance Companies”) filed an application with the Commission to create the Alliance RTO. Exh. AEP-1 at p. 7; Docket No. EC99-80-000 *et al.* On December 20, 1999, the Commission issued Order 2000, which, among other things, specified requirements for RTOs.

13. On March 15, 2000, the Commission conditionally approved the merger of AEP with CSW. 90 FERC ¶ 61,242 (2000) (“AEP Merger Order”) order on reh’g, 91 FERC ¶ 61,129 (2000), *aff’d sub nom Wabash Valley Power Ass’n Inc. v. FERC*, 268 F.3d 1005 (2001). Approval was conditioned on AEP’s transferring operational control of its transmission facilities to a fully-functioning, Commission-approved RTO by December 15, 2001. *Id.* at 61,799-800. AEP, along with the other Alliance Companies, was pursuing development of the Alliance RTO. Although the Commission had issued a series of orders directing modification of the Alliance RTO or directing other filings, on December 20, 2001, FERC issued an order denying RTO status to the Alliance Companies. *Alliance Companies*, 97 FERC ¶ 61,327 (2001). In that order, AEP was directed to pursue membership in another RTO.

14. AEP and other Alliance Companies began negotiations with MISO and reached an agreement in principle with MISO management. Exh. AEP-1 at p. 9. However, after consultation with MISO stakeholders, MISO notified AEP and other Alliance companies that it could no longer support the agreement. *Id.* On April 25, 2002, the Commission issued an order directing the former Alliance companies to make a compliance filing stating which RTO they intended to join. *Alliance Companies*, 99 FERC ¶ 61,105. AEP, on May 28, 2002, submitted a compliance filing stating its intent to join PJM. The Commission

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<sup>14</sup> “ISO” refers to Independent [transmission] System Operator.

conditionally approved AEP's compliance filing on July 31, 2002. Exh. EXE-7; *Alliance Companies*, 100 FERC ¶ 61,137 (2002). On December 11, 2002, AEP filed for approval to transfer control of its transmission facilities to PJM, and the Commission, on April 1, 2003, approved the transfer application. *American Electric Power Service Corporation*, 103 FERC ¶ 61,008 (2003).

15. The Commonwealth of Virginia enacted the Virginia Electric Restructuring Act in March, 1999, which, among other things, required Virginia electric utilities to join regional transmission entities on or before January 1, 2001. *Code of Virginia 56-576 et seq.* Subsequently, Virginia amended this statute, effective April 2, 2003, prohibiting Virginia incumbent electric utilities from transferring control of their transmission facilities to RTOs until July 1, 2004. Exh. VCC-9 at p. 1. This law prohibited AEP's Virginia operating company from transferring control of its transmission facilities to PJM until July 1, 2004, and thereafter only with the approval of the VSCC. The application of AEP's Virginia operating company ("AEP-Virginia") to transfer control of its transmission facilities to PJM remains pending before the VSCC.

16. On July 17, 2003, the KPSC denied a request made by AEP's Kentucky operating company, Kentucky Power Company ("KPC") to transfer control of its transmission facilities to PJM. Exh. KYC-2. The KPSC has subsequently agreed to rehear that decision, but that action also remains pending.

17. On September 12, 2003, the Commission initiated an inquiry "to gather sufficient information for moving forward in resolving the voluntary commitment made by several entities to increase regional coordination by joining RTOs" and to "explore ways to resolve the interstate disputes... and enhance regional coordination to establish a joint and common market in the Midwest and PJM region." *The New PJM Companies*, 104 FERC ¶ 61,274 at P 1, 2 (2003). Hearings were held before the undersigned and the Commissioners on September 29 and 30, 2003. As noted above, the Commission subsequently issued an order making three preliminary findings and setting the matter for further public hearing under PURPA section 205(a). 105 FERC ¶ 61,251.

18. We turn next to consider those preliminary findings in light of the record developed in this proceeding.

**ISSUE NO. 1 - Whether AEP's voluntary commitment to join PJM is designed to obtain economic utilization of facilities and resources in the Midwest and Mid-Atlantic areas, as set forth in Section 205(a) of PURPA.**

19. Section 205(a) of PURPA provides:

The Commission may, on its own motion, and shall, on application of any person or governmental entity, after public notice and notice to the Governor of each affected state and after affording an opportunity for

public hearing, 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, including any agreement for central dispatch, if the Commission determines that such voluntary coordination is designed to obtain economic utilization of facilities and resources in any area. No such exemption may be granted if the Commission finds that such provision of State law or rule or regulation-

- (1) is required by any authority of Federal law, or
- (2) is designed to protect public health, safety, or welfare, or the environment or conserve energy or is designed to mitigate the effects of emergencies resulting from fuel shortages.

20. The first question set for hearing by the Commission concerns the provision of this statute that requires a Commission determination, in order to exempt an electric utility from a provision of state law, rule or regulation that it finds to be preventing the voluntary coordination of electric utilities, that such coordination is designed to obtain economic utilization of facilities and resources in any area. Specifically, the Commission has inquired whether AEP's voluntary commitment to join PJM is designed to obtain economic utilization of facilities and resources in the Midwest and Mid-Atlantic areas, as set forth in Section 205(a) of PURPA.

**A. Whether AEP's joining PJM constitutes the "coordination of electric utilities, including any agreement for central dispatch" within the meaning of Section 205(a) of PURPA?**

**1. Positions of the Parties**

21. The VSCC argues that, considering the historical context in which Section 205(a) was enacted, AEP's transferring control of its transmission facilities to PJM has not been shown to constitute coordination or an agreement for central dispatch as required by the statute. VSCC offers the testimony of Howard M. Spinner, Director of the VSCC's Division of Economics and Finance. According to Mr. Spinner, in response to the nation's energy crisis in the mid-1970s, Congress enacted PURPA "to encourage improvements in energy efficiency through the ...use of cogeneration and by creating a market for electricity produced from unconventional sources like renewables and waste fuels, not natural gas." Exh. VCC-19 at p. 6. However, Mr. Spinner stated that nearly all of the 6,750 MW of generation said to be added in PJM is, or will be, gas-fired. *Id.* at p. 17. He argues that expansion of PJM will likely further increase the use of gas, the very resource that consumption in electric generation Congress intended to minimize in enacting PURPA. *See id.* at pp. 17-18.

22. VSCC also argues that in encouraging voluntary coordination of electric utilities, Congress did not have in mind a competitive, bid-based arrangement such as PJM. Rather, by “voluntary coordination” Congress meant formation of centrally dispatched, cost-based tight power pools, which were “very well known propositions in 1978,” according to Mr. Spinner. Exh. VCC-19 at pp. 18-19. The North Carolina Parties and other parties make similar arguments. VSCC argues that PJM “now relies upon a competitive, bid-based system to dispatch generation, an arrangement at odds with the cooperative, cost-based systems that Congress sought to encourage in enacting Section 205(a) of PURPA.”<sup>15</sup> *VSCC Post-hearing Brief* at p. 19. The Joint Southern Commissions, WUTC/NMAG, and the North Carolina Parties make similar arguments, stating that “cooperative” participants in a tight power pool become “competitive rivals” in PJM, a result that was not contemplated by PURPA. VSCC argues that cost-based economic dispatch based on fuel costs and generating unit heat rates achieves the Congressional goal of saving fuel. But in the absence of certain market assumptions that VSCC argues have not been proven to exist in this case, if bids exceeding marginal cost are accepted, it claims that the resulting dispatch will differ from least-cost dispatch. Thus, VSCC argues that, by invoking Section 205(a) of PURPA to cut off states’ assessment of the costs and benefits of AEP’s joining PJM, the Commission improperly seeks to accomplish a result completely outside the intent, scope and applicability of that provision. Exh. VCC-19 at p. 22.

23. The Joint Southern Commissions and WUTC/NMAG also argue that the coordination of electric utilities under Section 205(a) refers only to power pools, and claim that the section’s title (“Pooling”) is an aid to resolving any doubt about the meaning of the statute. They cite to *Public Service Company of New Mexico*, 25 FERC ¶ 61,469 at 62,038 (1983), arguing that Section 205(a) granted to FERC a mandate only to promote the voluntary coordination already contained in Section 202 of the FPA, which allowed the encouragement of voluntary interconnections. They argue that state public utility regulation is a critical state function, and a federal agency may only preempt state law if it is acting within the scope of its congressionally delegated authority. They argue Congress did not give the Commission a broad preemption tool in enacting PURPA, but intended only to help ensure the viability of voluntary power pooling arrangements.

24. The Joint Midwest and Mid-Atlantic Commissions, on the other hand, argue that the integration of AEP into PJM will entail “coordination of electric utilities” under PURPA Section 205(a). They argue that the proposed integration is “designed to obtain economic utilization of facilities and resources in any area” within the meaning of Section 205(a), as discussed under Issue No. 1(C), below.

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<sup>15</sup> VSCC asserts that several witnesses at the hearing conceded that bids in PJM do not always equal the bidder’s marginal cost, and that often bids are accepted that exceed marginal cost.

25. Staff agrees. Staff argues that AEP's integration into PJM falls within the plain meaning of the phrase, "coordination of electric utilities, including any agreement for central dispatch," and that in enacting Section 205(a) of PURPA Congress intended such an arrangement to fall under the meaning of that phrase. Exelon, Cinergy, CMTC/PJMICC, EME, and PJM echo Staff's arguments on this point. Staff responds to VSCC witness Spinner's testimony concerning what Congress intended by "coordination of electric utilities" within the meaning of PURPA, stating that Mr. Spinner (who is not a lawyer) admitted he was not a legal expert on PURPA and lacked first hand knowledge of the events leading to the enactment of PURPA. Staff points out that Mr. Spinner testified that Congress in 1978 intended to limit Section 205(a) of PURPA to the tools known to the electric industry at that time (*i.e.* cost-based tight power pools), but also admitted that since 1882 the electric utility industry has undergone a constant evolution. Tr. at pp. 1046-1047; Exh. VCC-19 at p. 8. PJM adds that had Congress meant for Section 205(a) only to apply to the types of arrangements in effect in 1978, it would have subsequently made changes to Section 205. EME adds that there is not an express limitation on what constitutes "coordination of electric utilities," and that VSCC's interpretation would conflict with the clear goal of Section 205(a) to achieve improved efficiencies through voluntary coordination.

26. Cinergy adds that Section 205(a) states that coordination includes any agreement for central dispatch, not "only" central dispatch, or "limited" to central dispatch. According to Cinergy, the PJM Operating Agreement is clearly such an agreement for central dispatch. Exh. PJM-6 at pp. 9-10. Cinergy and EME claim that even Mr. Spinner acknowledged that PJM's form of bid-based central dispatch would be included within the meaning of Section 205(a) if Congress passed the same law today. Tr. at p. 1050. Cinergy also refers to Mr. Spinner's testimony that he had "no opinion" as to whether Congress intended to "tie the FERC's hands" and require "in perpetuity" that FERC could only exercise its authority under Section 205(a) in the case of incremental dispatch. Tr. at pp. 1035-36.

27. Mr. Spinner's arguments, according to Cinergy, suggest that the method of obtaining benefits was more important to Congress than the benefits themselves. Cinergy disagrees. It argues that the proposed integration will result in "coordination" of electric utilities on many levels, including coordination of transmission facility outages, planning and operation of the transmission system, generation interconnection, demand response, ancillary services markets, and market monitoring. EME also makes this point. Thus, according to Cinergy, the form of central dispatch here will, in fact, result in economical utilization of facilities and resources.

28. According to Exelon and EPSA, the body of administrative case law holds that Congress's delegation of its legislative function to agencies is interpreted as giving the agencies substantial latitude to choose which regulatory tool to use in accomplishing the goals created by the statute. *See, e.g., Rust v. Sullivan*, 500 U.S. 173, 186-187 (1991). Such agencies are presumed to have the ability to adapt to changing circumstances over time, unless the statute expressly constricts this discretion, they argue. *Id.*

29. Staff, Exelon, and EPSA argue that greater weight should be given to the testimony of Exelon witness Philip R. Sharp, a former Congressman who participated as a member of the U.S. House of Representatives during the enactment of PURPA and who currently serves as Senior Policy Advisor at Van Ness Feldman, P.C. According to Staff, Mr. Sharp's testimony supports the assertion that the evolution of the electric industry is what Congress intended to encourage in enacting Section 205(a) of PURPA. Exh. EXE-100 at p. 2. According to Witness Sharp, Section 205(a) was not intended to promote only tight power pool coordination, but other forms of coordination as well. *Id.* at pp. 2-3. Regarding PJM, which began as a tight power pool, Staff argues there is no doubt that PJM centrally dispatches generators within its control area and will do so after AEP joins.

30. Exelon adds that Mr. Sharp refuted Mr. Spinner's contention that no changes to the cost-based pricing of utility regulation were contemplated at the time Section 205(a) was enacted. According to Mr. Sharp, PURPA took a step away from traditional cost-of-service rate regulation for a sector of the industry by using utilities' avoided cost as the basis for compensating qualifying facilities ("QFs"), instead of the QFs' own costs. Exh. *Id.* at p. 2. One of the purposes of PURPA was to encourage innovation, according to Exelon witness Sharp. *Id.* Exelon argues that Congress did not intend to limit the use of the Commission's exemption authority under Section 205(a) to the particular type of power pooling arrangements in existence in 1978. Nonetheless, Exelon argues that PJM does engage in central dispatch within the meaning of Section 205(a).

31. Exelon also offers the testimony of Michael M. Schnitzer, Director of the Northbridge Group, an economic and strategic consulting firm specializing in the electric and natural gas industries. According to Mr. Schnitzer, Mr. Spinner was incorrect in his characterization of Locational Marginal Pricing ("LMP") markets, which PJM employs to manage congestion, as totally different from the tight power pools that came before them. EXE-130 at p. 7. Both are based on regional least-cost dispatch, and the underlying policy rationale for PJM in the 1970s and in 2004 (*i.e.* more efficient utilization of facilities and resources) is the same, according to Mr. Schnitzer. *Id.* Thus, according to Staff and Exelon, the proposed integration does constitute the coordination of electric utilities as described under Section 205(a) of PURPA.

32. PJM argues that, although some parties disagree about the extent of benefits that integration will bring, "it is undisputed in this record that 'coordination of electric utilities' will occur." *PJM Post-hearing Brief* at p. 8. PJM offered the testimony of Richard A. Wodyka, Senior Vice-President of Transmission at PJM. Referring to Mr. Wodyka's testimony, PJM argues that AEP and PJM will coordinate facility outages, transmission planning processes, generator interconnection, demand response, capacity commitment, transmission service, ancillary services markets, and market monitoring, permitting economic dispatch of generation across a broad area. Exh. PJM-1 at pp. 10-18. PJM claims that the PJM Operating Agreement (to which AEP will become a signatory upon integration) is an agreement for central dispatch that is identified as one of the kinds of coordination that was

contemplated under Section 205. PJM states the Operating Agreement provides that PJM shall utilize least-cost security-constrained central dispatch to schedule and dispatch generation in the day-ahead and real-time markets. Exh. PJM-1 at p. 5. CMTC/PJMICC adds that AEP will also be required to sign other agreements, including the PJM West Transmission Owners Agreement and the PJM West Reliability Assurance Agreement, which they argue provide for central dispatch and other forms of coordination of resources and facilities, all of which are designed to obtain economical utilization of regional resources and facilities.

## 2. Discussion and Conclusion

33. Considering the plain meaning of Section 205(a) and the historical context in which PURPA was enacted, the record evidence demonstrates that the proposed integration of AEP into PJM constitutes the “coordination of electric utilities, including any agreement for central dispatch.”

34. When interpreting a statute, “[w]e begin with the familiar canon of statutory construction that the starting point... is the language of the statute itself. Absent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive.” *Consumer Product Safety Comm’n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980); *See also INS v. Elias-Zacarias*, 502 U.S. 478, 482 (1992) (In construing statutes, we assume that the legislative purpose is expressed by the ordinary meaning of the words.). In addition, courts and this Commission rely on legislative history as an aid in construing statutes. *See, e.g., Jubail Energy Co.*, 106 FERC ¶ 61,136 (2004).

35. In this case, there is a dispute concerning what constitutes “coordination of electric utilities” under this Section of PURPA. The two central witnesses who testified on this issue were VSCC witness Spinner and Exelon witness Sharp. Mr. Sharp is well qualified to express opinions regarding PURPA’s legislative history, having been a member of Congress from 1975 to 1995 who served on the Interstate and Foreign Commerce Committee, the House committee that had jurisdiction over electric utility regulatory issues. Exh. EXE-30 at p. 1. Mr. Sharp was an active participant throughout the House’s development of PURPA in 1978, serving as a member of the Subcommittee on Energy and Power, the Interstate and Foreign Commerce Committee, and the Ad Hoc Energy Committee created to draft PURPA. *Id.* Mr. Sharp also served on the House-Senate Conference Committee which crafted the final version of PURPA. *Id.* While it is correct, as argued by VSCC, that post hoc observations of a single member of Congress have been found to carry little weight, *Quern v. Mandley*, 436 U.S. 725, 736 (1978), Mr. Sharp offers not only his Congressional experience to support his view, but his experience as a teacher of electric policy at Harvard University’s Kennedy School of Government, and as a senior electric policy advisor to several organizations. In short, his credentials as an expert witness in the field of electric policy are beyond question.

36. VSCC offered the testimony of Mr. Spinner, the Director of its Division of Economics and Finance, who has been involved with the analysis of network public utility industries for over 20 years, whose background in utility work began after enactment of PURPA. He asserts that, in enacting PURPA, Congress envisioned a voluntary coordination employing only the cost-based, tight power pools then known to the industry at the time PURPA was enacted. Exh. VCC-19 at p. 19. VSCC witness Spinner, whose is an economist, offers no evidentiary or other support for his “frozen in time” interpretation of Section 205(a).<sup>16</sup>

37. Mr. Spinner’s opinion is persuasively rebutted by Mr. Sharp, who testified that PURPA arose out of a larger energy policy package responding to the energy crisis of the mid-1970s. He explained that PURPA had policy goals to promote energy efficiency, conservation, and development of domestic energy resources, thereby reducing the cost of energy to the consumer. See Exh. EXE-30 at p. 2. Mr. Sharp stated that Section 205(a) grew out of the continuing debate concerning how to increase efficiency and gain reliability benefits from greater coordination among utilities. *Id.* at p. 4. One of the underlying purposes of PURPA, according to Mr. Sharp, was to encourage innovation and new entrants in the electric industry. Exh. EXE-100 at p. 2. Thus, rather than inhibit the ongoing evolution in the electric industry, he testified that Congress sought to foster innovation and competition.

38. Moreover, as noted by Witness Sharp, Congress did not specifically limit the means by which voluntary coordination of electric utilities could be achieved, and required only that such coordination be designed to promote the economic utilization of facilities and resources. *Id.* at p. 3. The argument that relies on Section 205’s title, “Pooling,” to conclude that tight power pools are the only arrangements that comport with the principles of the statute is baseless. Proponents of that argument offer no evidence that Congress in enacting Section 205(a) had in mind any one particular coordination arrangement, other than voluntary coordination which is designed to obtain economic utilization of facilities. Furthermore, it is well settled that “the title of a statute and the heading of a section cannot limit the plain meaning of the text.” *Brotherhood of Railroad Trainmen v. Baltimore & Ohio Railroad Co.*, 331 U.S. 519, 528-529 (1947). The United States Supreme Court had long ago acknowledged that often a statute’s heading “is but a short-hand reference to the general subject matter involved[,]” and that it is not unusual for headings to fail to refer to all the matters which the drafters of that section wrote into the text. *Id.* at p. 528. Section 205(a)

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<sup>16</sup> Mr. Spinner’s argument that expansion of PJM will likely further increase the use of natural gas, the very resource that consumption in electric generation Congress intended to minimize in enacting PURPA, has no merit in this case. The record reflects that AEP has excess low-cost coal-fired generation, while PJM has, at the margin, more expensive coal-fired generation available. Exh. EXE-50 at p. 9. Furthermore, there is a surplus of nuclear/coal energy in the Midwest available for sale outside the region. Tr. at pp. 1098-99 (Schnitzer); Exh. EXE-80 at pp. 11-12.

states that *any* agreement for central dispatch or other voluntary coordination of electric utilities is acceptable if it meets the economic utilization standard. The VSCC and its supporters have failed to provide adequate justification for deviating from the text's literal meaning nor have they offered persuasive evidence to support their particular view of the statute.

39. The type of coordination sought here is set out in PJM's Operating Agreement, which provides for security-constrained economic dispatch of resources to serve load in the PJM area. This constitutes an agreement for central dispatch, within the meaning of Section 205(a) of PURPA. Exh. PJM-1 at pp. 5-6; Exh. PJM-6 at p. 9; Exh. EXE-130 at p. 7. Under the planned coordination, AEP will become subject to PJM's Operating Agreement after integration. Exh. PJM-1 at p. 4. There is also strong evidence that the underlying policy rationale for PJM in the 1970s and PJM in 2004 are the same, *i.e.*, to achieve more efficient utilization of facilities and resources. Exh. EXE-130 at p. 7. Exelon witness Schnitzer convincingly testified that today's LMP markets are not as different from earlier tight power pools as Mr. Spinner suggests. *Id.* He states both are based on a regional least-cost dispatch that aims to achieve a more efficient result than multiple single company dispatches. *Id.* PJM witness Wodyka also testified persuasively that "PJM was formed as a power pool for the very purpose of allowing its member utilities to obtain the most economical use of their facilities, through an agreement for coordinated use of their transmission and central dispatch of their generating resources." Exh. PJM- 1 at p. 3. Although VSCC argues that Congress had in mind only cost-based tight power pools in 1978, even VSCC witness Spinner agreed that bid-based central dispatch pools like the current PJM would be included within the meaning of Section 205(a) if Congress passed the statute today. Tr. at p. 1050.

40. Opponents to integration argue that the pooling arrangements in existence in 1978 did not require relinquishing control of transmission facilities to the extent that is commonly seen today, and caution that control of transmission functions traditionally remained under the purview of state authority. Although those arguments seem plausible at first blush, they do not hold up when scrutinized within the context of PURPA's legislative history, including Mr. Sharp's testimony, the Conference Committee Report,<sup>17</sup> and corresponding House and Senate Reports on the final bill. *See* Exh. EXE-30 at p. 10. Moreover, PJM has managed a grid, operating and controlling transmission lines, long before its incarnation as an RTO. So,

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<sup>17</sup> At the hearing, counsel for the KPSC and VSCC challenged Mr. Sharp's use of the Conference Committee Report as one source that formed the basis of his opinion. Tr. at p. 309. However, "[i]n surveying legislative history... the authoritative source for finding the Legislature's intent lies in the Committee Reports on the bill, which 'represent the considered and collective understanding of those [members of Congress] involved in drafting and studying proposed legislation.'" *Eldred v. Ashcroft*, 537 U.S. 186, 210 (2003), quoting, *Garcia v. United States*, 469 U.S. 70, 76 (1984).

this is not a radical new concept requiring special approvals and extra scrutiny. Exh. PJM- 1 at p. 4.

41. Mr. Sharp testified that the legislation originally proposed by the President in 1977 and that ultimately led to the enactment of PURPA “envisioned a massive expansion of federal authority over the electric power industry.” Exh. EXE-30 at p. 4. It sought a broader and more direct assertion of federal authority over the coordination of transmission service. *Id.* at p. 5. For this reason, PURPA was a controversial piece of legislation. Exh. EXE-100 at p. 1. Ultimately, Congress granted FERC much more limited authority to order utilities to interconnect and to wheel power, and to exempt voluntary coordination efforts from state interference, with some exceptions. Exh. EXE-30 at pp. 3-4. While it did not give this Commission authority to mandate coordination, it allowed FERC to prevent states from blocking or frustrating coordination efforts. *Id.* at p. 8. Moreover, the statute exempts electric utilities from certain state laws if they meet the economic utilization standard “in any area.” 16 U.S.C. § 824a-1. Thus, Congress recognized that there might be some objecting states that would not benefit from a regional coordination effort. The statute was a tool that would enable improvements in the bulk power transmission system where a state may disagree with FERC’s judgment. Exh. EXE-100 at p. 4.

42. Administrative agencies are empowered to exercise discretion in enforcing a statute in order to carry out the intent of Congress. In so doing, they are permitted to adapt their rules and policies to the demands of changing circumstances, unless expressly prohibited from doing so. *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 784 (1968); *See also FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944) (The Commission is not bound by any specific method of ratemaking.). It is clear that Congress intended to empower this Commission with the authority to decide what constitutes the “coordination of electric utilities, including any agreement for central dispatch” within the meaning of Section 205(a) of PURPA, and to resolve disputes regarding this issue with the collective public interest in mind. *See* Exh. EXE-100 at p. 5. In this case, it has been shown by the preponderance of the evidence that PJM constitutes coordination under Section 205(a). Issue No. 1(A) is answered in the affirmative.

## **B. Whether AEP’s joining PJM constitutes a “voluntary” coordination within the meaning of Section 205(a)?**

### **1. Positions of the Parties**

43. AEP’s witness, J. Craig Baker, Senior Vice-President – Regulation and Public Policy, reviewed in his testimony the history of AEP’s planned participation in PJM. Exh. AEP-1. He noted that the company had been working on Independent System Operator or RTO formation activities since the mid-1990s. In the context of AEP’s plan to merge with CSW, it began to work with other utilities to form what came to be known as the Alliance RTO. Exh. AEP-1 at p. 5-6. In light of the Commission’s RTO rulemaking and rulings in other

cases, AEP felt it likely that the Commission would condition approval of its merger with CSW on its joining one or more RTOs. Subsequently, on May 24, 1999, AEP entered into a stipulation with the Staff in the CSW merger proceeding that provided, among other things, that AEP would file with FERC a proposal to transfer operation and control of the bulk transmission facilities in the company's east zone to an RTO.<sup>18</sup> Exh. EXE-1 at p. 6.<sup>19</sup> The Commission approved the merger, as conditioned, and required AEP to indicate its acceptance of the conditions, which it did on March 27, 2000. *American Elec. Power Co.*, Opinion No. 442, 90 FERC ¶ 61,242 at p. 61,786-90 (2000) ("Opinion 442"); *American Elec. Power Co. & Central South West Corp.*, 91 FERC ¶ 61,208 (2000).

44. Mr. Baker maintains in his testimony that AEP has, since at least September, 1999, continuously and conscientiously pursued membership in an RTO, first through its efforts to form, with eight other utilities, the Alliance RTO. In a series of orders in 1999, 2000 and 2001, the Commission substantially approved the Alliance RTO.<sup>20</sup> Mr. Baker reports that AEP continued to develop the proposed Alliance RTO at considerable expense. However, the Commission, on December 20, 2001, eventually found that the Alliance RTO failed to meet its requirements for scope and regional configuration. *The Alliance Companies*, 97 FERC ¶ 61,327 (2001). After a further order in April, 2002, he reports that AEP decided to pursue other alternatives, and signed a memorandum of understanding choosing to pursue membership in PJM. AEP formalized its commitment to PJM in an Implementation Agreement signed on September 30, 2002, which committed AEP to expend about \$13 million to accomplish the integration into PJM. Later in 2002, it filed for approvals with the KPSC, the VSCC; PUC Ohio; and the Indiana Utility Regulatory Commission ("IURC"). Exh. AEP- 1 at p. 10. AEP most recently confirmed that it has every intention of integrating its transmission facilities and functions with PJM, and is developing systems and dedicating resources to do so by October 1, 2004. *AEP Post-Hearing Brief* at p. 1.

45. The original plan for integrating into PJM was to accomplish "Day One" activities, namely, transferring functional control over AEP's transmission facilities to PJM on February 1, 2003, and "Day Two" activities, which consisted of integration of AEP into PJM's energy and ancillary service markets, by May 1, 2003. However, according to Mr. Baker, it became clear in early 2003 that AEP's integration into PJM would be delayed by what he called "legal and regulatory considerations." Exh. No. AEP-1 at p. 12. The most significant cause for the delay, according to Mr. Baker, was the Virginia General Assembly's

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<sup>18</sup> A similar commitment was made in the west zone, which is not the focus of this proceeding.

<sup>19</sup> See also: *Stipulation of American Electric Power Co., Central and South West Corp. and Commission Staff* at pp. 2-4, Docket No. EC98-40-000 (May 24, 1999) (Exh. EXE-4).

<sup>20</sup> *The Alliance Companies*, 89 FERC ¶ 61,298 (1999); *The Alliance Companies*, 91 FERC ¶ 61, 152 (2000); *The Alliance Companies*, 94 FERC ¶ 61,070 (2001); and *The Alliance Companies*, 96 FERC ¶ 61,052. (2001)

enactment of legislation prohibiting transfer of ownership or control over any Virginia transmission system to any person before July 1, 2004. Also important, according to Mr. Baker, were Kentucky regulatory proceedings and an order of the KPSC rejecting a transfer, regulatory uncertainty in Ohio and Indiana, certain conditions imposed by Commission Order issued July 31, 2002, and timing factors relating to reliability issues and preferences for the timing of integration activities outside of peak periods. *Id.* at pp. 12-15.

46. Although Mr. Baker gave no explicit indication that AEP viewed its decision to join an RTO as anything but voluntary, certain of Mr. Baker's statements and other considerations have led some parties to question that contention. For example, he stated that, when the Commission issued its merger order, and when AEP accepted the conditions, the Commission had defined the attributes of an RTO differently than it does now. He contends that administration of energy markets and LMP congestion management originally were not RTO requirements. *Id.* at p. 33. Hence, the Company's belief, discussed below, that a partial integration proposal without the market participation and LMP-based congestion management would suffice to fulfill its commitment to join an RTO. He also noted that the physical scope of RTOs has expanded significantly, and there has been added a requirement for inter-RTO pancake rate elimination. *Id.* at p. 33-34.

47. The Virginia Governor and Attorney General, on behalf of the Commonwealth of Virginia ("Virginia"), argue that, given AEP's alternative proposal, and its assertions that partial integration would suffice to fulfill its RTO commitments, it is incongruous to argue that AEP has voluntarily agreed to integrate fully into PJM. The fact that the Commission has commenced this proceeding *sua sponte*, rather than following a request by AEP, also suggests to Virginia a reluctance on the part of AEP to have the Commission invoke Section 205(a) of PURPA, further weakening arguments about the voluntariness of its commitment. This view is shared by the North Carolina Parties, who contend that the utility's actions must be "truly voluntary" in order to invoke Section 205(a) of PURPA.<sup>21</sup> Here, they see reluctance on the part of AEP to fully integrate into PJM by offering a partial integration proposal, which suggests to them that the company is not undertaking a voluntary action. The North Carolina Parties make much of the differences between the PJM model RTO and the one that existed at the time of AEP's original commitment to join an RTO, arguing that AEP is being compelled to join PJM as it is currently configured. They argue that the Commission has no authority to dictate the terms and conditions involved in "voluntary" coordination, such as participation in bid-based markets and reliance on LMP to manage congestion.

48. VSCC also argues that AEP's commitment to join PJM is not voluntary but was instead designed to secure approval of its merger with CSW. It sees confirmation of this

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<sup>21</sup> *Pre-Trial Brief of the North Carolina Utilities Commission, the Public Staff – North Carolina Utilities Commission, and the Attorney General of the State of North Carolina*, at p. 2.

motive in AEP's own statement that the main focus of its commitment to join an RTO was to guard against a perceived use of transmission facilities to discriminate against competing power sellers. Exh. VCC-16 at p. 5. VSCC also contends that AEP's motivations to join an RTO reasonably could include a desire to comply with Virginia state law, which requires such action (albeit in a later time frame and subject to VSCC approval), and similar laws of other states. Because AEP claims already to have lowest cost dispatch, VSCC sees no evidence that AEP's commitment to join PJM was a voluntary one designed to obtain economic utilization of facilities and resources.

49. KPSC witness Buechel agreed with VSCC that AEP's commitment to join PJM was made to satisfy regulatory concerns about market power as a result of the merger with CSW. That the commitment was made a part of the conditions of the Commission's merger approval order raises an interesting question whether the commitment was in fact voluntary, Mr. Buechel argues.

50. The Joint Southern Commissions also contend that AEP's commitment to join PJM was made in order to obtain approval of AEP's merger with CSW, and required state approvals, rather than being made voluntarily. That a docket has been established here to consider overriding state laws and to force AEP into PJM demonstrates to these Commissions that AEP did not make a voluntary commitment within the meaning of Section 205(a).

51. Exelon's witness was Elizabeth Anne Moler, former Chair of the Federal Energy Regulatory Commission, former Deputy Secretary of the U.S. Department of Energy, and now Executive Vice President for Government and Environmental Affairs and Public Policy at Exelon Corporation. She responds, pointing out prior statements of the VSCC which accepted the voluntary nature of AEP's commitment, such as VSCC's initial brief in the AEP merger case, where the VSCC said:

The applicants' [AEP and CSW] decision to propose a merger was voluntary and their decision to accept any Commission decisions will be voluntary.<sup>22</sup>

52. Ms. Moler also points to VSCC witness Spinner's testimony in the instant proceeding, where he refers to AEP's voluntary commitment to join an RTO. Exh. VCC-19 at p. 28. She refers as well to the KPSC Order of July 17, 2003, where the agency stated:

While Kentucky Power argues that RTO membership was a condition imposed by FERC in approving the AEP-CSW merger, the record shows that AEP voluntarily

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<sup>22</sup> *Initial Brief of the VSCC State Corporation Commission*, Docket Nos. EC98-40-000, *et al.*, at pp. 1, 3. Exh. EXE-91.

agreed to such membership. It was this voluntary agreement that FERC then elevated to a merger condition.<sup>23</sup>

53. Ms. Moler argues that VSCC and KPSC are bound by their prior statements and have therefore conceded that AEP's decision to accept the merger condition was voluntary. Ms. Moler further testified that AEP voluntarily accepted the condition that it join a Commission-approved RTO after the Commission approved Order No. 2000, which contained requirements for RTOs, which included a market-based congestion management system. She concludes that AEP's willingness to join an Order No. 2000-compliant PJM, demonstrated by its voluntary application to join PJM in May, 2002, forecloses arguments that its commitment to join an RTO was anything but voluntary. Exh. EXE-7.

54. CMTC/PJMICC argues that it should be a non-issue that AEP's commitment to join PJM was voluntary, referring to AEP's voluntary acceptance of a condition of its merger approval that it join a fully functioning, Commission-approved RTO in its March 27, 2000 letter to the Commission, and the company's voluntary submission of an application to join PJM on May 28, 2002. Exhs. AEP-1 at p. 6, EXE-7. CMTC/PJMICC further points to the same prior statements of VSCC and KPSC noted by Ms. Moler, acknowledging that AEP's actions were voluntary. CMTC/PJMICC sees strong evidentiary support for a finding that AEP voluntarily agreed to accept the merger condition requiring RTO membership, voluntarily agreed to satisfy that condition by joining PJM, and is voluntarily agreeing to the coordination of AEP and PJM facilities. This view is shared by PJM, Staff, and EME.

## **2. Discussion and Conclusion**

55. First and foremost, there has been no statement from AEP that its commitment to join a Commission-approved RTO, made by its acceptance of the conditions imposed upon its merger approval, and by its actual application to join PJM, was anything but voluntary. Mr. Baker's testimony, objectively read, contains numerous favorable references to the benefits of membership in PJM for the company, its customers, and the regions identified in the Commission's November 25 Order. Exh. AEP-1 at pp. 22-26. Moreover, the company actually has signed an agreement and committed substantial funds to implement its membership in PJM. *Id.* at p. 10. And, it has recently confirmed that it has every intention of integrating its transmission facilities and functions into PJM. *AEP Post Hearing Brief* at p. 1. There is no evidence of coercion here. This is an entity that knows its rights and is fully capable of defending them. If it did not want to join an RTO, or believed the Commission was acting in excess of its authority, AEP knows how to pursue avenues to obtain relief. One can only conclude from the evidence presented on this record that AEP

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<sup>23</sup> *In re: Application of Kentucky Power Company d/b/a American Electric Power for Approval, to the Extent Necessary, to Transfer Functional Control of Transmission Facilities Located in Kentucky to PJM Interconnection, L.L.C., Pursuant to KRS 278.218, Case No. 2002-00475, at p. 13 (KPSC July 17, 2003).* Exh. EXE-14.

saw substantial benefits from membership in a Commission-approved RTO, found PJM to its liking after the Alliance initiative imploded, and signed on voluntarily.

56. Further, on this issue, VSCC, KPSC, and their state allies have searched the record for inferences from which they weave together an illusion of argument to support contentions that they themselves have previously denied. They have attempted to construct an argument that AEP has not made a voluntary commitment to join a Commission- approved RTO because AEP attempted to devise an alternative compromise approach that fell short of full and immediate integration into PJM. Rather than seeing this AEP effort as evidence of regulatory coercion or as revealing AEP's hidden motives, it is far more reasonable to view this as an attempt, albeit unsuccessful, to devise a means of avoiding jurisdictional conflict. Exh. AEP-1 at p. 28. Even under the AEP partial integration approach, eventual full integration was presumed, so that the end state of joining a Commission-approved RTO would be achieved.<sup>24</sup> Again, this is no indication that the company's original commitment was made involuntarily.

57. Equally unpersuasive is the similar argument that AEP's commitment to join an RTO was made reluctantly for the purpose of obtaining regulatory approval of its merger with CSW. Mr. Baker testified that AEP was working on ISO and RTO membership possibilities since the mid- 1990s. *Id.* at p. 4. In undertaking these studies, AEP may have seen the proverbial handwriting on the wall, but, if the regulatory decrees were adverse to its interests, AEP was free to decline the Commission's RTO membership merger condition and defend its position in the courts. There is no evidence to suggest that AEP was secretly opposed to RTO membership. Certainly, its actions to vigorously pursue such membership since obtaining approval of the merger belie such a contention. *Id.* at pp. 7-11. Neither does the fact that AEP apparently believes that it committed to something different in 2000 change the nature of its commitment. What is required to fulfill that commitment may be subject to debate, but there is nothing in this record that suggests the commitment to join a Commission-approved RTO was made involuntarily or with a hidden agenda to delay and oppose its implementation.

58. The argument of the Southern Commissions that the mere existence of this proceeding is evidence of the lack of a voluntary commitment by AEP is, to be charitable, unpersuasive. To re-cap, AEP has voluntarily agreed to join PJM. It has applied to the Commission for authorization to do so. It has committed millions of dollars to that effort, only to be frustrated, it claims, by state laws, rules and regulations. And the Southern Commissions want us to believe that the Federal proceeding inquiring into those state actions is proof that AEP's original commitment was not made voluntarily? I find that argument difficult to take seriously.

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<sup>24</sup> AEP did not propose a date certain for full integration in its partial integration proposal, but expected that would evolve from a dialogue with regulators. Tr. at p. 865.

59. Finally, there is Exelon's point that the prior statements of VSCC and KPSC recognized that AEP made a voluntary commitment to join PJM. The unexplained inconsistency between this view and the one these agencies now espouse is troubling. The agencies' prior statements confirm what the record here demonstrates, namely, that AEP's commitment to pursue membership in a Commission-approved RTO was voluntary. Exhs. EXE- 91; EXE- 14.

**C. Whether the coordination of AEP and PJM facilities and resources is “designed to obtain economic utilization of facilities and resources in any area” within the meaning of Section 205(a)?<sup>25</sup>**

**1. Positions of the Parties:**

60. VSCC contends that AEP's plan to join PJM is not designed to obtain economic utilization of facilities and resources unless it will result in greater or enhanced efficiency with respect to the management of transmission congestion and/or the generation of electricity and will yield cost savings. While VSCC witness Spinner agreed that AEP's joining PJM could obtain economical utilization of facilities or resources, VSCC argues it had not been established in the record that such “economical utilization” *would* in fact result. For instance, although Mr. Spinner states that “combining two optimally operated control areas using economic cost based central dispatch... could be more efficient than continued split operation[.]” he states that the modeling results presented by other witnesses that tout the economic benefits of the combination are flawed because “[t]hey assume, without any demonstration that it exists, a perfectly competitive market and that generation bids do not exceed marginal cost.” VCC-30 at p. 4. However, VSCC argues that bids can and do exceed marginal cost within PJM. Thus, VSCC argues that the witnesses who claim that economic utilization will result from AEP's joining PJM assume away market imperfections and the potential for generation to engage in strategic bidding. VSCC also asserts that studies by various experts were flawed because they did not encompass the entire Eastern Interconnection. Exh. VCC-19 at pp. 32-35 (discussing study prepared for Dominion by Charles River Associates and included in Dominion's application to join PJM). VSCC argues that the Commission's restriction of the question to only the Midwest and Mid-Atlantic areas “makes for electrical and economic non-sense.” Exh. VCC-19 at p. 35.

61. A second flaw in the economic analyses of witnesses who claimed that economic utilization will result from integration, according to VSCC, is that such analyses disregard the costs of the transaction. VSCC points out that the cost to AEP alone of its integration into PJM is approximately \$51 million per year. Exh. AEP-1 at p. 15. VSCC states that several witnesses conceded that their studies did not take into account the costs involved in achieving integration. The Joint Southern Commissions and the North Carolina Parties also

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<sup>25</sup> WUTC/NMAG support the arguments contained in the Post-hearing Brief of Arkansas, Louisiana, and Mississippi on this issue.

make this point. For example, they state that AEP witness Baker did not offset the benefits of increased system sales profits with potential congestion costs to wholesale customers, unhedged LMP congestion costs, or administrative costs. The Joint Southern Commissions argue that FERC recognized the importance of such cost-benefit studies in its *Order Providing Guidance on Continued Processing of RTO Filings*, 97 FERC ¶ 61,146, in which the Commission stated it would perform additional analyses to demonstrate to what extent RTOs will yield customer savings. Although VSCC concedes that the Commission in its April 1, 2003 Order conditionally approving AEP's application to join PJM stated that it "has never required companies to submit a cost-benefit analysis solely for the purpose of allowing them to join an RTO," 103 FERC ¶ 61,008 at P 41, the central issue in this case (*i.e.* whether AEP may be exempted from the laws of VSCC and Kentucky under Section 205(a) of PURPA) rests upon analysis of whether voluntary coordination here is "designed to achieve economic utilization of facilities and resources in any area." Thus, VSCC argues that one cannot reach a conclusion regarding the purported overall benefits of a transaction without taking into account the costs of that transaction.

62. Staff addressed VSCC's assertion that studies by various experts were flawed because they did not encompass the entire Eastern Interconnection. *See generally* Exh. VCC-19 at pp. 32-35 (discussing study prepared for Dominion by Charles River Associates and included in Dominion's application to join PJM). Staff asserts that under Section 205(a), the Midwest and Mid-Atlantic region comes within the plain meaning of the phrase, "in any area." Staff states that if the geographical focus under Section 205(a) of PURPA was in 1978 tight power pools, it can also be of a coordination arrangement such as that which will exist when AEP joins PJM. Cinergy, EME, and EPSA make the same point, arguing the Commission in its Hearing Order chose to examine economic utilization of facilities and resources in the Midwest and Mid-Atlantic region, which falls under the meaning of "in any area." Citing to the cost savings associated with various studies discussed below, Staff also argues that AEP's joining PJM is designed to obtain economic utilization of facilities and resources in any area.

63. AEP argues that its participation in PJM will provide net benefits to the company and its customers, in addition to other customers in the PJM/MISO region. This includes increased revenues from system sales that result principally from the Commission's elimination of out-and-through rates. Exh. AEP-1 at p. 25. AEP claims this will benefit AEP's ratepayers and shareholders. *Id.* at pp. 22, 23. Staff adds that in a Kentucky-specific cost-benefit study presented to the KPSC, AEP identified approximately \$333 million in increased system sales profits over a five year period, which reflects a 57% increase in system sales profits over the base case of AEP's study. *Id.* at p. 24; Tr. at p. 839. AEP argues that another potential benefit is the use of LMP to manage congestion in place of the TLR procedures currently in effect on AEP's system. *See* Exh. EXE-50 at p. 4; Exh. EXE-80 at p. 8.

64. PJM argues that the qualitative economic benefits of AEP joining PJM are uncontested. These include PJM's development of a single expansion plan for its entire

region; the coordination of facility outages; elimination of the seam between AEP and PJM through PJM's generation interconnection process providing a single regional process for the AEP-PJM region; PJM's single, region-wide demand response program; PJM's capacity commitment program that ensures all load serving entities commit sufficient regional capacity to serve all loads; access to competitive suppliers in a transparent market; PJM's use of LMP; and central dispatch of resources through the energy market. Exh. PJM-1 at pp. 10-17. PJM maintains that these coordination activities provide economical utilization of facilities and increase reliability.

65. PJM asserts that the Commission in Order No. 2000 has confirmed the economic benefits arising from these coordination efforts, stating that "a single entity must coordinate these actions to ensure a least cost outcome that maintains or improves existing reliability levels." *Regional Transmission Organizations*, Order No. 2000, 1996-2000 FERC Stats. & Regs., Regs. Preambles ¶ 31,089, at 31,164. PJM claims the Commission also found that PJM's generator interconnection procedures are consistent with or superior to the pro forma tariff; that PJM's demand response program puts downward pressure on price because it creates an incentive for suppliers to keep bids close to their marginal production costs; that PJM's rules on spinning reserve ancillary service creates a more efficient market because it sends appropriate price signals to market participants; and that PJM's oversight of transmission maintenance practices help ensure that transmission owners are unable to favor their affiliates. Finally, PJM points out that the Commission has favored the use of LMP over the TLR method of handling congestion, because TLR and other non-price based methods "make congestion management decisions on administrative grounds and are not reflective of the value that transmission users place on transmission service." *Midwest Indep. Transmission Sys. Operator, Inc.*, 102 FERC ¶ 61,196, at P 31 (2003). Moreover, PJM notes that the Commission found LMP encourages sellers to submit bids that reflect their marginal costs and that the sellers selected are likely to be the sellers with the lowest actual costs. *Cleco Power LLC*, 103 FERC ¶ 61,272 at P 67 (2003).

66. PJM also argues that the quantifiable benefits of joint economic dispatch are real. According to PJM witness Ott, Executive Director of the Market Services Division at PJM, if AEP, Dayton Power & Light Company ("DP&L"), and Commonwealth Edison Company ("ComEd") joined PJM, approximately \$300 million in annual net production cost savings would result, only \$70 million of which are attributable to ComEd's integration into PJM. Exh. PJM-2 at pp. 14, 20. PJM notes that these savings stem from various efficiency benefits obtained from operating the AEP and PJM regions as one, as noted above. AEP witness Baker also testified that integration would lead to a 57% increase in sales from AEP generators. Tr. at p. 839. PJM argues that the annual production cost savings far exceed the costs of obtaining these benefits. PJM notes that integration of AEP, DP&L, ComEd and Dominion into PJM will result in an incremental increase in annual PJM expenses (including depreciation and amortization) of \$95 million per year. Exh. PJM-1 at p. 21. PJM also estimates that its current bundled equivalent rate per MWh of \$0.54 for its administration of the RTO will decrease to \$0.43 after integration of the four transmission owners. *Id.*

67. PJM counters VSCC witness Spinner's assertion that the studies of production cost savings may be invalid because they assume a perfectly competitive market. *See generally* Exh. VCC-30 at p. 4. PJM states that it was not shown that the problems cited by Mr. Spinner would actually occur (*i.e.* PJM market participants could engage in "strategic bidding" by submitting bids into PJM's LMP market in excess of marginal cost), and Mr. Spinner conceded that PJM's bid-based central dispatch market would produce economical utilization of facilities and resources if the market is competitive. Tr. at p. 1020. PJM argues that its markets are competitive and limit the ability of generators to exercise market power in the marketplace as a whole. The Commission already determined that the PJM market is competitive when it allowed PJM to use bid-based pricing in its markets and established a PJM market monitor to ensure continued competitiveness of the market, according to PJM. *Atlantic City Elect. Co.*, 86 FERC ¶ 61,248 (1999); *PJM Interconnection, L.L.C.*, 86 FERC ¶ 61,247 (1999).

68. Exelon argues that the real issue is whether the coordination at issue is "designed" to obtain economical utilization, not whether the Commission's intent in imposing the merger condition was to obtain economical utilization. Exelon argues that the coordination at issue here, AEP joining PJM, is designed to make the facilities and resources in the region work more efficiently. Exelon argues that the States' claim that the proposed integration was not "designed" to economically utilize facilities and resources because the Commission imposed the RTO condition to mitigate market power considerations in the AEP-CSW merger case is flawed for two reasons. Exh. EXE-130 at p. 2. First, the merger condition partly stems from the Commission's objective to improve economic utilization of facilities and resources, as was a stated policy goal in Order No. 2000, Exelon argues. *Id.* Secondly, Exelon argues that when the Commission imposes conditions to a merger designed to mitigate market power, it is seeking to promote the economical utilization of facilities. *Id.* at pp. 2-3.

69. Exelon argues that facilities on the seam between AEP and PJM are underutilized in a way that can be cured only by fully integrating AEP into PJM. Exelon gives examples of situations that arise today without AEP's integration with PJM, such as its current use of inefficient TLRs. Exelon refers to testimony from Witnesses Naumann, Henderson, Schnitzer, Ott, and Tabors in support of its proposition that TLRs inhibit effective utilization of facilities and thwart wholesale competition, because curtailment is not based on the relative economic impact of the curtailments. Exelon lists the benefits of LMP as a superior means to manage congestion across the interface between AEP and PJM. Exelon argues that LMP allows the system operator to accommodate more transaction volume through the same constrained facilities at a lower cost.

70. Exelon contends that LMP also provides reliability advantages over TLRs, which take time to effectuate (*i.e.* 30 minutes or longer) and often do not provide the full relief required the first time. Exh. EXE-40 at p. 13. EME also makes similar arguments regarding the benefits of an LMP system. According to Exelon, LMP allows more transmission service requests to be granted. *Id.* at p. 16. Under AEP's current system, denials of service often

occur even if the transmission system would be constrained for only one hour of the interval requested. *Id.* at p. 15. AEP's limited obligation to redispatch generation (*i.e.* pursuant to requests for firm point-to-point service) is only applicable to the transmission provider on whose system transmission service is requested, according to Exelon. *Id.* Moreover, PJM is not required to redispatch to grant service on the AEP system so long as PJM is not the transmission provider. However, Exelon argues that if generation on both sides of a constraint were available for redispatch, fewer transactions would be denied. *Id.* at p. 16. Redispatch would only be required for those hours when the transmission is constrained, allowing the transaction to occur. *Id.* Exelon argues that although there are no requests for transmission service in PJM's system, under an LMP system that is operated on both sides of the constraint the result would be similar. Thus, using LMP dispatch would allow more transmission service requests to be granted, Exelon argues.

71. EME adds that the LMP methodology "provides a real-time picture of congestion that identifies the marginal cost of serving load and transparently displaying that cost at each node along the transmission system." *EME Post-hearing Brief* at p. 23; Exh. EME-1A at p. 15. EME argues that the LMP system creates financial incentives to find the most economic means to relieve congestion by determining the least-cost redispatch option or to otherwise alleviate load conditions. *EME Post-hearing Brief* at p. 17.

72. Exelon sums up the overall benefits of AEP's integration into PJM with reference to Witness Henderson's testimony. Dr. Henderson is the Vice-President at Charles River Associates, who was formerly Associate Director of the Office of Economic Policy at FERC. According to Dr. Henderson, under an LMP system the physical use of the system is not limited to those who have secured specific transmission rights in advance, allowing more efficient and full use of the real-time capacity of the transmission system. Exh. EXE-50 at p. 5. If transmission congestion occurs in real-time, PJM operators alter the dispatch of generators to relieve the overload at the lowest cost, rather than based on a non-economic prioritization of transactions. *Id.* at p. 6. Finally, by increasing geographic scope of control, Dr. Henderson contends that the proposed integration will give system operators more ways of cost-effectively resolving any transmission overload by using units that are well-positioned to ramp up or ramp down on the AEP and PJM systems. *Id.* EME adds that according to Dr. Henderson, PJM's ability to redispatch the most economically efficient generation to relieve congestion could yield annual savings of approximately \$5.7 million to \$7.7 million for six flowgates between AEP and PJM whose transmission capacity was regularly constrained. *Id.* at p. 25. In sum, Exelon and EME argue that LMP creates a financial incentive to use the most economic means to relieve congestion by sending price signals allowing consumers to choose whether or not they wish to incur these costs. Exh. EME-1 at pp. 16-17. Exelon also draws from testimony of Dr. Henderson, Mr. Schnitzer, Mr. Baker, Mr. Wodyka, and Ms. Fahey in support of its claim that there are several benefits to using LMP to manage congestion.

73. Exelon states that the studies performed by Mr. Ott for PJM and by Dr. Tabors for Cinergy quantify the substantial economic benefits to the enlarged PJM region, as discussed under PJM's and Cinergy's contentions. Exelon argues that the proposed integration will also result in reliability benefits to AEP's customers and customers in other parts of the Midwest and Mid-Atlantic region. Exh. AEP-1 at p. 22. For example, AEP witness Baker stated that integration will expand the generation resources available to customers, and consolidate transmission reliability functions that were formerly performed by several utilities and control areas. *Id.* at pp. 23, 27. Ms. Fahey also testified that AEP's integration into PJM will result in enhanced reliability through increased competition, improved planning, and broader access to real-time generation resources. Tr. at p. 589. Exelon states that a long-term benefit is that integration will create price signals for how new generators should choose where to locate in the AEP footprint for future location decisions. Exh. EXE-80 at p. 15.

74. Exelon argues that the Kentucky and VSCC Commissions (and their supporters) have failed to offer any empirical testimony showing that that AEP joining PJM is not designed to obtain economic utilization of facilities under Section 205(a). Exelon disputes Witness Spinner's testimony that challenges the studies on bid-based central dispatch (*i.e.* the studies of Witnesses Ott, Tabors, Henderson, and Baker) on the basis that they assume that the market is competitive, and fail to address that suppliers may exercise their market power to inflate their bids. *See, e.g.*, Exh. VCC-19 at p. 30; Exh. VCC-30 at p. 4; Tr. at p. 1015. PJM, Cinergy, and EME also challenge Witness Spinner's testimony on this point (Cinergy's arguments addressing this point are discussed in detail below). Exelon claims Mr. Spinner's arguments are baseless because the PJM market is workably competitive and will remain so after the proposed integration.

75. EME claims that PJM has market mitigation measures in place to protect against any generators' attempts to capitalize on its market power. For example, under PJM's Open Access Transmission Tariff ("OATT"), generators serving congested areas cannot bid more than 110% of their marginal costs, according to EME. Exelon states that "the PJM market rules are designed so that market participants have an incentive to bid resources at prices consistent with their marginal cost of operation, including both engineering and opportunity cost[.]" according to Dr. Henderson. Exh. EXE-120 at p. 1. Dr. Henderson further stated that the PJM merit order based on bids "comes very close to reflecting the same merit order stack that you would have if you stacked them by cost." Tr. at p. 169. Exelon lists several of Dr. Henderson's other assertions that address Mr. Spinner's market power concerns. Tr. at pp. 204-206, 208-210. Exelon states that the record demonstrates that the two percent distortion in market prices postulated by Mr. Spinner would reduce the economic efficiencies by only 0.02 percent. Tr. at p. 182.

76. Exelon and EPSA argue that the Commission made clear that no specific cost-benefit study is required before an entity such as AEP can join an RTO. *American Elec. Power Serv. Corp.*, 103 FERC ¶ 61,008 at P 41 & n.39 (2003). EME also argues that a cost-benefit

analysis is not required under Section 205(a), and the only evidentiary requirement on the Commission is to conduct a public hearing before issuing any order under Section 205(a). If any party felt aggrieved by FERC's order, it may exercise the right for review under the FPA on the basis that the order was not supported by substantial evidence. *See* Exh. EXE-100 at p. 6.

77. Nonetheless, according to Exelon the analyses presented by Mr. Ott's and Dr. Tabors' studies represent savings that clearly outweigh the administrative costs of joining PJM. Moreover, despite their contentions regarding a margin of error, Exelon argues that the State Commissions never challenged the underlying assumptions and conclusions of the studies, and were unable to demonstrate that the benefits were overstated. Tr. at pp. 172, 563-564, 1060. Cinergy also makes similar arguments. Finally, Exelon argues that these benefits could not be realized simply with the Commission's elimination of through-and-out rates, but could only be remedied through full integration of AEP into PJM. Tr. at p. 1074.

78. Exelon argues that AEP's current arrangement does not already constitute economic dispatch across the Midwest and Mid-Atlantic areas, in part because the seam between AEP and PJM is underutilized. Exh. EXE-80 at p. 2. Cinergy and MISO make the same point, adding that AEP's membership in PJM will be an improvement over the *status quo*. As to allegations that the proposed integration will make some entities worse off, Exelon argues that neither Mr. Spinner nor Mr. Brown offered any probative evidence to support this claim. Cinergy also disputes Mr. Spinner's concerns about the ability of the generation sector to suffer "bottom line" revenue losses if consumer savings did come to fruition, stating that Mr. Spinner offers no evidence in support of his assertion. Exelon argues that "[i]t would make little sense to impose a no-loser requirement on short-run benefits given that the larger benefits that are likely to occur in the longer term will have widespread benefits." *Exelon Post-hearing Brief* at p. 38.

79. Cinergy argues that integration will achieve Congress's objective of encouraging coordination of electric utilities designed to result in economical utilization of facilities and resources. Cinergy disputes VSCC witnesses Walker's and Spinner's assertions that AEP's integration into PJM is not "designed" to obtain economic utilization of facilities and resources because the intent in integrating AEP with PJM may have been to fulfill AEP's merger commitment or to comply with the requirements of Virginia law. *See, e.g.* Exh. VCC-1 at pp. 28-29. Cinergy claims that AEP's subjective intent in proposing coordination is irrelevant, because the statute simply states that coordination be "designed" to achieve efficiencies, and does not refer to matters of subjective intent regarding coordination. Exh. EXE-130 at p. 2. Furthermore, Cinergy claims that even if AEP's subjective intent was relevant, VSCC has not shown that AEP's desire to achieve the merger was its only objective in proposing to join PJM.

80. Cinergy argues that the evidence in this case, including testimony of ten witnesses, shows that integration will result in the economical utilization of facilities and resources.

Cinergy states that even Mr. Spinner concedes that integration will result in economical utilization of facilities if the market is sufficiently robust that it is effectively competitive, and Cinergy argues that PJM is a sufficiently competitive market. Cinergy points out that Witnesses Tabors, Ott, Henderson, and Baker all offer empirical analyses showing that integration will result in significant benefits, and that no witness testified that integration will not obtain such a result. EME and EPSA take similar positions.

81. Cinergy offered the testimony of Dr. Richard Tabors, president of an electric power systems consulting firm, who is on leave as a Senior Lecturer at the MIT School of Engineering's Technology and Policy Program. Dr. Tabors has extensive experience and knowledge about the restructuring of wholesale electric markets and the development of LMP Congestion Management. Cinergy states that Dr. Tabors conducted two separate empirical analyses using GE MAPS computer modeling, which simulates unit commitment and dispatch to predict wholesale prices. Exh. CIN-1 at pp. 3-4. Dr. Tabors conducted a Unit Commitment Analysis where he studied one scenario in which AEP is not fully integrated into PJM, and one in which it is. He found that for the East Central Area Reliability Council ("ECAR") and PJM areas, the integrated scenario would result in \$149 million in reduced wholesale power costs to load in 2005, and that the benefits would rise to \$214 million in 2005 taking into account the full region, including New York, New England, Ontario, New Brunswick, and the VSCC-Carolinas Area Reliability Council ("VACAR"). *Id.* at p. 6. In his Price Distortion Analysis, Dr. Tabors focused on benefits resulting from increased coordination in the operation of the transmission systems of PJM and AEP. *Id.* at pp. 6-7. This analysis takes into account market inefficiencies that can arise when there is reduced information flow between an RTO and a transmission owner. *Id.* Cinergy points out that Dr. Tabors found the lack of comprehensive sharing of congestion information results in a potential average-load weighted LMP price distortion. The impact on load in the expanded PJM region would range from \$66 million to \$235 million in 2005. *Id.* at p. 9.

82. Cinergy disputes in detail arguments that were made by AEP, VSCC, and the Muni-Coop Coalition in an effort to cast doubt on aspects of Dr. Tabors' analysis. Cinergy claims that VSCC witness Spinner did not understand Dr. Tabors' Unit Commitment Analysis when he testified that the analysis used a "base case" that did account for the exercise of market power and a "change case" that did not account for the exercise of market power. Tr. at pp. 1037-1038. According to Cinergy, Dr. Tabors used the same marginal cost bidding assumption in both his "base case" and "change case" analyses. Exh. CIN-1 at p. 16. Cinergy states that all assumptions and physical conditions were held constant with the output difference "reflecting only the change in PJM footprint leading to the scope of regional unit commitment and dispatch procedures within the system." *Id.* Moreover, Cinergy argues that if the assumptions in the "base case" were altered to address bidding above marginal cost, the same changes would have been made in the "change case," "with very little impact on the actual savings being measured." Exh. CIN-1 at p. 16, Tr. at pp. 1066-1067.

83. Cinergy maintains that Mr. Spinner's market power concerns do not reflect real-world operating conditions in PJM. Cinergy refers to PJM witness Ott's testimony that significant incentives exist in PJM for market participants to submit offers based on their variable operating costs. *See* Exh. PJM-6 at p. 7. EME adds that Mr. Spinner's comparison of the costs to consumers under a bid-based system and a cost-based system ignores the practical realities of the PJM market and the history regarding PJM's implementation of an LMP-based market structure. EME argues that competition ensures that bid prices approach marginal costs, and Ms. Fahey testified that bid prices exceed marginal costs, on average, by only two percent. Tr. at pp. 576-577. The resulting increase in production cost would be only 2/100 of one percent on average, according to Dr. Henderson. Exh. PJM-6 at p. 8; Tr. at p. 182. Furthermore, Cinergy maintains that market power will not be exercised unless there is a failure of regulatory oversight. Tr. at pp. 197-198.

84. CMTC/PJMICC argue that in the context of Order No. 2000, in which RTO participation was designed to produce economical utilization under a transmission pricing system promoting efficient use and expansion of transmission and generation facilities, AEP's voluntary commitment to join a fully functioning, Commission-approved RTO is designed to achieve economical utilization of facilities and resources. Exh. EXE-1 at p. 4. CMTC/PJMICC offered the testimony of Paul R. Williams, Director of Energy Management at MG Industries, a manufacturer and distributor of industrial, medical and specialty gases, and Larry Stalica, Manager of Energy and Regulatory Affairs for BOC Gases and BOC Energy Services, Inc., a worldwide company dealing in industrial cases, vacuum technologies, and distribution services. Although CMTC/PJMICC caution against undue reliance on cost-benefit studies alone (*i.e.* because they fail to account for non-quantifiable benefits), CMTC/PJMICC assert that all analyses presented in this proceeding demonstrate that AEP's integration into PJM is designed to produce, and very likely will produce, more economical utilization of facilities and resources than exists in the *status quo*. The Joint Midwest and Mid-Atlantic Commissions make similar arguments.

85. CMTC/PJMICC and the Joint Midwest and Mid-Atlantic Commissions rely on the results of several studies conducted by AEP witness Baker, Cinergy witness Tabors, PJM witness Ott, and Exelon witness Henderson. The AEP study projected approximately \$333 million in increased off-system sales profits for the AEP east zone operating companies over a five year period, in addition to benefits derived from increased reliability, and the elimination of through-and-out transmission rates in the PJM-MISO region. Exh. AEP-1 at pp. 24-25. The Tabors study projects that more efficient unit commitment and improved real-time dispatch will result in incremental economic gains available to customers totaling at least \$214 million for 2005 in the portion of the Eastern Interconnection analyzed under the study. Exh. CIN-1 at pp. 6, 25. Other benefits identified in the Tabors study include ancillary services coordination, reliability benefits, and an LMP system that will reflect the financial consequences of transmission constraints not provided for under the current TLR approach. *Id.* at p. 6. According to the Ott study which applies a less conservative approach than the Tabors study, the combined region including integration of AEP, DP&L, ComEd,

and PJM will realize approximately \$300 million in annual net production cost savings. Exh. PJM-2 at p. 14.

86. Finally, CMTC/PJMICC and the Joint Midwest and Mid-Atlantic Commissions state that the Exelon study revealed benefits associated with replacing the inefficient TLR system with PJM's market-based congestion management system. Exh. EXE-50 at pp. 2-3, 7; EXE-40 at p. 11; *see also* PJM-1 at p. 10. They claim that TLRs are flawed because they curtail transactions solely on the basis of physical attributes (*i.e.* the impact they have on constrained flowgate) without consideration for what the most economic redispatch would be. *See* EXE-40 at pp. 11-12. CMTC/PJMICC state that under TLR protocols, market participants cannot "buy through" congestion by paying a transmission provider to redispatch generation that would provide the required congestion relief, even if doing so may accommodate higher valued transactions. Exh. EXE-50 at p. 5. The Exelon study concluded that joint redispatch could provide a substantially larger amount of total relief (because the available supply of redispatch is substantially larger under joint dispatch), and could provide a given quantity of relief at a substantially lower cost. *Id.* at p. 19. Thus, they argue that these studies illustrate that integration of AEP into PJM will produce considerable quantifiable benefits that will accrue to customers in the Midwest and Mid-Atlantic region. CMTC/PJMICC and EME refer to the "firsthand experiences" of MG Industries and BOC Gases and BOC Energy Services, whose witnesses stated that integration is expected to result in lower and more stable wholesale energy prices and more reliable electric service. Exh. IND-1 at pp. 1-2, 6-7; Exh. IND-2 at p. 8.

87. EME and EPSA also argue that the integration of AEP into PJM will lead to economical utilization of facilities and resources. EME sponsored the testimony of Reem J. Fahey, who is Region Vice-President of Market Policy for Edison Mission Energy. Ms. Fahey testified that AEP's membership in PJM will increase economical utilization of the generation and transmission resources in the region through improved market operations and transmission reliability. Exh. EME-1A at p. 10. EME also refers to Mr. Schnitzer's and Mr. Spinner's testimony that "economical utilization" means an improvement over the *status quo*. Exh. EXE-80 at p. 2; Tr. at p. 1024 (Spinner). Here, that will be achieved through the addition of over 24,000 MW of generation capacity to PJM and becoming subject to PJM's centralized dispatch (EME adds that PJM offers the incentives needed to encourage new investment). Exh. EME-1A at pp. 10, 23. The improvements in centralized dispatch are also likely to be experienced within the AEP region because all generation (both AEP's own generation and generation which is not owned or under contract to AEP) will become subject to PJM's least-cost security-constrained dispatch system, according to EME. EME refers to benefits to integration that were shown in studies conducted by Cinergy and PJM, and argues that the benefits vastly exceed the expected costs. According to EME, after the one-time charges are paid, the ongoing annual administrative costs will be dwarfed by the \$300 million of annual savings.

88. PSEG argues that integrating AEP into PJM would result in more efficient dispatch of non-AEP generation within its control area, and would more efficiently utilize the transmission ties between PJM and AEP. PSEG refers to the testimony Mr. Sorenson, Managing Director of Energy Operations at PSEG, who stated, “the availability of a spot market in the PJM design allows all generation to participate on an equal footing” and would produce a more efficient dispatch of non-AEP units. Exh. PS-1 at pp. 6-7. PSEG elaborates on its own experience in marketing the output of its Lawrenceburg and Waterford units. According to Mr. Sorenson, PSEG encountered problems in marketing output from its Lawrenceburg unit on December 27, 2003, notwithstanding its willingness to sell that output at a price discounted below the cost of production of AEP’s own generating plants on that date. Exh. PS-1 at pp. 8-10, 14. AEP had the operational ability to accept the output of the Lawrenceburg plant, and would have realized savings on a purchase but had failed to modify its dispatch to accommodate the Lawrenceburg production. Exh. PS-2 at pp. 7-8. If AEP had been part of PJM, PSEG argues that the Lawrenceburg unit could have been dispatched more efficiently, allowing that unit to displace more expensive AEP-owned generation or other more expensive generation. PSEG also claims that if AEP was a member of PJM on June 4, 2003, PSEG’s Waterford unit could have been dispatched more efficiently. Exh. PS-2 at p. 9.

89. Finally, AEP, PJM, Exelon, CMTCC/PJMICC, MISO, and PUC Ohio argue that there are numerous benefits that are not easily quantifiable, such as enhanced reliability and removing any perceptions that AEP could use its transmission facilities to hamper competition. Although many of these benefits were not quantified, they maintain that there was no requirement to quantify them, and nonetheless it was uncontested that these economic and reliability benefits would exist. MISO adds that integration will result in savings for customers, due to incorporation of LMP and more efficient unit commitment and dispatch, more accurate calculation of ATC, and internalization of loop flows. Exh. MIS-1 at p. 5. MISO argues that reliability of transmission service in the Midwest and Mid-Atlantic markets will improve due to improved availability of information, and centralization of the coordination of transmission operations and planning. Exh. EME-1A at p. 25.

90. Muni-Coop argues that proponents of integration ignore the potential impact of PJM’s LMP pricing methods on AEP-area customers, failing to meet the economical utilization standard under PURPA Section 205(a). According to Muni-Coop, under LMP customers are charged directly for the costs of redispatch that may be occasioned by the presence of binding transmission constraints, which may be extremely large depending on whether a customer is located on a portion of the network that suffers frequently from constraints and whether the sources of energy deliverable to that customer are relatively high-cost. Exh. MCC-1 at p. 8. Citing to *Municipal Resale Serv. Customers v. FERC*, 43 F.3d 1046, 1054 (6<sup>th</sup> Cir. 1995), Muni-Coop argues that the requirement that jurisdictional rates and services be just, reasonable, and not unduly discriminatory is a pertinent consideration in applying PURPA Section 205(a).

91. According to Muni-Coop the impacts that AEP's full integration may have on AEP-area customers are not known and the economic burdens on AEP-area customers must be considered. Exh. MCC-1 at pp. 17-18. Muni-Coop states that the Financial Transmission Rights ("FTRs") described by PJM witness Wodyka as a consumer hedging mechanism against LMP-based congestion charges are insufficient to protect consumers. Exh. MCC-1 at p. 11; Tr. at pp. 545, 548. Muni-Coop also claims that PJM's mitigation measures, as propounded by Exelon witness Henderson, are insufficient.

92. According to Muni-Coop witness Brown, the application of LMP in PJM could have extremely burdensome impacts on customers located on constrained portions of a utility's transmission system. Exh. MCC-1 at p. 8. Muni-Coop describes the constraints and associated congestion costs experienced in PJM's portion of the Delmarva Peninsula after the implementation of LMP. See Exh. MCC-2 and Exh. MCC-3. In that situation, congestion occurred during 6,762 hours (25% of the hours in the study period), with cumulative cost to consumers exceeding \$102 million, according to Muni-Coop. MCC-2 at p. 1; MCC-3 at p. 1. Muni-Coop points out that the proponents of integration undertook no analysis of the impacts that PJM pricing methods will have on AEP-area customers after full integration. Exh. MCC-1 at pp. 13-15. Muni-Coop states that Mr. Brown has shown there is a possibility that the impact on consumers could be great, and on this basis Muni-Coop argues for adoption of its staged implementation proposal, as described in greater detail under Issue No. 1(D).

93. Muni-Coop concludes that if it correctly asserts that the impact of integration on customers is a relevant consideration in this case, then the record should be reopened to receive sufficient evidence regarding customer impacts. Alternatively, the Commission could find that the economical utilization standard has been met, but condition its finding on steps being taken to mitigate any unduly burdensome customer impacts that are identified through further pre-integration analysis. Muni-Coop supports the second proposal, and illustrates Mr. Brown's three-step approach to identifying customer impacts before LMP is implemented in the AEP area. Exh. MCC-1 at pp. 18-21.

94. EME refutes Muni-Coop witness Brown's contentions that the Commission should postpone any effort to fully integrate AEP into PJM until further analysis is performed. EME contends that this would create an insurmountable barrier to taking action under Section 205(a), and would delay the overall benefits to society that are presented under the proposed integration. EME also contends that Muni-Coop's assertions regarding the experience of the Delmarva Peninsula are misguided, as that was a temporary situation while PJM was implementing long-term relief to the transmission constraint. See *Transmission Congestion on the Delmarva Peninsula*, 105 FERC ¶ 63,004 at P 137 (2003). EME claims that the Delmarva experience demonstrated that LMP can reveal longstanding constraints that create higher costs for all and lead to implementation of cost effective long-term solutions. EME also argues that FTRs and auction revenue rights are adequate hedging methods to protect load-serving entities from price spikes that would occur due to transmission constraints. EME refers to witness Ott's testimony that the annual credit percentage received by FTR

holders has ranged from 90.4% to 100%, and he estimates that FTRs will be 95% to 98% funded once AEP is integrated. Tr. at pp. 549-550.

## 2. Discussion and Conclusion

95. The evidence of record strongly supports the conclusion that integration of AEP into PJM is designed to obtain economic utilization of facilities and resources in the Midwest and Mid-Atlantic regions. As the discussion below will demonstrate, there are numerous benefits to the proposed integration. Many are quantified, such as annual production cost savings and increased system sales profits, which are reflected in the testimony of Dr. Tabors, Mr. Ott, Dr. Henderson, Mr. Schnitzer, and Mr. Baker. There are also many benefits that are not easily quantified, such as improved system reliability, reduced capacity reserve requirements, and incentives for the construction and proper location of new investment. In all, there is in this record an impressive array of consistent expert testimony as to the benefits of the planned integration of AEP into PJM, all of which support the finding that the integration of AEP into PJM is designed to obtain economic utilization of facilities and resources.

96. Parties arguing that this question should be answered in the negative focused primarily on claims that the costs of the implementation were not being considered adequately in assessing the overall benefits of the integration, or that the savings suggested by the proponents were overstated for various reasons. Although a cost-benefit analysis is technically not required in this case, I find that the costs of the proposed integration must be considered and evaluated to determine whether the proposed coordination is designed to obtain economic utilization of facilities within the meaning of Section 205(a). The evidence in this record, which is sufficient to permit such a determination, demonstrates that the quantified benefits substantially outweigh the identified costs of implementing the integration.

97. Some parties also were wary of the switch from TLR to LMP-based congestion management, fearing that strategic bidding or transmission constraints might lead to higher costs and a dysfunctional marketplace. Here, the evidence also leads to the conclusion that these fears are unwarranted. There is every reason to believe that LMP-based congestion management, as implemented by PJM, will be superior economically and in virtually every other way to the existing TLR regime. We turn now to examine these issues in more detail.

98. In their testimony, Dr. Tabors, Mr. Ott, Dr. Henderson, Mr. Schnitzer, and Mr. Baker all demonstrate that the quantifiable benefits to the proposed integration are quite substantial.<sup>26</sup> In a cost-benefit analysis filed with the KPSC, AEP identified approximately

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<sup>26</sup> While VSCC sought to portray these studies as unreliable in part because of a range of error, where an error range was identified (plus or minus 10%), I find that it is not material, considering the scope of estimated benefits (*e.g.* between \$270 - \$300 million, annually, according to Mr. Ott). VSCC also asserts that studies by various

\$333 million over a five-year period in increased system sales profits available to the AEP east zone operating companies if AEP joins PJM. Exh. AEP-1 at p. 24. This reflects a 57% increase in system sales profits over the base case of AEP's study. Tr. at p. 839. Dr. Tabors concluded that the proposed integration would result in \$149 million in reduced wholesale power costs to load in the year 2005 alone for the ECAR and PJM areas. Exh. CIN-1 at pp. 5, 6. Taking into account the full region, including New York, New England, PJM, Ontario, New Brunswick, ECAR and VACAR, Dr. Tabors estimated \$214 million in cost savings.<sup>27</sup> *Id.* at pp. 6, 13. Indeed, the record reveals that Dr. Tabors' study was conservative. His Unit Commitment Analysis assumed that real-time dispatch across the region is currently utilized, and Dr. Tabors did not include benefits from the elimination of through-and-out-rates.<sup>28</sup> Exh. CIN-1 at pp. 13, 17-18; Tr. at p. 836 (Baker).

99. Mr. Ott found that, compared to the base case of no integration, PJM would realize annual production cost savings of \$300 million if AEP, DP&L, and ComEd join PJM.<sup>29</sup> Exh.

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experts were flawed because they did not encompass the entire Eastern Interconnection. Exh. VCC-19 at p. 32-35. VSCC argues that the Commission's restriction of the question to only the Midwest and Mid-Atlantic areas "makes for electrical and economic non-sense." Exh. VCC-19 at p. 35. However, under Section 205(a), the Midwest and Mid-Atlantic region comes within the plain meaning of the phrase, "in any area." Thus, this argument is rejected for the same reasons discussed under other matters of statutory construction in Issue No. 1(A).

I conclude that the reliability of these studies was not seriously impugned on this record (see also the discussion of VSCC's and AEP's criticism of Dr. Tabors' study, below) and that they can be reliably employed for the purposes of determining the economic implications of the proposed transaction.

<sup>27</sup> In his Price Distortion Analysis, Dr. Tabors also found that the lack of congestion information exchange results in a potential average-load-weighted LMP price distortion that could impact load in the integrated PJM region ranging from \$66 million to \$235 million. Exh. CIN-1 at pp. 23, 28.

<sup>28</sup> The VSCC's criticism of Dr. Tabors' study reflected a misunderstanding of the methodology that he employed, a fact that also was evident from AEP's criticism of the Tabors study. The VSCC attempted to show that Dr. Tabors' base case and change case improperly dealt with the exercise of market power, without realizing that assumptions would need to be changed in both cases to address bidding above marginal cost, leaving essentially the same conclusion. Tr. at pp. 1066-1067. AEP witness Baker's criticism of Dr. Tabors' testimony at Exh. AEP-3 at pp. 11-14 that Dr. Tabors may have overstated benefits was refuted on cross-examination by Cinergy. Tr. at pp. 833-34.

<sup>29</sup> Mr. Ott testified that the production cost savings figures are not net of costs, as

PJM-2 at p. 14. Because \$70 million in savings are attributed to ComEd, production costs will be approximately \$230 million less with the integration of AEP and DP&L. Exh. EXE-120 at pp. 2-3. The bulk of that amount is attributable to AEP's integration into PJM.<sup>30</sup> *Id.* at p. 3. Mr. Ott estimated that the 10-year production cost savings would be approximately \$3 billion. Exh. PJM-2 at p. 19. These studies offer strong support for finding that the proposed integration is designed to obtain economic utilization of facilities and resources.

100. Several parties correctly state that a cost-benefit analysis is not required under Section 205(a), and that the only evidentiary requirement on the Commission is to conduct a public hearing before issuing any order under Section 205(a). They reasoned that, if any party felt aggrieved by FERC's order, it may exercise the right for review under the FPA on the basis that the order was not supported by substantial evidence. *See* Exh. EXE-100 at p. 6. However, the parties that argue that consideration of costs is a necessary component of the economic utilization determination under Section 205(a), are in my judgment, correct. I find and conclude that consideration of the costs that are to be incurred in implementation and operation of the expanded PJM footprint that will result from the planned integration is a relevant and necessary element of a determination whether the planned coordination is designed to obtain economic utilization of facilities and resources for purposes of PURPA Section 205(a).

101. I find and conclude that the record established here as to the costs and benefits of the transaction is sufficient for the purpose of considering both sides of the cost-benefit equation and that a further study is not required. As discussed above and below, the record contains a wealth of information on the costs and benefits of the planned integration, including reliable cost projections, so that it is not necessary to perform a technical cost-benefit analysis, as that term is commonly understood. Nor is such a study required for the purposes of Section 205(a). The key point is that costs must be considered, not that a particular type of analysis must be performed. I find there is sufficient evidence on record to support a meaningful evaluation of whether the planned coordination is designed to obtain economic utilization of facilities and resources.

102. PJM estimates that it will incur a one-time expense of approximately \$63 million in capitalized project costs to integrate AEP, ComEd, DP&L, and Dominion. Exh. PJM-1 at p. 20; Tr. at p. 489. These costs will be borne by all PJM members, and will be depreciated over the useful lives of the assets, which is projected to be three years. Exh. PJM-1 at p. 21.

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he did not factor the costs of implementation into his calculations. Tr. at p. 561.

<sup>30</sup> Mr. Ott's study measured the reduction in the costs of operating generation to serve load and to supply reserves. Exh. PJM-6 at p. 2. Dr. Tabors' study differed in that it measured the benefits in terms of load-weighted average cost of energy delivered on an hour-by-hour basis to each load bus in the study area. *Id.* at pp. 2-3.

PJM expects that membership of the four companies will result in an increase in annual incremental expenses for staff, leased facilities, etc., which would be approximately \$95 million for 2005. *Id.* AEP's share of PJM's annual administrative costs is estimated at approximately \$51 million. Exh. AEP-1 at p. 15. However, one year of depreciation is included in the calculation of total annual costs, such that the \$95 million figure will decrease by approximately one third after capitalized project costs are fully depreciated at the end of year three. Tr. at p. 533 (Wodyka). Moreover, according to Mr. Wodyka, PJM's unit cost of providing its services will decrease as a result of the integration of AEP, ComEd, DP&L and Dominion. Exh. PJM-1 at p. 21. PJM estimates that its current bundled equivalent rate of \$0.54 per MWh will decrease to \$0.43 MWh after the integration of these four companies. *Id.*

103. When the \$95 million in annual incremental expenses are offset against the projected savings under each study (\$214 million in 2005 under Dr. Tabors' analysis and \$230 million in annual production cost savings under Mr. Ott's study) and increased system sales profits (\$333 million over a five-year period), the proposed integration would result in a net efficiency gain under every scenario. Moreover, the \$95 million figure will be reduced by approximately one third after the one-time capitalized project costs are fully depreciated. Consequently, the record shows beyond a preponderance of the evidence that the quantifiable benefits to integration far outweigh the costs of implementation.

104. The analysis does not end there, of course, because there are nonquantifiable benefits to integration that are also substantial and offer further support for the proposition that the proposed integration is designed to capture economies and efficiencies. AEP's membership in PJM will offer access to a highly liquid market supported by 150,000 MW of generation. Exh. AEP-1 at p. 23. The consolidation of transmission functions will facilitate coordination and improve communication in the operation of the regional market. *Id.* RTO participation will result in enhanced reliability through broader access to real-time generation resources, and improved planning for regional transmission and regional resource adequacy. Exh. EXE-120 at p. 4. RTO participation will also result in increased wholesale and retail competition. In addition, if AEP joins PJM, interconnecting generators in its service territory will be subject to PJM's interconnection funding policies, which create incentives for new investment and send economic signals helping generation developers choose where to site new generation. Exh. EXE-80 at pp. 15-16; Exh. PJM-1 at p. 13; Exh. EME-1A at p. 23. Finally, and very significantly, the integration of AEP into PJM would also allow PJM's reliability criteria to be satisfied with a lower percentage reserve requirement. Exh. PJM-1 at p. 15. According to Witness Wodyka, when AEP and the other new transmission owners join PJM, the capacity reserve requirement can be reduced by one percent as a result of improved load and resource diversity. *Id.* This represents one percent of the RTO's total load, or almost 1,300 MW of capacity, which is a significant savings. *Id.* All of these advantages over the long term will serve to foster wholesale competition and will ultimately benefit consumers through lower generation costs in the region. Exh. EME-1A at p. 20. This

testimony has not been persuasively challenged on this record. The unquantified benefits alone would represent a sufficient basis upon which to conclude that the transaction planned here is designed to obtain economic utilization of facilities and resources.

105. Another source of benefits from integration is attributed to the move from AEP's current TLR method of managing congestion to PJM's LMP system. Several witnesses testified persuasively that LMP is a more efficient method for managing transmission congestion than TLR. The TLR method is used by a Reliability Coordinator to relieve congestion by changing the output level of generation when a transmission facility is either loaded in excess of its rating, or would be loaded in excess of its rating in the event of a contingency. Exh. EXE-40 at pp. 4-5. The amount of relief needed is determined according to which schedules are affecting the transmission facility in question. *Id.* at p. 5. Those schedules are curtailed in an order of priority based on firmness and duration of the service under the OATT. *Id.* Thus, two schedules having the same firmness and duration and the same MW impact on the flowgate would have their flows reduced by the same amount. *Id.* However, several witnesses persuasively argued that "[t]he TLR process, while non-discriminatory, is blind to economics." *Id.* at p. 6.

106. TLRs are based on the physical effect of generators on the transmission constraint, without taking into account what would be the most economic redispatch. *Id.* at pp. 11-12. When a transaction is curtailed under TLR, market participants who control generation must change the output of their generation in response to the TLR. Those market participants who are contracted to serve load must either shed load (if there is no other generation deliverable to serve their load) or find other sources of generation to serve their load. *Id.* at pp. 6-7. Rather than shed load, more expensive generation dispatch is often used to serve load. *Id.* at p. 7. Furthermore, TLRs determine the impact of a transaction on flowgates by averaging the effect of many generators within the control area. *Id.* 12. Under LMP, only those entities causing congestion pay the costs imposed by the congestion. Exh. PJM-1 at p. 9. The LMP method places an economic value on the use of constrained transmission facilities. *Id.* at pp. 7-8. Thus, "the 'cost causer' can make an economic decision whether it wishes to incur those costs, as opposed to having such costs socialized among all users of the grid." *Id.* at p. 9.

107. The record evidence reveals a multitude of other advantages of the LMP system. For example, under PJM's LMP system, there is no denial of transmission service for services within PJM. Exh. EXE-80 at p. 8. All schedules are accepted and charged for congestion based on LMP. *Id.* However, under NERC standards, TLRs mandate curtailment of any transaction that results in more than a 5 percent effect on a flowgate.<sup>31</sup> Exh. PJM-1 at p. 8. As a consequence, TLRs can curtail numerous transactions that exceed the amount of flow

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<sup>31</sup> Transactions having less than a 5 percent effect on a flowgate continue to flow, which allows market participants to arrange transactions in such a way to avoid TLRs. Exh. EXE-40 at p. 13-14.

reduction actually required. *Id.* This results in underutilization of available transmission capability, because TLRs curtail economic transactions that, under the LMP system, would be allowed to flow. Exh. AEP-1 at p. 24. Thus, the LMP system can accommodate more transaction volume through the same constrained facilities at a lower cost.<sup>32</sup>

108. The expert witness testimony in this record also established that there are reliability advantages to the LMP system. According to Witness Naumann, because the PJM system occurs in real time with generators responding to price signals, transmission elements that are controlled with redispatch do not become overloaded in the first place. Exh. EXE-40 at p. 13. TLRs, however, occur after transmission facilities are already overloaded or would be overloaded if a contingency occurs. *Id.* Moreover, TLR's can take 30 minutes or longer to effectuate, and often do not provide the full amount of relief required the first time, causing further delays in bringing the transmission system back within its ratings. *Id.*

109. Finally, because the geographic scope of control is increased in an integrated AEP/PJM, a system operator has more flexibility in utilizing units that are best suited to change the output of their generation. Dr. Henderson points out that many of the key transmission constraints in the AEP/PJM area are positioned such that most of the units that are well positioned to ramp down are in AEP's control area, but most of the units that are well positioned to ramp up are in PJM's control area. Exh. EXE-50 at p. 6; Exh. EXE-40 at pp. 14-15. Thus, the most economic and efficient means of resolving transmission constraints could be achieved under an LMP system by coordinating between units on the AEP and PJM systems. Exh. EXE-50 at p. 6.

110. There are no TLRs on transactions internal to PJM, and PJM does not have the authority to use its LMP congestion-management system for the AEP-PJM interface unless AEP joins PJM. Exh. EXE-40 at pp. 8, 10. AEP currently manages external power flows using a combination of OASIS procedures and TLR calls. Exh. EXE-50 at p. 3. A party must obtain transmission service from AEP by making a request through OASIS, and AEP's Service Administrator, Southwest Power Pool ("SPP") determines whether a request may be accommodated. *Id.* However, if a flowgate becomes overloaded, TLR protocols are used to curtail the transmission obtained through the OASIS system to provide the needed relief. *Id.*

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<sup>32</sup> PSEG describes its own experiences in which it was unable to market output from its plants due to a TLR that curtailed two PSEG units, notwithstanding its willingness to sell that output at a price discounted below the cost of production of AEP's own generating plants on that date. Exh. PS-1 at pp. 8-10. PSEG claims that AEP had the operational ability to accept the output and would have realized savings on a purchase but failed to modify its dispatch to accommodate the production. Exh. PS-2 at pp. 7-8. If AEP was a member of PJM, PSEG argues that its units could have been dispatched more efficiently. Exh. PS-1 at p. 14. Although AEP disputed many of the points made by PSE&G surrounding this particular transaction, there is little quarrel with the proposition that more efficient dispatch would be possible in an integrated system.

at p. 4. In its role as Reliability Coordinator, PJM currently utilizes TLRs when it controls generation on only one side of an interface, such as instances of congestion that occur at a seam between PJM and another control area. Exh. EXE-40 at p. 10. In 2003 PJM called 286 TLRs curtailing approximately 1,100 GWh of transactions in its role as Reliability Coordinator for PJM, AEP, DP&L, ComEd and OVEC. *Id.* at p. 8. Approximately eighty percent of those occurred on the PJM-AEP interface. *Id.* However, if AEP were fully integrated into PJM, approximately 634 GWh or 58 percent of the transactions curtailed would be internal to the PJM system and would likely have been managed through LMP signals to generators.<sup>33</sup> Exh. EXE-50 at p. 5. In an empirical study comparing the costs of TLRs versus hypothetical redispatch across the AEP-PJM region using a sample of actual TLR events, Witness Henderson testified that the curtailment costs significantly exceed the costs of a hypothetical redispatch of the AEP and PJM systems. *Id.* at p. 21. Dr. Henderson reported a range of net savings under redispatch compared to TLR of \$5.7 million to \$7.7 million per year. *Id.* at p. 25. In light of the foregoing evidence, the VSCC's arguments that it has not been established in the record that "economical utilization" *would* in fact result lack merit.

111. The VSCC and its supporters express concerns regarding PJM's bid-based congestion management method. Under its LMP system, PJM uses bid-based security-constrained dispatch. Exh. EXE-40 at p. 9. Using bids from generators, PJM calculates the least cost dispatch accounting for transmission constraints. *Id.* Based on this dispatch PJM calculates prices for LMPs. Generators are paid the LMP at their bus for what they dispatch and loads are charged the LMP at their load bus for what they consume, creating an incentive for market participants to respond to price signals. *Id.* at p. 10. The VSCC and its supporters express concern that the implementation of a bid-based LMP system will result in strategic bidding because bids accepted in PJM can exceed marginal cost, causing a distortion in the merit order of the dispatch. Tr. at p. 167. Thus, VSCC argues that the resulting dispatch will differ from least-cost dispatch. However, this argument is unpersuasive. According to Dr. Henderson, the PJM merit order based on bids "comes very close to reflecting the same merit order stack that you would have if you stacked them by cost." Tr. at p. 169. Moreover, competition ensures that bid prices approach marginal costs. Ms. Fahey testified that bid prices exceed marginal costs, on average, by only two percent. Tr. at p. 577; Exh. PJM-6 at p. 8. The two percent distortion in market prices would reduce the economic efficiencies by only 0.02 percent. Tr. at p. 182 (Henderson). Furthermore, while there is a \$1,000 bid cap on energy, Mr. Naumann testified that PJM commonly uses bid caps for transmission constraints at cost plus ten percent. Tr. at p. 257; Tr. at p. 551 (Ott). Although local market power mitigation rules exclude generation that was built after July of 1996, Mr. Ott testified that this constitutes only five percent or less of the total generation available in the PJM area. Tr. at p. 565.

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<sup>33</sup> An additional 309 GWh or 28 percent of the curtailments were associated with TLRs called for flowgates on AEP's Virginia transmission system. Exh. EXE-50 at p. 5.

112. This modest mark-up over marginal cost is consistent with the 2002 State of The Market Report, in which the PJM Market Monitor found that the PJM market is competitive, as he found for the prior three years. Exh. PJM-6 at p. 8; Tr. at p. 555 (Ott); MCC-16. Mr. Ott also testified that “[t]he PJM market is a competitive market with transparent pricing which limits the ability of generators to exercise market power in the marketplace as a whole.” Exh. PJM-6 at p. 7. Thus, a market participant that submits a bid with a significant increase over marginal cost risks not being selected to run, because an alternative, lower priced offer would be accepted instead. *Id.* at p. 8. Nonetheless, PJM’s market rules recognize that sellers may be positioned to exercise market power when transmission capacity is constrained, and PJM has in place local market power mitigation rules limiting generation offers to prices that are tied to cost or to prices that were offered under competitive conditions prior to the transmission constraint. *Id.* PJM’s Market Monitoring Unit also helps ensure the competitiveness of the market by identifying potential opportunities to exercise market power and recommending preventive actions.<sup>34</sup> *Id.* at p. 9. According to Mr. Ott, PJM and its stakeholders have implemented virtually all of the independent Market Monitor’s recommendations. *Id.* Although VSCC and its supporters claim that PJM has an ineffective market monitor, there is little evidence to support such a conclusion. Further, a market participant may pursue other avenues before PJM and this Commission to obtain relief in the event that a problem of this nature is experienced.

113. The record further discloses the existence of several other mitigation measures in place to guard against strategic bidding and other market power concerns. In addition to PJM’s active market monitor and local market power mitigation rules, customers can protect themselves against the payment of congestion charges by obtaining FTRs and Auction Revenue Rights (“ARRs”), which serve as a hedge against congestion. Exh. PJM-1 at p. 10, Tr. at p. 543 (Ott). Although in PJM today all FTRs are auctioned under ARR rather than allocated to loads, Witness Wodyka testified that for the new joining companies, FTRs or ARR would be assigned during a period of transition. Tr. at pp. 513-514. Moreover, auctions provide an added benefit in that they are a transparent means to establish the value the market places on avoiding congestion costs, which aids the market’s determination of the most economical use of constrained transmission facilities. Exh. PJM-1 at p. 10. Furthermore, arguments that FTRs as a consumer hedging mechanism against LMP-based congestion charges are insufficient to protect consumers are baseless. FTRs were 100 percent funded in 1998, 98.4 percent in 1999, 90.4 percent in 2000, 98.8 percent in 2001, 95.2 percent in 2002, and 92.5 percent for the period January to July 2003. Tr. at p. 549 (Ott). FTRs are projected to be 95 percent to 99 percent funded for future years. Tr. at p.

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<sup>34</sup> Furthermore, Witness Fahey persuasively argued that AEP’s failure to integrate could result in potential gaming activities. Exh. EME-1A at p. 24. She states that if AEP is not subject to a Market Monitor, transactions scheduled within AEP could artificially create congestion within PJM, but without LMP price signals the party causing the congestion would not face the associated costs of congestion. *Id.*

550 (Ott). These figures are sufficient to alleviate concerns that FTRs will be inadequately funded. In addition, several witnesses testified persuasively that consumers will benefit from the vast savings that will be realized if AEP joins PJM, as was noted in several empirical studies on record. Exh. EME-1A at p. 20.

114. Muni-Coop's recommendation that the Commission should condition its finding that the economic utilization standard has been met on steps being taken to identify and mitigate the impacts of the proposed integration on individual sub-groups is rejected for reasons similar to those stated under the discussion addressing Muni-Coop's staged implementation proposal, *supra*. Suffice it to say here that, when shaping policy, the Commission strives to obtain results that are consistent with the collective public interest, and is cognizant that there are often inevitably "winners" and "losers." Here, the estimated production cost savings will serve to make everyone collectively better off. Exh. EXE-120 at p. 5. Exelon Witness Henderson correctly stated that the longer-term benefits, although difficult to quantify, will yield widespread social benefits in the future. *Id.* at p. 6. Mechanisms can be designed to correct for inequities to individual customers or groups of customers who may be adversely affected.

115. Although the record demonstrates that AEP's membership in PJM will achieve economic efficiencies, it is important to recognize that AEP's integration should not be studied in a vacuum. AEP's membership in PJM is critical to the successful integration of other market participants and thus the success of the region as a whole. The transmission grid serving the Midwest and Mid-Atlantic areas is not simply a collection of separate control areas, but is one vast interconnected and interdependent system. Exh. EME-1A at p. 5. Witness Fahey correctly states that AEP plays a central role in the region due to its large size and central location.<sup>35</sup> *Id.* at p. 6. Serving as the major interconnection between PJM and MISO, AEP has the ability to transfer over 40,000 MW to members in the Midwest and Mid-Atlantic region. *Id.* Ms. Fahey persuasively argues that AEP's inability to join PJM could hamper the viability of the RTO choices of other former Alliance companies. *Id.* at p. 7. For example, ComEd and AEP must be members of the same RTO because ComEd has one 765kV and two 345 kV ties to AEP, with the summer normal capacity of those ties exceeding 5,900 MW. *Id.* If ComEd is able to join PJM before AEP, ComEd's control area "will be a virtual island," connected to the rest of PJM by only a 500 MW pre-existing contractual pathway. *Id.* at p. 8. Thus, without AEP's membership in PJM, other market participants such as ComEd will be unable to bring the benefits of an integrated market to customers within their service area. Consequently, there is abundant support for the conclusion that AEP's integration into PJM is designed to obtain economic utilization of facilities and resources under Section 205(a) of PURPA.

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<sup>35</sup> AEP is the largest generator in the region, owning approximately 24,000 MW of generation in AEP East. Exh. EME-1A at p. 6. AEP also owns a 765 kV transmission line which represents the highest voltage pathway across PJM and MISO. *Id.*

116. In conclusion, the record overwhelming supports an affirmative answer to the question whether the proposed coordination of AEP and PJM is designed to obtain economic utilization of facilities and resources in the studied Midwest and Mid-Atlantic region.

#### **D. Other proposals advanced by AEP and the Muni-Coop Coalition**

##### **1. AEP's "partial integration" and "cost allocation" proposals**

###### **a. Positions of the Parties**

117. AEP's witness Baker recommended a consensual resolution of issues surrounding the integration of his company into PJM. He believed that the Commission should reconsider a proposal that AEP made in the Inquiry stage of this case, under which AEP would transfer functional control of its east zone transmission assets to PJM, but that PJM's functions would be limited to those which AEP believes were contemplated originally under Order No. 2000. Exh. AEP- 1 at pp. 28-34. Under this plan, AEP would not be integrated into PJM's voluntary markets, but could participate in PJM markets on a bilateral basis. He believed such a proposal would win approval with the state agencies opposing AEP's efforts fully to join PJM, and meet the Commission's merger condition that AEP join PJM. *Id.* He contended that the merger approval condition contemplated an RTO with attributes required by the Commission in its Order No. 2000, which did not include RTO market administration or LMP congestion management. *Id.* at p. 30. RTO market administration was added under the Commission's Standard Market Design initiative, according to Mr. Baker.

118. Mr. Baker suggested yet another alternative as a means to begin a dialogue with the States, this one involving an alternative allocation of PJM administrative costs under which customers who benefit most from expanding PJM markets would be allocated a greater share of administrative costs. Exh. AEP-1 at p. 35. He argued that customers in the Mid-Atlantic region benefit significantly in the short term from the removal of out-and-through rates associated with PJM's expansion. Mr. Baker suggested that one way of alleviating states' concerns about whether administrative costs might exceed benefits for their customers would be to reallocate those costs to the load-serving entities that provide service to the benefiting customers. *Id.*

119. PUC Ohio maintains that AEP must fulfill its commitment to join an RTO, noting that there can be no joint and common market in the Midwest and Mid-Atlantic region without AEP and its facilities and resources. However, it goes on to advocate that AEP be allowed to develop its alternative proposals in light of that agency's concern that the timing of integration of AEP into PJM be coordinated with operations of the MISO. It suggests that demanding coordination might further delay the establishment of a joint and common market. *Post Hearing Brief of PUC Ohio.*

120. Exelon's witness Moler maintained that the AEP proposal was essentially identical to one that the company advanced in the Inquiry stage of this proceeding, which was dubbed "PJM-Lite." Exh. EXE- 97. She further argues that the Commission has already rejected this partial integration proposal in its November 25 Order, because, as the Order finds, the proposal would not comply with AEP's merger commitment and because AEP would not be committed to an organization that operates a balancing market and manages congestion through market mechanisms, thus failing to meet the requirements of Order No. 2000. November 25 Order at p. 101. Ms. Moler refers to the Commission's conclusion in that Order that full integration of AEP into PJM was required. *Id.* at pp. 93, 97. Ms. Moler believes that this renewed proposal is outside the scope of the instant proceeding because it has already been decided, but nevertheless concludes that the partial integration proposal would fail to meet Order No. 2000's requirements and therefore fails to satisfy AEP's merger commitment. Exh. EXE-90 at pp.15-18.

121. Exelon witness Mr. Schnitzer testified that AEP has voluntarily agreed to join an Order No. 2000 compliant RTO, i.e., one that satisfies the characteristics and performs the functions set forth in Order No. 2000. Exh. EXE- 130 at pp. 8-10. He contends that AEP's proposed partial integration proposal would fail to satisfy Order No. 2000 in several ways. First, Order No. 2000 requires a market-based congestion management system. 18 C.F.R. § 35.34(k)(2). In PJM, this is accomplished by use of LMP energy markets, which AEP would not participate in under its partial integration proposal. In addition, under Order No. 2000, an RTO, not the transmission owner, must be the provider of last resort of ancillary services, according to Mr. Schnitzer. *Id.* Again, Mr. Schnitzer argues, AEP would exclude administration of ancillary markets as one of the PJM functions under its partial integration proposal.

122. Other witnesses, including Ms. Fahey for the EME Companies, Dr. Tabors for Cinergy, and Mr. Wodyka for PJM, emphasize the importance of full integration of AEP into PJM in order to achieve economical utilization of facilities and resources in the regions identified by the Commission and to satisfy the requirements of Order No. 2000. See Exhs. CIN- 7; PJM- 4 at pp. 1-3; and EME – 1A and 14. Ms. Fahey argued that the partial integration scheme would fail to change the *status quo* and would result in no new economic benefits to the market. Exh. EME-14 at p. 4. She described AEP's absence as creating a "huge hole in the middle of the PJM and MISO markets," which would obstruct efficient transmission across the region, limit access to low-cost generation sources and frustrate Commission conditions attendant to establishment of a joint and common market in the combined PJM/MISO footprint. Exh. EME-1A at p.7. She notes that the AEP partial integration proposal would not include AEP participation in a market-based congestion management plan or in real time energy balance, both requirements of Order No. 2000. Exh. EME- 14 at p. 4. She further maintained that AEP's partial integration proposal may provide AEP's generation affiliates with an unfair advantage because AEP's generators can sell into PJM at the interface points, but can operate without fear of competition within the AEP control area because generators within PJM can only serve within AEP's territory through a

bilateral transaction. Thus, she testified, the PJM and MISO market monitors have concluded that a partial integration approach will allow the continued existence of gaming and inefficient dispatch opportunities along the company's seams with the two RTOs. *Id.* at p. 5

123. PJM's Mr. Wodyka advised that the AEP partial integration proposal is disfavored among the PJM membership and may not be able to obtain necessary approvals for implementation. Exh. PJM-4 at p. 2. In addition, it is not really joining PJM, he contended. While the integration always assumed a "Day One," where the transmission control would be transferred, and a "Day Two," where AEP would become integrated into the RTO's markets, Mr. Wodyka maintained that it was expected to be a limited transition period, and certainly not an open-ended one. *Id.* at p. 2-3. PJM further argues that AEP's partial integration proposal would require reopening the Commission's proceeding where it set the rules for integration of AEP into PJM, and other state proceedings which would bring the matter no closer to resolution.

124. CMTIC/PJMICC argues that there is no guarantee that the partial integration approach would be acceptable to the states in a timely fashion, which is troubling, because AEP has not yet filed such a proposal with any state commission. Tr. at p. 919. EME noted, along this same line, that AEP could not even begin to discuss this proposal as long as the states' regulatory proceedings were open, which would defer the start of any dialogue indefinitely. Nor is there any reason to expect the underlying concerns of the states to disappear in a dialogue, EME suggests.

125. Staff and EME further point out that, in prior testimony in the AEP-CSW merger case, AEP's Mr. Baker agreed that AEP would participate in ancillary service and balancing markets and to redispatch generation consistent with the RTO's bidding requirements, if it joined an RTO other than MISO.<sup>36</sup> Under the partial integration proposal, these commitments would remain unfulfilled, according to Staff and EME.

126. The Joint Midwest and Mid-Atlantic Commissions are suspicious about AEP's motives and the call for dialogue, contending that history has demonstrated a pattern of avoidance of commitments on the part of AEP, and lengthy, unproductive dialogues. *Post-hearing Brief of Midwest and Mid-Atlantic Commissions* at pp. 15-20, 22. The Commissions strongly oppose the alternative partial integration proposal. They argue that the proposal, in addition to forfeiting the economic advantages of full participation in PJM pooling operations, would also adversely affect reliability. Exh. EME-14 at p. 4-5. The proposal would continue or introduce major operational and economic seams across the region, as confirmed by the market monitors for MISO and PJM, the Commissions assert. Exh. EME-

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<sup>36</sup> Exh. S-10 at p. 6; *see also* Tr. at p. 953. Mr. Baker's references to paragraphs I.C.1 through I.C.2 apparently refer to Sections II.C.1 through II.C.3, as there is no Section I.C.

1A at p. 12. They conclude that the only acceptable alternative is to compel AEP to honor its longstanding voluntary commitments to fully participate in PJM immediately.

127. AEP argued on brief that its proposal was intended to begin a dialogue between regulators, while capturing some of the benefits of RTO participation, so that a protracted jurisdictional battle might be avoided. Of significance, AEP has removed all doubt as to whether there would ever be a Day Two under its proposal. It states that it has never suggested an open-ended interim phase, but one only sufficiently long as to ensure that the states are comfortable with the operations of PJM. *AEP Post-Hearing Brief* at p. 7. It professes to be skeptical of the benefits of LMP on its system, which it describes as having low costs and little congestion, so that it believes deferral of its implementation to seek regulatory peace will be no great loss. Participation in PJM's markets is voluntary, AEP argues, so a deferral of that activity until the states become more comfortable with PJM would also be no great sacrifice. AEP continues to argue that its partial integration proposal would be consistent with its merger conditions, in that it would satisfy the principal concern that the merged company would use its transmission assets to frustrate competitors' access to relevant markets. It again states its view that Order No. 2000 did not specify LMP as a market-based congestion management system, and other approaches would be consistent with the Order's requirements. Neither would a deferral of participation in PJM's balancing regime be troubling, according to AEP, because it is not seeking a permanent exemption from that process. *Id* at pp. 7-10.<sup>37</sup>

128. As for AEP's proposal to reallocate administrative costs, Mr. Wodyka from PJM stated that PJM's administrative costs are already unbundled, so customers pay only for services they use. Measuring benefits of membership would be difficult and subjective, he argued, and could be expected to change over time, making a reallocation of costs on such a basis impractical. Exh. PJM- 4 at p. 3. Staff agrees that this proposal offers little prospect for bringing forth a consensus, given differing perceptions of benefits among stakeholders, many of whom did not appear in this case but who can be expected to participate in a cost allocation dialogue. Staff concludes that this alternative has little support and should not be pursued. *Staff Post-hearing Brief* at pp. 38-39.

### **b. Discussion and Conclusion**

129. The Commission has already spoken on this issue and I find nothing in the record of this phase of the proceeding to warrant advice to the Commission that it reconsider its previous decision. First, while it certainly would be preferable to have a consensual resolution of the issues in this proceeding, AEP witness Baker, in answer to an inquiry form

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<sup>37</sup> AEP notes that the Commission, in a recent order involving the Southwest Power Pool RTO, deferred implementation of a real-time energy balancing market until a stakeholder process developed an acceptable plan. *Southwest Power Pool, Inc.*, 106 FERC ¶ 61,110, (2004) at p. 156.

the bench, was frank to admit that a dialogue such as he recommended was now difficult to convene, and was trapped to some degree by the litigation mode and the legal processes initiated by the state agencies and this Commission. Tr. at p. 906. In any case, it does not appear likely that the particular proposal for partial integration advanced here by AEP would be a vehicle that all sides could rally around, or for that matter, one that the Commission, or even the states, could approve.<sup>38</sup> It suffers from numerous drawbacks, as the record confirms, chief among them the failure of the proposal to satisfy the Commission's Order No. 2000 requirements for market-based congestion management and RTO-provided ancillary services. While AEP is right that Order No. 2000 does not require specifically that LMP be the basis for market-based congestion management, it does contain such a market-based requirement. 18 C.F.R. § 35.34(k)(2). I find persuasive Staff's and EME's arguments that AEP itself committed to participate in RTO administered energy balancing and market-based congestion management regimes, which the partial integration proposal would fail to accomplish. Exh. S-10 at p. 6; *see also* Tr. at p. 953. It is simply an insufficient answer that, eventually, there would be compliance.

130. Moreover, even if one accepts that there would, under the AEP proposal, eventually be a "Day Two," when full integration into PJM markets would occur, as AEP now suggests, the partial integration proposal advanced by AEP remains silent as to the time frame within which that might happen. The open-endedness of such a commitment renders it virtually valueless, particularly in the context of the heated advocacy that now surrounds this issue, suggesting a long and difficult path to Day Two. Also very troubling is the continued opportunity for gaming and inefficient dispatch associated with seams transactions that would exist under the partial integration proposal, as identified by EME witness Fahey, an argument that was not refuted on this record. Exh. EME-14 at p. 5. In addition, the loss of benefits associated with AEP's participation in all of PJM's markets, occasioned by a further delay in the integration of AEP into PJM, would be detrimental to the participants in the regional energy marketplace and their customers. Exhs. EME- 14 at p. 4-5, CIN- 7 at p. 4.

131. For these reasons, I find and conclude that the alternative partial integration proposal, resurrected here by AEP in substantially the same form as previously considered by the Commission, should be rejected as a means of resolving this matter. As noted, I do not believe it has sufficient support or merit even to begin a dialogue with the states, who are proceeding with their own cases and their own agendas. While this result is unfortunate in that it presages a likely lengthy period of litigation and appeals, there is little to suggest that the AEP partial integration plan would avoid the litigation and appeal process, since it has

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<sup>38</sup> Indeed, the North Carolina Parties argue that the partial integration approaches advanced by AEP and the Muni-Coop Coalition do not suffice to address legitimate state concerns. *Post-hearing Brief of the North Carolina Parties* at p. 15. This is not a particularly auspicious indication of a willingness to conduct a dialogue or to find a compromise solution. *See also: Late Intervention filing of Midwest and Mid-Atlantic Commissions* at p. 10.

only very limited support from other parties. Also, it might be difficult for AEP to secure approval for such a plan within PJM, as Mr. Wodyka has argued. Exh. PJM- 4 at p. 2. If anything, I believe the evidence suggests that following the path of partial integration would be at least as difficult as pursuing full integration using Section 205(a) authority, and the potential is there for an even longer process. Unfortunately, therefore, the partial integration proposal does not offer a realistic and viable alternative to proceeding with the exercise of authority here, assuming requirements of other aspects of the Section 205(a) have been met.

132. As for AEP's proposed reallocation of administrative costs, suggested as a means of alleviating state cost/benefit concerns, PJM and Staff have persuasively pointed out the impracticalities associated with that proposal from an administrative standpoint, and the unlikelihood of its acceptance by other PJM members. Accordingly, it too must be rejected as a means to facilitate further dialogue with the states.

## **2. The Muni-Coop Coalition's "Staged Implementation" approach.**

### **a. Positions of the Parties**

133. Muni-Coop Coalition witness Seth Brown, in a rebuttal presentation, concluded that there was insufficient information about the impacts of LMP on AEP-area loads to allow one to conclude that full integration of AEP into PJM would be consistent with economical utilization of resources in the Midwest and Mid-Atlantic areas. Exh. MCC-1.<sup>39</sup> He worried about burdens on customers that might flow from market-based congestion management, fearing that they could be substantial, and may bear on public health, safety and welfare considerations. He offered a staged implementation approach whereby AEP would be brought under the PJM tariff as soon as practicable for transmission scheduling, ATC and TTC calculations, security coordination, planning, and other non-market functions. He proposed that AEP's entry into PJM energy markets be deferred for a finite period, so that the following activities, which he believed possible to complete by October 1, 2004, could be conducted:

- An evaluation of the adequacy of transmission infrastructure, including identification of load pockets and other areas of persistent congestion in the AEP area;
- An evaluation of the potential economic impacts on loads in the identified constraint areas when LMP is instituted; and

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<sup>39</sup> I denied a motion to strike Mr. Brown's testimony as improper rebuttal, accepting an alternative suggested by the movant, Exelon, to allow oral surrebuttal. That surrebuttal was presented by Mr. Schnitzer at Transcript pages 1071- 1080.

- Development, through the PJM stakeholder process, of appropriate price mitigation or other remedial strategies for those areas where LMP is expected to produce prices that would be burdensome to consumers.

*Id.* at p. 18; Tr. at p. 997-98.

134. Mr. Brown also was concerned about the ability of the PJM Market Monitor to monitor the expanded market footprint with AEP integrated into PJM, and thought that a deferral period would enable the Market Monitor to secure the data gathering and analytical capabilities he believed are needed to perform monitoring responsibilities effectively. *Id.* at pp. 23-28.

135. The Muni-Coop Coalition argued that its proposal should be adopted for the policy reason that it would address and resolve what it describes as one of the most serious and nagging issues related to AEP's integration into PJM, namely, the impacts of LMP. It alleges that LMP in chronically constrained areas has led to persistently high energy prices. Exh. MCC-1 at p. 11-12. This, it contends, was a factor underlying Virginia's trepidation to proceed with a plan that included LMP, in light of the problems experienced on the Delmarva peninsula, which has been chronically constrained. Tr. at p. 786. Adoption of its proposed staged implementation would reduce the backlash likely to follow the Commission's decision here, if it stays on the course indicated in its November 25, 2003 Order, according to the Muni-Coop Coalition.

136. Exelon's witness Schnitzer disagreed with Mr. Brown that it was necessary to examine the impacts of integration of AEP into PJM on subgroups or classes of customers, because he contended that economic utilization of facilities is an efficiency issue that must be viewed in the aggregate. In his opinion, impact on individual customers or subgroups of customers is an equity issue, more than an efficiency consideration. Tr. at p. 1072. He also testified that a downside to Mr. Brown's deferral approach would be a delay in realization of the improved economic utilization of facilities, to the tune of \$200 to \$300 million each year that the integration is delayed. *Id.* at p. 1073.

137. Exelon also elicited under cross-examination that the Commission had dealt with most of the concerns expressed by Mr. Brown in its order issued April 1, 2002, authorizing AEP's membership in PJM. *American Elec. Power Service Corp., et al.*, 103 FERC ¶ 61,008 (2002). Also, Mr. Brown has testified that his proposal is similar to AEP's partial integration proposal discussed above, with the main difference being that he calls for full integration by a finite, yet still undetermined, date. Under his approach, full integration would be deferred only until the items he identified for further study were resolved to the Commission's satisfaction.

138. Cinergy argues that the Muni-Coop Coalition, by raising issues previously decided by the Commission in the April, 2002 order, is engaged in an impermissible collateral attack on the Commission's decision. Cinergy contends that Mr. Brown is raising equity issues that lie

outside the scope of this hearing and that have been dealt with in other contexts. Cinergy further maintains that there is no proper basis for Mr. Brown's recommendations in that he is contending that benefits to many customers should be delayed just in case full integration may cause increases to a few customers. Cinergy refers to its witness Tabors' finding of \$200 to \$300 million of benefits per year from full integration that would be delayed under the Brown proposal. Tr. at p. 1073. Moreover, Cinergy argues that there is no evidence that market power will be exercised or how many "losers" there will be. It concludes by observing that even Mr. Brown testified that initiatives that will bring major benefits should not be sacrificed for a few customers. Tr. at p. 980, 982.<sup>40</sup>

139. CMTC/PJMICC contends that the staged implementation proposal advanced by Mr. Brown is conceptually the same as the AEP partial integration approach that the Commission has already rejected. While Mr. Brown contended that the deferral he envisioned would be for a finite period, CMTC/PJMICC suggests that period could be many years long, in that it might require transmission upgrades. It points to testimony of Mr. Brown acknowledging that full integration should not be delayed as a result of an adverse impact on a customer or a subset of customers, if a net benefit can be demonstrated for the combined AEP/PJM region. Tr. at pp. 981-982. Given the results of many studies disclosing a regional net benefit to full integration of AEP into PJM, CMTC/PJMICC finds the staged implementation proposal to be unnecessary and inconsistent with the Commission's November 25 Order.

140. Staff argues that this proposal would be fruitless to pursue in that it involves determinations of equity and benefit distribution issues among groups of customers, which will be difficult to resolve and are not appropriate for resolution in a proceeding designed to discuss regional economic utilization of facilities and resources.

### **b. Discussion and Conclusion**

141. First, customer impact issues are beyond the scope of this inquiry to determine whether the Commission should exercise its Section 205(a) authority to exempt electric utilities from state laws that may be prohibiting or preventing a voluntary coordination of electric utilities. This proceeding is, accordingly, not for the purpose of relitigating the issues surrounding AEP's integration into PJM. Those issues, which include most of Mr. Brown's points, have by and large been dealt with by the Commission in its April 1, 2002 order, where the Commission rejected a proposal to conduct a study of the effects on end users of LMP. Tr. at pp. 965-67. The Muni-Coop Coalition argues that it is not seeking to revisit closed issues, but is, instead, attempting, among other things, to ensure that potential impacts from the introduction of LMP-based congestion management are addressed before LMP is imposed. However, the evidence suggests that congestion will not be a problem in this region, and the benefits of an LMP-based congestion management system have been amply

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<sup>40</sup> Mr. Brown presumed steps could be taken to alleviate the harm to the few. Tr. at p. 982.

demonstrated in this record.<sup>41</sup> Tr. at pp. 923-24; 549-50; *see also* Discussion of LMP in Issue No. 1 C above.

142. The Muni-Coop Coalition next contends that its recommendations for further customer impact study should be adopted on a policy basis, even if not a proper consideration in this proceeding. However, Staff and parties offering similar arguments are correct that the expectation of region-wide benefits should not be delayed or foreclosed by undue concerns about equity considerations among groups or sub-groups of customers. Indeed, Mr. Brown himself agreed essentially to that contention in his testimony that a net benefit to the region should not be delayed as a result of impacts on a customer or a sub-set of customers. Tr. at p. 982. He recognized that steps could be taken to mitigate negative implications of the integration on individual customers. *Id.* While the Muni-Coop Coalition argues that it is preferable to study and identify potential impacts in advance of the integration, that may be an impractical and time-consuming process, as CMTC/PJMICC argues. There is little to support Mr. Brown's contention that much of this study could be accomplished before October, 2004. Indeed, the history of events in this case suggests that a far longer process would be required. To delay implementation of a regime that promises region-wide benefits of the magnitude disclosed on this record for the purpose of predetermining individual customer or sub-group impacts would itself be inequitable and is certainly not justified on this record.<sup>42</sup>

143. What perhaps is the most persuasive reason for rejecting the type of further study exercise recommended here by the Muni-Coop Coalition is the blind eye that it turns to the inefficiencies of the current TLR system of congestion management, and the inefficiencies of the AEP dispatch regime currently in place, including the existing opportunities for gaming associated with the absence of a consistent market structure in the region under study, all of which have been amply demonstrated on this record. See, e.g., Exhs. AEP-1 at p. 24; PJM-1 at pp. 10-17; EXE- 40 at pp. 13-16; EME- 1A. One can only conclude that the existing structure is far more inefficient and inequitable than the one posited for introduction via the integration of AEP into PJM.

144. The staged implementation approach advanced here is similar to AEP's partial integration approach rejected above, and is unacceptable as well for the reasons set forth in that discussion. The fact that Mr. Brown's proposal has what he describes as a "finite" period of deferral does not render it any more persuasive than AEP's proposal because the period of deferred integration is not specified and is subject to the completion of tasks and studies of undefined duration. The benefits of integration should not be delayed or deferred

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<sup>41</sup> AEP's Mr. Baker explained that the company has an unparalleled system because of its size, and he expected no load pockets on the AEP system. Tr. at p. 923-24.

<sup>42</sup> The evidence further does not support the Muni-Coop Coalition's position that the PJM market monitor will not be able to handle the expanded market footprint. Mr. Brown's suspicions are not enough to warrant countenancing further delay.

for the consideration of equity issues that can be dealt with after the integration occurs, if at all necessary.

**ISSUE NO. 2 - Whether the laws, rules or regulations of Virginia and Kentucky are preventing AEP from fulfilling both its voluntary commitment in 1999, as part of merger proceedings, to join an RTO, and its application to join an RTO pursuant to the Commission's Order No. 2000.**

145. The Commission's second question inquires whether the laws, rules or regulations of Virginia and Kentucky are preventing AEP from fulfilling both its voluntary commitment in 1999, as part of merger proceedings, to join an RTO, and its application to join an RTO pursuant to the Commission's Order No. 2000.

**A. Whether the laws, rules or regulations of Virginia are prohibiting or preventing AEP from joining PJM within the meaning of Section 205(a)?**

**1. Positions of the Parties**

146. AEP states that, after the Commission's ultimate rejection of the planned Alliance RTO, which it had intended to join, it filed with the VSCC a request for permission to transfer functional control of transmission facilities to PJM on December 19, 2002. At this time, the planned integration date was May 1, 2003. Exh. PJM-1 at p. 22. Almost a year later, on November 7, 2003, the VSCC issued an order requiring AEP to supplement its application with additional information, including a cost benefit analysis, as required by a Virginia statute.<sup>43</sup> Exh. AEP- 1 at p. 13. AEP advises that it filed that document on January 20, 2004. In an order issued January 15, 2004, the VSCC established a procedural schedule which calls for a hearing to commence on July 27, 2004. Exh. VCC- 23.

147. AEP considers the most obvious impediments to its participation in PJM to be the KPSC's initial disapproval of AEP operating company Kentucky Power Company's application for approval to participate in PJM and the Virginia law prohibiting any Virginia utility from participating in any RTO until July, 2004, and thereafter, only with the approval of the VSCC. Exh. EXE-11. AEP's witness Baker testified that Virginia and Kentucky laws, along with other factors, have led AEP to delay its plans to join PJM. Mr. Baker notes that the requests for approval in Virginia and Kentucky are still open, and that no final order denying AEP's request for state approval has been issued. He testified that it is still possible that the two states could approve such a transfer. Exh. AEP-1 at p. 27. AEP noted in its presentation the existence of other barriers to accomplishment of its goal of membership in PJM, which are discussed, *infra*.

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<sup>43</sup> The VSCC had earlier requested supplemental information, including identification of facilities for which transfer of control was requested, in an order issued March 7, 2003. Exh. ALJ -2.

148. While recognizing that the laws, rules or regulations of Virginia and Kentucky have delayed implementation of AEP's membership in PJM, and recognizing as well the Commission's authority to impose a solution, AEP states a preference for a "mutually agreeable solution." Exh. AEP-1 at p. 29. As discussed in detail above, it offered a suggestion for the start of a dialogue between the state regulators and the Commission – where AEP would transfer functional control of its east zone transmission facilities to PJM, but AEP would not be integrated into PJM's voluntary markets. *Id.* at pp. 28-35. In addition, the proposal would implement the directives of the Commission's November 17, 2003 Order on the elimination of through-and-out rates. AEP is hopeful that such a proposal would be acceptable to Virginia and Kentucky.

149. PJM maintains that the actions of the Virginia General Assembly, by erecting a categorical ban on RTO approvals until July 1, 2004, have frustrated AEP's integration into PJM and brought to a halt the steady progress AEP had made to join PJM by May 1, 2003. Exh. PJM- 1 at p. 22. PJM reviews the timeline surrounding Virginia's actions. The Commission accepted AEP's decision to join PJM on July 31, 2002, with a goal of integrating by May 1, 2003. PJM then approved changes to its Tariff and Operating Agreement, and filed them with the Commission in December, 2002. In February, 2003, however, the Virginia General Assembly passed HB 2453, which amended the Virginia Electric Utility Restructuring Act, which was originally enacted in 1999. Exh. VCC- 9. The original Virginia Electric Restructuring Act had required RTO membership by Virginia electric utilities by January, 2001, subject to VSCC approval. In the 2003 amendment, that deadline was deleted and an express prohibition on RTO membership by Virginia electric utilities until July 1, 2004 was enacted. *Id.* at p. 2. This immediately prohibited and prevented AEP from integrating into PJM in the spring of 2003, according to PJM, a prohibition which remains in effect today. Because the Virginia ban ran until July 1, 2004, a new target date for AEP integration into PJM of October 1, 2004, had to be established, according to PJM.

150. The Virginia statute also contains a requirement that the state's electric utilities join an RTO by January 1, 2005, which is seized upon by the VSCC and its allies as indicative of a continuing intent not to prohibit or prevent the voluntary coordination of electric utilities such as AEP's joining PJM. However, PJM argues that HB 2453 has outright prohibited Virginia electric utilities from joining an RTO since February, 2003, a ban that continues in force today. PJM says that this outright legal prohibition is the essential reason that the AEP integration has not yet occurred, and cannot occur until at least July 1, 2004, and even then, it is subject to VSCC approval. PJM further argues that the purpose of the legislation was to delay the implementation of the Commission's RTO policies in Virginia. The bill's sponsors, PJM points out, stated that the bill's moratorium (or ban) on RTO membership was to protect Virginia from federal intrusion. Exh. PJM- 5 at p. 4.

151. PJM sees VSCC approval of AEP's RTO membership application as doubtful, given VSCC's track record of support for the moratorium and delays in scheduling and processing

AEP's application, a delay which PJM claims ended only after the Commission issued its November 25 Order setting up this proceeding. PJM sees no reason to allow the VSCC to further frustrate the desires of other states and market participants to reap the benefits of AEP's membership in PJM.

152. EME offered the testimony of Mr. John Mathis to address this subject. Exh. No. EME-1. Mr. Mathis, who has a distinguished background in regulatory law, found the legislative actions of the Virginia General Assembly, the regulatory actions of the VSCC, and the regulatory actions of the KPSC unquestionable obstacles to AEP's membership in PJM, because each state has taken the view that AEP cannot transfer control of its transmission assets without VSCC and KPSC prior approval. He stated that the Virginia General Assembly passed legislation prohibiting an electric utility from transferring ownership or control of any electric transmission system located in Virginia to an RTO before July 1, 2004. Exh. VCC-9. While also requiring such a transfer to an RTO by January 1, 2005, that action cannot be accomplished without the prior approval of the VSCC. Exh. No. EME-11. According to Mr. Mathis, the VSCC, in a March 7, 2003 order, declared that it would wait to consider the AEP operating company application until a final rule was issued in a FERC proceeding on Standard Market Design ("SMD"). Exh. EME- 10 at p. 5. While it held open the possibility of re-examining that position, Mr. Mathis observes that the VSCC has recommended extending the moratorium on transfer of control of transmission facilities beyond July, 2004 and also recommended rebundling retail rates to avoid FERC jurisdiction. Exh. EME- 12. Thus, he concludes that Virginia legislative and regulatory actions prohibit or prevent AEP's Virginia operating company from transferring control of its transmission facilities to, and AEP from joining, PJM.

153. Mr. Mathis went on to discuss the history of HB 2453, which he concluded was motivated by opposition to FERC's SMD proposal and FERC policy on transmission pricing, including opposition to LMP-based congestion management. He found that the Virginia legislature was preoccupied with the economic effects of RTOs when it passed HB 2453 and established the current moratorium. Exh. EME- 15 at pp. 5-6. He also pointed to a letter sent by the VSCC to the General Assembly on March 20, 2003, which advocated rebundling rates to preserve Virginia jurisdiction. Exh. EME-18. A review of this and other documents convinced him that the Legislative Transition Task Force ("LTTF") and the VSCC were opposed to integration of Virginia utilities into PJM, based upon their fear that LMP would cause rates to rise and would subject Virginia utilities to SMD. Indeed, Mr. Mathis states his conclusion from an analysis of the documents from the VSCC, LTTF, and the legislative history of HR 2453, that the purpose and intent of HR 2453 was to exclude application of FERC's proposed SMD rules in Virginia in order to prevent loss of state jurisdiction to regulate wholesale transmission rates and costs. Exh. EME-15 at p. 10.

154. MISO argues that a regional approach to operation of the transmission grid is a proper objective of federal regulatory authorities. Exh. MIS-1 at p. 5-6. The evidence here demonstrates, MISO contends, that the affected states, whose jurisdiction is limited, were

motivated by a desire to preserve their jurisdiction or cabin state-related benefits to the detriment of consumers as a whole, and with a clear objective to frustrate a proper federal initiative they oppose--- Standard Market Design ---in support of transmission efficiency. Tr. at pp. 624, 676-77 (Mathis). Here, MISO says that the VSCC delayed taking action on AEP's application to transfer control of its Virginia transmission assets to PJM pending issuance of a final Commission rule on SMD, while encouraging the Virginia legislature to pass legislation to preserve the state's jurisdiction over matters of federal control. It is important to recognize, according to MISO, that state jurisdiction here is limited by the Commission's exclusive jurisdiction over transmission in interstate commerce. See Tr. at p. 678-679 (Mathis).

155. On this question, Exelon offered the testimony of Ms. Moler. She testified that the laws, rules, or regulations of Virginia and Kentucky are preventing AEP from fulfilling its commitment to join an RTO. Exh. No. EXE-1. She noted that both AEP and Exelon's subsidiary ComEd were scheduled to be integrated into PJM in the spring of 2002, but that the laws of Kentucky and Virginia are blocking AEP's path. She calls attention to positions of AEP officials J. Craig Baker and Susan Tomasky who, in a September 23, 2003 filing with the Commission, state that the most obvious impediments to AEP's participation in PJM are the actions of Virginia and Kentucky.<sup>44</sup> She notes that AEP pointed out, in a compliance report dated February 28, 2003, that the Commission could use Section 205 of PURPA to exempt AEP from the laws, rules or regulations of the states.<sup>45</sup> She further reviews the statutory changes introduced by the Virginia General Assembly in February 2003, which banned RTO membership by Virginia utilities until July 1, 2004, and then required such membership by January 1, 2005, but subject to VSCC approval.

156. The witness goes on to point out that the VSCC has subsequently recommended continuation of the RTO moratorium, to preserve state jurisdiction and in light of what the VSCC believes to be many "serious problems," including possible elimination of native load preferences, the Commission's questionable ability to oversee markets, the potential exercise of market power, cost increases related to LMP, and regional resource adequacy requirements.<sup>46</sup>

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<sup>44</sup> Prepared Testimony of Susan Tomasky and J. Craig Baker on Behalf of AEP, Docket Nos. ER03-262-001, *et al.* at p. 6. (September 23, 2003), Exh. No. EXE-11.

<sup>45</sup> AEP's February 28, 2003 Compliance Report, at p. 15, Exh. No. EXE-5. See also AEP's March 31, 2003 Response to Motion for Expedited Consideration, at p. 9. Exh. No. EXE-10.

<sup>46</sup> *Virginia State Corporation Commission, Report to the Commission on Electric Utility Restructuring of the Virginia General Assembly, and the Governor of the Commonwealth of Virginia Status Report: The Development of a Competitive Retail Market for Electric Generation Within the Commonwealth of Virginia, Exec. Summ. at p. 2 and Part III, Recommendations to Facilitate Effective Competition in the*

157. Ms. Moler contends that the existing moratorium on Virginia electric utilities joining an RTO plainly means that the laws of Virginia are preventing AEP from joining PJM. The state obstacles have, according to the witness, already delayed AEP from joining PJM, because the original schedule for implementation by December, 2002, has slipped by almost two years, due to delays caused by state actions. Exh. No. EXE-19. The fact that the states may yet remove the obstacles and grant authorization for the integration of AEP into PJM is speculative and an improper basis for planning, she asserts. Ms. Moler finds it more likely that continued delays will result from a failure to act now to preempt state actions that are at odds with the public interest.

158. Ms. Moler argued in rebuttal that any delay in an already protracted process is unacceptable. Moreover, she contends that the few months delay posited by VSCC witness Walker, who presumed integration would occur by January 1, 2005, as set forth in Section 56-579 of the Virginia code, fails to take account of the fact that approval is still required by the VSCC, the statutory date notwithstanding. She further argues that there is no final date by which the VSCC must approve an application for a Virginia utility to join an RTO. Thus, she concludes that the VSCC could delay AEP from joining an RTO indefinitely, not just for a few months.

159. She points out that the VSCC approval process was seen by the Virginia House of Delegates in a floor debate as an additional requirement that must be met, and one that could delay approval of the transfer by some indefinite period beyond January 1, 2005. Exh. EXE-92, at pp. 19-20. The legislative debate further suggests, Ms. Moler stated, that delay was a principal objective of the Virginia statute. She observed that a discussion of Virginia Delegate Parrish in the debate suggested that the purpose of the bill was to slow down the transition to a deregulated electric industry by delaying the [transmission control transfer process] somewhat. *Id.* at p. 12-13. Ms. Moler further maintains that the VSCC advocated a "time-out" to review the impacts of the Commission's SMD initiative, and that the Virginia statute was enacted with full knowledge that parties were advocating that the Commission use its authority under Section 205(a) of PURPA to override the state law that was delaying AEP's integration into the PJM RTO. The evidence confirms, she argues, that the Virginia statute was designed to delay AEP from joining PJM, as a first step in a strategy to avoid SMD and RTOs, and to preserve state jurisdiction.

160. VSCC's witness, Cody D. Walker, is the Assistant Director of the VSCC's Division of Energy Regulation. He has a deep background in regulatory work, including extensive experience with Virginia's electric utility restructuring activities. Mr. Walker testified that Virginia law does not prohibit or prevent AEP from fulfilling its voluntary commitment to join an RTO or the voluntary coordination of electric utilities to obtain economical utilization of facilities and resources in the pertinent geographic regions. Exh. VCC-1. He calls

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*Commonwealth* at p. 20-21 (August 29, 2003) (August 29, 2003 VSCC Status Report) (the latter report is Exh. No. EXE-18.)

attention to the fact that Section 56-577.1 of the Virginia Electric Restructuring Act promotes such an outcome in that it requires each Virginia electric utility to join or establish a regional transmission entity. VSCC argues that the original Virginia Electric Restructuring Act was passed in 1999, and in that year, mandated Regional Transmission Entity<sup>47</sup> membership for Virginia electric utilities by December 20, 2001, and required VSCC approval for the transfer of management and control over transmission assets. VSCC says that it is wrong to suggest that these requirements are new. What was new in 2003, he argued, was House Bill 2453 (Exh. VCC-9), which amended the Restructuring Act by changing the dates surrounding RTO participation, and required utilities to study the comparative costs and benefits of RTO participation. While the amendment also precluded incumbent electric utilities from transferring control of their transmission systems to an RTO before July 1, 2004, the VSCC claims it reiterated the requirement that Virginia electric utilities join RTOs, albeit by a later date and with a continued requirement for VSCC approval. *Id.* at p. 2.

161. VSCC does agree that the Act restricts utilities from transferring control of transmission facilities prior to July 1, 2004, and that it requires VSCC approval. However, Mr. Walker states that it is entirely possible that AEP's Virginia operating company ("AEP-Virginia") could obtain such approval in time to meet the Commission's planned integration date of October 1, 2004, assuming that AEP-Virginia can satisfy the requirements of the VSCC's RTE regulations. Mr. Walker posits that even a brief delay in realization of the October 1, 2004 target date for integration of AEP into PJM necessitated by Virginia law and VSCC review does not constitute prevention of AEP from joining an RTO, and would represent a "flimsy excuse" for exempting AEP from the laws and regulations of a sovereign state. Exh. VCC-1 at p. 20. This is particularly the case, he maintains, in the context of the delays countenanced by the Commission's actions leading up to this point, such as the requirement in *American Electric Power Co., et al.*, 90 FERC ¶ 61,242 (2000) that AEP join an RTO by December 15, 2001, and the Commission's rejection of AEP's attempt to join the proposed Alliance RTO. *Midwest Independent Transmission System Operator, Inc.*, 97 FERC ¶ 61,326 (2001).

162. Parallel state proceedings need not be concluded before federal processes, Mr. Walker contends. It made good sense, he argues, for VSCC to have awaited the outcome of the controversial Alliance RTO proposal at the Commission, and would have been a waste of scarce resources for the VSCC to have acted first on the Alliance filing, given its ultimate rejection by the FERC.

163. Mr. Walker agreed that there was one scenario whereby the Virginia laws and regulations would prevent AEP from fulfilling its commitment to join an RTO. That scenario assumes resolution of all of the obstacles other than state laws and AEP's failure to

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<sup>47</sup> The Virginia legislation refers to a "Regional Transmission Entity," which is considered herein to be interchangeable with "Regional Transmission Organization," or "RTO."

make an adequate showing before the VSCC that its participation in an RTO is in the public interest and compliant with VSCC's pertinent regulations. Because the VSCC has not ruled on AEP's request, Mr. Walker argues that exempting AEP from compliance with Virginia laws "must rest on unsupported speculation by the Commission that the VSCC will not approve AEP-Virginia's pending request." Exh. VCC-1 at p. 24. He considers that to be premature, highly speculative, and presumptuous. Moreover, Mr. Walker argues, in such a case, it would not be Virginia law that prevents the integration of AEP into the PJM RTO, but AEP-Virginia's failure to comply with that law.

164. Mr. Walker also testified that the Commission was wrong to assume that no Virginia utility will be permitted to transfer transmission assets to an RTO until the VSCC's concerns about market design are fully satisfied. He urges the Commission to pay little heed to his own agency's recommendations to the Virginia legislature, which expressed such concerns, because the VSCC is bound by current law, and not its own legislative preferences. VSCC argues that these recommendations are irrelevant. He observed that, in another application from a Virginia utility to join an RTO, the VSCC established a procedural schedule that is not dependent upon adoption of a final SMD rule, and, on December 20, 2003, it granted AEP-Virginia's request for a procedural schedule without awaiting a decision on SMD. Exh. VCC- 14.

165. For his part, VSCC witness Walker insists that the VSCC cannot ignore the law that requires RTO participation by Virginia utilities. Exh. VCC- 20. Only if AEP-Virginia could not satisfy the requirements of the Virginia Electric Restructuring Act and pertinent VSCC regulations affecting transfer of transmission assets would approval not be obtained, he argues. He goes on to suggest that it remains speculative that the VSCC will not approve AEP-Virginia's plans to join PJM or that the Virginia General Assembly will delay its RTO "time-out" beyond the currently effective date of July 1, 2004. Moreover, Mr. Walker contends that it is improper to rely on the VSCC's recommendations to the Virginia General Assembly that it rebundle rates or extend the moratorium on a utility transferring control over its transmission assets to RTOs beyond July 1, 2004. There is nothing to suggest, Mr. Walker maintains, that the General Assembly will follow these recommendations or that, by making them, that the VSCC has prejudged AEP's application. For the sake of accuracy, Mr. Walker states that the recommendation by the VSCC in August, 2003, was that the moratorium be "continued," not that it be extended beyond July 1, 2004. Exh. VCC- 20 at p. 5.

166. Mr. Walker further contends that the so-called moratorium, or time-out, was originally suggested by a utility, Dominion Virginia Power, and not by the VSCC. He further asks that any alleged prejudgment be measured against the actions of the VSCC, which he states has directed filings designed to process the AEP-Virginia application to transfer control of transmission assets to PJM so that the hearing can begin on July 27, 2004. The matter has been assigned directly to the Commissioners for hearing, Mr. Walker advises, eliminating the time required for an interim report and replies thereto by a hearing examiner.

In addition, he says that the VSCC has retained consulting services to assist in its review of costs and benefits, which should assist in the expeditious review of the application.

167. VSCC argues that, on its face, the statutory “time-out” expires on July 1, 2004, three months before the contemplated date for integration of AEP into PJM, which is October 1, 2004. Therefore, VSCC argues, it cannot be deemed to be preventing or prohibiting AEP from meeting the Commission’s October 1, 2004 target date for joining PJM. Further, VSCC claims that a “yet-to-be-issued order of a state utility commission”, presumably to deny approval to the AEP application, is not a law, rule or regulation within the meaning of Section 205(a) of PURPA. VSCC Initial Brief at p. 36. Thus, there are no grounds upon which the Commission can find that Virginia law rule or regulation is preventing or prohibiting AEP’s integration into PJM, VSCC argues, citing *Public Service Comm’n. of Utah v. Wycoff Co.*, 344 U.S. 237, 247 (1952); and *Texas v. United States*, 523 U.S. 296 (1998). VSCC contends that the Commission should not take action based upon an anticipatory denial of a state authority. There is no evidence, VSCC argues, as to how that agency will act on AEP’s application, and it would be wrong to assume rejection at this point.

168. VSCC portrays its opponents as wishing that Section 205(a) actually read: “The Commission may...exempt electric utilities...from any provision of state law...which prohibits or prevents, *or perhaps might in the future prohibit or prevent*, the voluntary coordination ...” The statute is not so worded, says VSCC, and it would be improper to interpret it in that manner. VSCC argues that the statute should be given its plain meaning. *Federal Energy Regulatory Commission v. Martin Exploration Management Co.*, 486 U.S. 204, 209-10 (1988) (quoting *Bethesda Hospital Assn. v. Bowen*, 485 U.S. 399, 403 (1988)). Here, it means that the state law in question must currently be prohibiting or preventing voluntary coordination before the Commission may exercise its authority under Section 205(a).

## **2. Discussion and Conclusion**

169. At the outset, it is appropriate to deal with the question of statutory interpretation. As discussed above in Issue No. 1, the VSCC is correct that the statute here should be given its plain meaning. Unfortunately, for the VSCC’s position, however, it is hard to interpret the Virginia statutory amendment enacted in 2003 as doing anything but currently prohibiting AEP from joining PJM. The plain words of the Virginia Electric Restructuring Act, Section 56-579 (A)(1) are:

“No such incumbent electric utility shall transfer to any person any ownership or control of, or any responsibility to operate, any portion of any transmission system located in the Commonwealth prior to July 1, 2004...”

170. Today’s date is March 12, 2004. By my simple reckoning, the plain language of this Virginia law prohibits any Virginia electric utility from joining an RTO until at least July 1,

2004, and has had that effect since its enactment into law on April 3, 2003. Assuming that the additional requirements of Section 205(a) of PURPA are met, the Commission can safely conclude that this Virginia statute currently prohibits AEP from joining PJM, and has prohibited the voluntary coordination of utilities sought to be accomplished by the integration of AEP into PJM since April 3, 2003.<sup>48</sup> Whether further analysis is required depends upon the timing of the actions that will follow this decision, so I will proceed to consider other arguments raised in the context of this issue.

171. VSCC further contends that it would be wrong to preempt state action where there remains the possibility of approval of AEP's application within a timeframe that would satisfy the Commission's October 1, 2004 goal. VSCC notes that the moratorium on approvals of transfers expires on July 1, 2004. It argues that there will then exist time before the planned October 1, 2004 date by which the necessary VSCC approval might be secured. While it would be tempting to accept that logic, because of the importance of maintaining cooperative federal-state relationships, the evidence of the likelihood of a far different result is overwhelming.

172. First, VSCC's argument that the integration may not be capable of occurring before October 1, 2004 is irrelevant. The statute does not require that the Commission wait until any particular date to determine if a state law, rule or regulation is prohibiting or preventing the coordination of electric utilities. Moreover, as discussed below, VSCC's actions caused the implementation date to be extended to October 1, 2004, in the first instance. So, VSCC is essentially claiming the benefit of the delay it created in arguing for a denial of a Section 205(a) exemption. That is not a proposition that I find particularly persuasive.<sup>49</sup>

173. It is certainly the case that the passage of the amendment to the Virginia Electric Restructuring Act in early 2003 had the effect of delaying VSCC consideration of the transfer application. It also required rescheduling events that were planned to culminate in AEP's membership in PJM by May 1, 2003. Exh. PJM- 1 at p. 22. The evidence demonstrates that the passage of this law had a direct and immediate adverse impact on plans to integrate AEP into PJM. *Id.*; see also Exh. AEP-1 at pp. 11-13, Tr. at p. 374. That application was filed in December, 2002. The first procedural order was issued in March, 2003, requiring AEP to file additional support for the transaction and signaling an intent to await a FERC decision on SMD. But, a procedural schedule for the case was not adopted until January, 2004, well after the Commission started the instant proceeding. Exh. VCC-23. It does not require much surmise to connect the dots and complete this picture. The VSCC, on record as opposing

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<sup>48</sup> The VSCC statute also requires VSCC electric utilities to join Regional Transmission Entities before January 1, 2005, subject to VSCC approval. This provision is somewhat inconsistent with the prohibition, but a key aspect of this requirement is that VSCC action is still required, which includes the authority to withhold approval. Exh. EXE- 92 at pp. 16-17.

<sup>49</sup> In fact, the word "chutzpah" would seem appropriate to describe this argument.

action to complete the RTO integration for fear of federal intrusion and FERC's SMD initiative (Exh. EME-18 at p. 5, and EME-19), bought additional delay by the enactment of the statutory ban on RTO transfers, and took advantage of it by not acting on AEP's still-pending application within a reasonable time frame. It does not matter whether AEP's integration into an RTO followed a smooth or rough path since the merger condition became effective, or whether or not there were lost opportunities along the way due to other reasons. The fact remains that, currently, there is in effect Section 56-579 of the Virginia Code, as amended in 2003, a state statute that prohibits AEP's Virginia operating company from transferring control over its transmission assets to an RTO until July 1, 2004, and, after that date, places the VSCC in ultimate control over such a transfer. That statute has prevented the integration and continues to do so today.

174. There are also the words and actions of the VSCC itself to consider. The VSCC indicated its opposition to taking actions that might affect Virginia's jurisdiction over its transmission and generation during the period of the so-called moratorium, which prohibits Virginia electric companies from joining an RTO before July 1, 2004. Exh. EME-19. Indeed, it argued strongly for additional measures to protect the state from the impacts of SMD, such as rebundling previously unbundled electric rates, as was suggested by its outside counsel, considered to be expert in FERC matters. *Id.*; Exh. S-6. The VSCC had previously recommended to the Virginia legislature that it defer until an unspecified date a requirement directing Virginia electric utilities to transfer control of transmission assets to an RTO. Exh. EME-18 at p. 5. This action was taken out of a fear that FERC's SMD would apply in Virginia, where it was strongly opposed. *Id.* Moreover, in August 29, 2003, the VSCC recommended continuing a moratorium on transfer of control over Virginia electric utilities' transmission assets to RTOs. Exh. EXE-18 at p. ii. While the VSCC argues that the verb "continues" suggests that it was merely asking to maintain the moratorium status quo, and was not meant to suggest extending the moratorium, the latter interpretation is more consistent with the tenor of the document and its strong advocacy on behalf of retention of Virginia's jurisdiction and fear of federal intrusion. Further, if maintaining the status quo was the intended recommendation, there would have been little reason to state it, because there is no evidence that the legislature was considering removing the ban.

175. After getting a feel for the rhetoric of these documents, and looking at the videotape of the Virginia Assembly's consideration of the 2003 legislation (Exh. EXE-93), one would have to be quite naïve not to be concerned about whether one could expect a timely or objective assessment of an application by a Virginia electric utility to join a Commission-approved RTO. There is also the problem of the current schedule. Hearings are not to begin on AEP- Virginia's application before the VSCC until July 27, 2004, leaving a scant three months for completion of hearings, consideration of the issues presented, and a VSCC decision before the planned October 1, 2004 implementation date. That is not sufficient time for an orderly implementation to proceed, even if one were to credit the possibility that the VSCC would approve the application, which, on this record would be a risky bet.

176. Finally, it remains to be determined whether, despite all of the above, VSCC should be given time to complete its review, and whether anticipated state action is sufficient to trigger application of the statute's exemption authority. The *Wycoff* and *Texas* cases cited by VSCC are not on point. Those cases involved requests of parties for declaratory judgments by Federal Courts to enjoin anticipated state actions. In addition to the fact that we are dealing here with a specific regulatory statute and an administrative agency, which is an entirely different procedural context than existed in those cases, the state action that is relevant here is not the actual VSCC administrative decision, the status of which remains open. The VSCC decision has not been made and is currently pending without any firm schedule for a decision. It may be deferred indefinitely, or the decision may never be made. A pending VSCC decision is not what triggers application of the Commission's exemption authority. The appropriate state law for Section 205(a) purposes is the one that prohibits RTO membership and grants authority to the VSCC to approve the transaction in the first place. That state action has occurred. Virginia Code 56-579, as amended in 2003 is the law of Virginia.

177. In addition to being currently outright prohibited from joining an RTO under that law, even after expiration of the ban, ultimate control over the AEP- Virginia's integration into PJM will remain with the VSCC. As noted above, this authority places the VSCC, which is openly hostile to RTO membership, in ultimate control of AEP's application to transfer control over transmission assets to the RTO.<sup>50</sup> Exhs. EME- 11 and 12. The VSCC plainly interprets Virginia law as empowering it to be the ultimate decisionmaker on applications of Virginia electric companies to voluntarily coordinate facilities with other entities in the region. As such, it may take any number of procedural and substantive actions that would continue to prevent such voluntary coordination, even after expiration of the statutory ban on transfers of control of electric transmission facilities.

178. The evidence here, summarized above, demonstrates that the requirement of Virginia law that subjects a transfer request to VSCC approval has prevented and continues to prevent AEP- Virginia from joining PJM. Indeed, this Virginia law is precisely the kind of state action that PURPA Section 205(a) was enacted to prevent – a state law, rule or regulation which prohibits or prevents the voluntary coordination of electric utilities for the benefit of regional and national interests. For these reasons, I find and conclude that the laws of Virginia are prohibiting or preventing AEP- Virginia from transferring control of its

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<sup>50</sup> At oral argument, counsel for the VSCC argued that the Commission's Order No. 2000 (*Regional Transmission Organizations, Order No. 2000*, 89 FERC ¶ 61,212) anticipated state regulatory approval of RTO transfers and suggested that states would have a key role in RTO formation. Clearly, however, in making such remarks, the Commission did not abdicate to the states its primary jurisdiction over matters important to electric transmission in interstate commerce, nor would it have been reasonable for the Commission to anticipate a state using its approval authority to prevent regional coordination of electric utilities.

transmission facilities to an RTO, which is a voluntary coordination of electric utilities, within the meaning of Section 205(a). AEP- Virginia should be exempted from the provisions of Section 56-579 of the Virginia Code, as amended in 2003, that prohibit it from transferring to PJM any ownership or control of, or any responsibility to operate, any portion of any transmission system located in Virginia prior to July 1, 2004, and from that provision of Section 56-579 which requires prior approval of the Virginia State Corporation Commission in order to effectuate such a transfer.

**B. Whether the laws, rules or regulations of Kentucky are prohibiting or preventing AEP from joining PJM within the meaning of Section 205(a)?**

**1. Positions of the Parties**

179. As for Kentucky, AEP's witness Baker related that AEP filed an application with the KPSC for approval to transfer functional control of transmission facilities of its Kentucky affiliate, KPC, to PJM on December 19, 2002. Exh. AEP-1 at p.13-14. That application was denied by the KPSC on July 17, 2003, after the state regulators found that AEP had not shown that the benefits to Kentucky from KPC's participation in PJM outweighed the costs. Exh. KYC-2. On August 25, 2003, the KPSC granted AEP's request for rehearing of that denial, allowing the company to submit the Kentucky-specific cost benefit analysis which the KPSC felt that it needed. Exhs. KYC-3, 4. That analysis was filed on December 23, 2003, according to Mr. Baker. *Id.* The VSCC's procedural schedule calls for hearings in April, 2004. *Id.*

180. KPSC offered the testimony of Charles Buechel, a utility and economic consultant and former Deputy Executive Director for that state agency. Exh. KYC- 5. Mr. Buechel reviewed Kentucky statutes, specifically, Ky. Rev. Stats. 278.218 and 278.214 (KRS 278.218 and KRS 278.214),<sup>51</sup> which govern KPSC review of requests for approval of the transfer of

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<sup>51</sup> KRS 278.218 states as follows:

- (1) No person shall acquire or transfer ownership or control, or the right to control, any assets that are owned by a utility as defined under KRS 278.010(3)(a) without prior approval of the commission, if the assets have an original book value of one million dollars (\$1,000,000) or more and (a) The assets are to be transferred by the utility for reasons other than obsolescence; or (b) The assets will continue to be used to provide the same or similar service to the utility or its customers.
- (2) The commission shall grant its approval if the transaction is for a proper purpose and is consistent with the public interest.

KRS 278.214 states as follows:

When a utility or generation and transmission cooperative engaged in the transmission of electricity experiences on its transmission facilities an emergency or other event that necessitates a curtailment or interruption of

control of transmission facilities at issue here. Under the state laws, before the KPSC can approve such a transfer, it must find that the transfer is in the public interest and for a proper purpose, and that the transfer will not violate the statutory provision against curtailing or interrupting retail electric service until service has been interrupted to all other customers whose interruption may relieve the emergency or other event. AEP's request to transfer control of its transmission facilities was denied by KPSC order issued July 17, 2003, based upon a finding that AEP had not met its burden to demonstrate that the transfer was in the public interest and that AEP failed to assure that it could meet the curtailment requirements of KRS 278.214. Exh. KYC-2. Mr. Buechel further noted that the KPSC granted rehearing on the AEP application by Order issued August 25, 2003, which required the submission of a Kentucky-specific cost benefit analysis. Such an analysis was filed on December 23, 2003. Because the case is still pending, Mr. Buechel argues that it cannot be deemed an obstacle to integration of AEP into PJM. A separate challenge has been made to the validity of KRS 278.214 in state court. This statute was also challenged in federal court, but the federal court abstained from deciding the case because it found that judicial review of the Kentucky Commission's actions is properly before the state court. *See: Kentucky Power Company d/b/a American Electric Power et al. v. Huelsman*, No. 03-47-JMH consolidated with No. 03-49-JMH (E.D. Ky. Dec. 18, 2003). Mr. Buechel notes that the legal process continues, inferring that it remains pending and unresolved. *Id.* at p. 7.

181. KPSC also offered the testimony of Thomas M. Dorman, its Executive Director. Exh. KYC- 1. Mr. Dorman advised that KPSC case No. 2002-00475, involving AEP affiliate KPC's application to transfer assets to PJM Interconnection, LLC, is still pending. The application was denied, but revived on rehearing. A schedule has been established with hearings set to begin on April 21, 2004. He testified that it is being handled on an expedited basis, with a decision expected no later than June 30, 2004.

182. KPSC argues that there is no evidence here, other than innuendo, supposition, and speculation, to suggest that KPSC will deny AEP's application. This is because the case is still pending, the KPSC has an open mind, and will rule on the basis of the record established in that proceeding. It would be wrong to anticipate a negative outcome, the KPSC argues, citing *Wycoff* and *Texas, supra*. As for the curtailment statute, KPSC argues that PJM's pro-

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service, the utility or generation and transmission cooperative shall not curtail or interrupt retail electric service within its certified territory, or curtail or interrupt wholesale electric energy furnished to a member distribution cooperative for retail electric service within the cooperative's certified territory, except for customers who have agreed to receive interruptable [sic] service, until after the service has been interrupted to all other customers whose interruption may relieve the emergency or other event.

Exh. KYC – 5 at p. 5-6.

rata curtailment practices will have no unique effect under Kentucky's curtailment statute, citing to EME witness Mathis' testimony. EME- 10A at p.7. Moreover, KPSC suggests that the issue is not unresolvable, citing to the testimony of witness Buechel suggesting that a creative solution might be found, and asserts that the issue is ripe for consideration in the rehearing of the transfer application. Exh. KYC- 5 at p. 12; Tr. at p. 1163.

183. EME witness Mr. Mathis also calls attention to the July 17, 2003 order of the KPSC denying KPC's application to transfer functional control of KPC's Kentucky transmission assets to PJM. Exh. EME-10 at pp. 5-6. In that order, the KPSC construed a Kentucky statute, KRS 278.214, as requiring Kentucky utilities to favor native load, which would conflict with PJM's pro rata curtailment requirements. *Id.* Mr. Mathis further notes that the KPSC found minimal benefits to Kentucky from KPC's joining PJM, but would be required to pay at least \$3 million annually for membership in PJM. The KPSC granted KPC's request for rehearing on this determination so that it could provide a Kentucky-specific cost benefit analysis demonstrating the effect of KPC's membership in PJM. Such an analysis, which found a net benefit to KPC from transfer of functional control of transmission to PJM, was filed with the KPSC on December 23, 2003. Exhs. AEP- 1 at p. 14; EME- 10 at p. 6.

184. Mr. Mathis also points out in his testimony that the agency denied a request for rehearing filed by PJM as to its interpretation of KRS 278.214, the curtailment statute. KPC pursued relief in the United States District Court from the KPSC interpretation of that statute. However, Mr. Mathis testified that the Court abstained from deciding the issue in favor of KPC's appeal of the KPSC order in state court. Exh. EME- 10 at p. 7. In light of the pending state of the law on this issue, Mr. Mathis concluded that the KPSC's interpretation of KRS 278.214 prohibits and prevents approval of KPC's transfer of control over its assets to PJM. *Id.*; Exh. EME- 15 at pp. 13-14.

185. PJM witness Mr. Wodyka also reviewed the procedural history of the KPSC's actions. Exh. PJM- 1 at pp. 23-24. As it now stands, Mr. Wodyka concludes that AEP is prevented by Kentucky law from joining AEP. *Id.* at p. 23. Mr. Wodyka further testified that these developments have relieved pressure to resolve other remaining obstacles, and forced changes in the schedule, raising additional problems with a non-contiguous integration of Exelon's ComEd. In addition, he opined that the schedule extensions attributable to the state actions prevented any integration from occurring before the August 14, 2003 blackout, which in turn caused the need for an additional pause in integration scheduling. *Id.* at p. 24. He stated that PJM should nevertheless have no difficulty finishing any technical work needed for AEP's scheduled integration into PJM on October 1, 2004. *Id.* PJM sees these KPSC actions as preventing KPC from voluntarily coordinating its facilities into PJM, noting that the statute does not require a permanent prohibition.

186. Exelon's witness, Ms. Moler, further described exactly how state laws in her view prevent AEP from fulfilling its RTO commitment. Exh. EXE-1 at pp. 12-14. First, she observes that the applicable Kentucky statute, KRS 278.218 (2003) requires prior KPSC

approval before a utility can transfer operational control of its transmission facilities to another entity. KPC's December 19, 2002 application for such a transfer to PJM was denied by the KPSC in July, 2003. The reasons offered for the denial were:

- That KPC had not met its burden to demonstrate that the benefits of PJM membership would outweigh the costs;
- KPSC's grave concern about surrendering even a portion of its own authority to protect KPC's customers;
- A concern that PJM in the future might require all member generation to be sold into PJM's markets, which might result in loss of an existing cost advantage that KPC's generation enjoys over existing PJM members; and
- Approval of the transfer would violate KRS 278.214, which requires favoring native load customers in curtailment regimes.

187. Ms. Moler updates the case in Kentucky by observing that KPC has submitted a cost study showing benefits to Kentucky ratepayers of PJM membership, but that the fact remains that, according to KRS 278.214, AEP cannot join PJM. *Id.*

188. Ms. Moler contends that, in Kentucky, there is also no assurance that the KPSC will overturn its previous rejection of AEP's application and certainly no assurance that it will occur in time to allow AEP to integrate into PJM on October 1, 2004, as currently planned. In addition, she points out that there is in Kentucky the separate problem of the statute regarding curtailment priorities, which the KPSC argues must be satisfied before it can approve AEP's integration into PJM. *Id.*

## **2. Discussion and Conclusion**

189. Unlike the case of Virginia, Kentucky has not enacted an outright ban on the transfer of control over transmission assets in the state to entities like RTOs. Its principal regulatory statute (KRS 278.218) is a typical state law that requires KPSC approval for transfers of ownership or control of assets of Kentucky utilities over a certain value. However, in Kentucky there is another problematic statute, KRS 278.214, which gives preference to native load customers in curtailment scenarios. Because the KPSC has once decided not to grant approval to KPC's request to transfer control over its transmission assets to PJM, and also indicated that it could not grant such approval in any event because the PJM curtailment tariff is inconsistent with KRS 278.214, certain parties argue that the Commission should move to exempt KPC from application of these Kentucky statutes to the extent required to allow KPC to integrate into PJM. They argue that these Kentucky laws are preventing AEP's Kentucky operating company, KPC, from joining PJM, impeding a voluntary coordination of electric utilities as contemplated by Section 205(a) of PURPA.

190. In ordinary circumstances, it would be reasonable to await the outcome of a state proceeding to consider a proposed transfer, such as the one underway in Kentucky, before acting to exempt a utility from state law under Section 205(a). This statute is, as noted, a fairly typical state law that has a broad public interest standard and one that could be expected to be enforced fairly and objectively, and a timely schedule has been established for the rehearing. But these are not ordinary circumstances for at least two reasons. First, there is the prior denial by the KPSC of KPC's transfer application for a multitude of reasons, some of which are grounded on typical public interest considerations, such as the cost and benefits of the proposed transfer. However, the denial is also based upon other grounds, some of which sound similar to the rhetoric of the Virginia legislators and the VSCC – a fear of losing local control, and a fear of losing a perceived local cost advantage. The additional evidence on cost and benefits is not likely to be responsive to those concerns. It is also clear that the KPSC sees itself as the ultimate decisionmaker as to KPC's transfer application. Exh. EME- 13. As EME witness Mathis testified, hoping for a positive outcome on the rehearing application in this context would be akin to Charlie Brown's continued trusting that his sidekick Lucy might this time allow him to kick the football. Tr. at p. 623. Even so, standing alone, I would be hard pressed to conclude that this statute constituted a barrier to the voluntary coordination of electric utilities sufficient to invoke the Commission's authority under Section 205(a) of PURPA. The hostility to the concept of regional coordination that exists in Virginia is muted sufficiently here that I might be inclined to give Kentucky the benefit of the doubt.

191. However, there are also the implications of the curtailment statute to consider, and the KPSC's use of that statute to deny KPC's transfer application. As to this state law, the KPSC has indicated that it cannot approve the KPC application until a federal/state conflict is resolved elsewhere concerning transmission curtailment practices. Its Order granting rehearing states:

While the Commission is willing to consider additional evidence as presented on rehearing, we do so with the caveat that the issue of Kentucky Power's non-compliance with KRS 287.214 has already been adjudicated in Case No. 2002-00349, and that adjudication is now pending review in both state and federal courts. Thus, the Commission's willingness to consider additional evidence in the form of analysis of cost and benefits of membership in PJM should not be misinterpreted as indicating that the Commission will not carry out its statutory responsibility to enforce KRS 278.214.<sup>52</sup>

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<sup>52</sup> *Case No. 2002-00475, Application of Kentucky Power Company D/B/A American Electric Power for the Approval, to the Extent Necessary, to Transfer Functional Control of Transmission Facilities Located in Kentucky to PJM Interconnection, LLC, Pursuant to KRS 278.218.* Order issued August 25, 2003 of the Kentucky Public Service Commission (Exh. KYC-3).

192. At oral argument, counsel for KPSC suggested that this order included an invitation to revisit this issue on rehearing. Tr. at p. 1163. However, I can ascertain no willingness to do so from that order. The fact that the subject is mentioned in the beginning of the order as one of the items for which rehearing was sought, and that the closing language of the order invites testimony on issues set for rehearing, conveniently ignores the quoted language, which to my reading indicates the item is not open for consideration on rehearing. Nor can I give much credence to witness Buechel's suggestion that there might be a way around the curtailment issue, or to counsel's suggestion that something creative might be done to eliminate this barrier to approval of the transfer. See Tr. at p. 1015; 1163. That is too wispy a reed upon which to lean in these circumstances.

193. The issue underlying KRS 278.214 is a conflict over federal and state curtailment issues that is tied up in the courts. Exh. KYC- 5 at p. 9. *See also*, Tr. at pp. 1014-15. It is also the case that this statute presents a problem no matter what entity operates the transmission system. But the fact remains that the KPSC will not act in contravention of this statute, which freezes integration in its tracks. In light of this Kentucky law and the KPSC's interpretation of its responsibilities thereunder, and the prior denial of KPC's application on this and other grounds, it is virtually certain that Mr. Mathis correctly perceived the risk of awaiting further KPSC action. There is no reason to await the KPSC's final decision on rehearing of the transfer application in light of the KPSC's decision that it cannot approve the transfer because of the curtailment statute. Exh. KYC- 2 at p. 21.

194. Here, I find and conclude that the two Kentucky statutes at issue, KRS 278.218 and KRS 278.214, as applied by the KPSC, are currently preventing AEP's Kentucky operating company, KPC, from entering into a voluntary coordination of electric utilities, as envisioned in PURPA Section 205(a), and that KPC shall be exempted from their application to the extent required to complete that company's integration into PJM.

**C. Whether, under Section 205(a) of PURPA, the Commission may exempt AEP from the laws, rules or regulations of Virginia and Kentucky, if there are other actions that need to be completed or issues that need to be resolved for AEP to join PJM.**

**1. Positions of the Parties**

195. As noted above, AEP's witness Baker contended that the actions of Virginia and Kentucky were the most important obstacles to integration of his company into PJM, but that other obstacles remained, including resolution of seams elimination charge issues, regulatory uncertainty in Ohio and Indiana, certain conditions imposed by Commission Order issued July 31, 2002, and timing factors relating to reliability issues and preferences for the timing of integration activities outside of peak periods. Exh. AEP-1, at pp. 12-15.

196. VSCC's witness Mr. Walker found a myriad of reasons other than Virginia laws and regulations why AEP has not yet joined PJM and may miss the October 1, 2004 deadline. In

his testimony, he presents twelve such obstacles, which he characterizes as “unfinished business.” In light of this list, Mr. Walker finds it “thoroughly unconvincing” to assert that it is the laws, rule and regulations of Virginia and Kentucky that are preventing AEP from joining PJM. Exh. VCC-1 at pp. 22-24.<sup>53</sup>

197. Exelon witness Naumann replied that a number of these issues remain outstanding because of Virginia and Kentucky’s failure to approve AEP’s entry into PJM, others are mere allegations of parties, still others have been resolved, and those that remain are within the control of FERC, require ministerial action by AEP, or are not required to be resolved to allow integration of AEP into PJM.

198. EME’s witness Mathis testified that there are a few conditions imposed by the Commission’s July 31, 2002 order conditionally approving the RTO choices of the New PJM Companies, as later amended by the Commission’s June 4, 2003 order on rehearing, which must be addressed before AEP can integrate into PJM. Exh. EME-10A. Mr. Mathis maintained that substantial progress has been made on many of these outstanding issues. For example, he noted that the Commission issued and reaffirmed orders on November 17, 2003, eliminating through and out rates of PJM, MISO and the former Alliance companies for transactions in the PJM/MISO region. Compliance filings to accomplish this and to implement Seams Elimination Cost Assignment (“SECA”) charges were made in January, 2004. He notes also that PJM and MISO filed a Joint Operating Agreement on December 31, 2003, which, among other things, attempts to solve operational and reliability impacts of loop flows and congestion relating to the hold harmless issue for Michigan and Wisconsin utilities. These issues, Mr. Mathis concludes, are fully resolvable by the Commission under the Federal Power Act and will not impede integration of AEP into PJM. *Id.* at p. 8-9.

199. PJM witness Wodyka agreed that all of the issues identified by Mr. Walker’s initial testimony are within FERC’s power to resolve, and that most of them have been resolved.

200. Addressing other actions that must be completed to effectuate the integration of AEP into PJM, Exelon’s witness Ms. Moler testified that parallel efforts to satisfy other requirements are irrelevant to whether the Virginia and Kentucky are preventing AEP from joining PJM. In any event, she is not aware of any requirement, other than the state approvals at issue here, that threatens the October, 2004 date for AEP to integrate into PJM. Exh. EXE- 1 at p. 18. Ms. Moler further expressed the view that Section 205(a) of PURPA: “cannot colorably be administered in a way that gives the states automatic rights to delay regional coordination merely by claiming that the Commission should not trigger exemption

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<sup>53</sup> As discussed below, VSCC and KPSC focused in their briefs on a narrower issue list. In my discussion below, I focus on the items pursued by VSCC and KPSC on brief, but note that Exelon has provided persuasive responses to the other actions, which I adopt as my conclusions as to those items.

proceedings until no other parallel requirements remain.” *Id.* She contends also that, if the Commission were unable to exercise its preemptive authority until a state authorization was the only remaining requirement, the Commission would be precluded from acting here where there are two outstanding state authorizations. She points out that each state could point to the other and claim it is not the “last man standing”, which would be an absurd outcome and contrary to the public interest. Finally, Ms. Moler expressed the opinion that a jurisdictional confrontation cannot be avoided due to the fundamental differences between Virginia and Kentucky’s views and the PJM model. She suggested that the benefits of wider coordination of wholesale electric markets and interstate transmission operations should not be held hostage to the narrower state interests advanced by these two objecting states. *Id.* at p. 19.

201. Staff argues that there are some important matters to be addressed before AEP integrates into PJM, but that it is specious to argue that all opposition assertions must be resolved before the Commission can decide a Section 205(a) issue. It contends that the Commission need not and should not wait until all else is resolved before deciding this Section 205 issue.

202. The North Carolina Parties, on the other hand, claim that AEP cannot meet the requirements of the Indiana Utility Regulatory Commission (“IURC”) approval order, presumably referring to Mr. Baker’s testimony that not all conditions in that order are under AEP’s control. The agencies also worry about the appeal of the Commission’s through and out rate order, also mentioned by Mr. Baker of AEP, arguing that this matter should be resolved before integration occurs. Another obstacle seen by the North Carolina Parties is the still pending decision by the Securities and Exchange Commission remand of the AEP/CSW merger case. *National Rural Elec. Coop. Ass’n., et al. v. SEC*, 276 F.3d 609 (D.C. Cir. 2002).

203. The North Carolina Parties further argue that the challenged state actions must be the sole obstacle in order to exercise the authority under Section 205(a). Finally the Agencies claim that PUC Ohio has abandoned the “strident” view of its Chairman, who spoke during the inquiry phase of this case, urging the Commission to “pull the trigger” and act quickly to move the integration forward. *Post-hearing Brief of North Carolina Agencies* at p. 26; Transcript of Sept. 29-30 Inquiry at p. 286-290. Ohio now favors giving the states the opportunity to complete their deliberations, the North Carolina Parties contend. *Post Hearing Brief of PUC Ohio*, at p. 3.

204. PJM contends that there is no provision in the statute that requires the State law, rule or regulation to be the sole impediment to regional coordination, since it provides the Commission with authority to exempt utilities “from *any* provision of State law, or any State rule or regulation, which prohibits or prevents the voluntary coordination of electric utilities...” 16 U.S.C. § 824a-1(a) (emphasis added). PJM points out that Indiana is among the coalition of Midwest and Mid-Atlantic Commissions supporting integration, and therefore would be an unlikely roadblock. PJM further argues that all technical requirements

of the integration would be complete by October, 2004, as AEP indicated in Mr. Baker's testimony, which identified the actions of Virginia and Kentucky as major hurdles to its integration into PJM.

205. VSCC and KPSC (since the two state Commissions offer similar arguments, I will use "VSCC" to refer to both) read the statute very differently, in effect adding the words "something that could otherwise occur" to the concept of prohibiting or preventing the voluntary coordination of electric utilities. Thus, under VSCC's reading of the statute, it would require a finding that AEP could otherwise immediately or promptly join PJM before the Commission could exempt AEP from state laws. This would, according to VSCC, require resolution of all other obstacles before the Commission could exempt AEP from state laws. Linchpin conditions remain unresolved, according to VSCC, noting Exelon witness Moler's admission that AEP would not be able to join PJM until October 1, 2004, and Exelon witness Mathis' statement that any one of a number of hurdles could stop integration. Tr. at pp. 403, 640.

206. On brief, VSCC lists the following among the hurdles remaining to be overcome:

- PUC Ohio approval for AEP's Ohio-jurisdictional operating company to join PJM.
- Conditions imposed by the IURC that are beyond AEP's control.
- Financial and operational seams issues between MISO and PJM, including resolution of the hold harmless issue for Wisconsin and Michigan utilities and implementation of the Joint Operating Agreement between MISO and PJM filed on December 31, 2003. ("JOA").
- Ongoing controversy pertaining to the "seams elimination charge/cost adjustment/assignment" ("SECA"), now the subject of settlement judge procedures.
- Cost recovery issues.

207. It is VSCC's position, as well as the position of the Joint Southern Commissions and WUTC/NMAG, that all of these issues need to be resolved before it can be found that state action is prohibiting or preventing the voluntary coordination of electric utilities, triggering FERC's Section 205(a) override authority.

208. Exelon disagrees with the VSCC's reading of the statute, arguing that it would result in the maximum possible delay in achieving Congress' intent to achieve voluntary coordination of electric utilities, or gridlock, where, as here, there are two states impeding coordination and each could point to the other as a remaining obstacle. *See* Exhs. EXE- 1 at pp. 23-24; EXE- 30 at p. 11; EXE- 100 at p. 2-3. In any event, Exelon claims that there are

no other actions needed for AEP to join PJM that cannot be resolved before October 1, 2004, as AEP's Mr. Baker testified recently. See Exh. EXE-12 at p. 57. Specifically, Indiana has already approved the transfer. Exh. AEP-1 at p. 14, Tr. at p. 705-706; Exh. VCC- 29 at p. 31. Moreover, Exelon points out that Indiana led the Midwest and Mid-Atlantic Commissions in their pleading expressing strong support for the Commission invoking its exemption authority. According to Exelon, PUC Ohio has repeatedly expressed support for AEP's joining PJM. It simply prefers that it not be accomplished by use of the Commission's Section 205(a) authority. Exh. AEP-1 at p. 14; Tr. at pp. 406, 410-11. In addition, Exelon and EME argue that there is an open question whether PUC Ohio permission is even required in this case for the transfer of control of transmission facilities of AEP's operational company in Ohio to PJM, noting that Cinergy and First Energy joined MISO without PUC Ohio approval. Tr. at p. 667.

209. As for the hold harmless issue, Exelon contends that the operational issues of the hold harmless condition have been addressed in the JOA, and the financial issues likewise have been addressed by AEP and ComEd in a joint filing made on December 31, 2003 in Docket No. ER04-364-000. Exh. EXE- 110 at p. 6. Final resolution of this issue, and other issues in the list of Mr. Walker are within the control of the Commission, and can be decided before October 1, 2004, Exelon argues.

## **2. Discussion and Conclusion**

210. I find and conclude that Section 205(a) is more reasonably construed as suggested by PJM, namely, that there is no requirement in PURPA that the challenged state law, rule, or regulation be the sole impediment to regional coordination. The statute provides the Commission with authority to exempt electric utilities "from *any* provision of State law, or from *any* State rule or regulation, which prohibits or prevents the voluntary coordination of electric utilities....." 16 U.S.C. § 824a-1(a) (emphasis added). The language is clear and unambiguous. Importantly, the statute does not say, as VSCC and its allies wish it did, "from any provision of State law, or State rule or regulation, which prohibits or prevents the voluntary coordination of electric utilities *that otherwise could occur*, or "from any provision of State law, or State rule or regulation that prohibits or prevents the voluntary coordination of electric utilities, *after the State has reached a final determination on a proposed utility action.*" For their theory to prevail, one has to add words to the statute or read in an intent that simply is not there.

211. In addition to the fact that the statute could not be clearer, the position of VSCC, KPSC, WUTC/NMAG and Joint Southern Commissions defies logic, as many parties have pointed out. For their interpretation to be plausible, one would have to find a way around the two state dilemma, where the Commission's authority under Section 205(a) could not be exercised so long as one state withheld its approval. If two states were involved, gridlock would ensue as each State could point to the other as the final impediment, Exelon witness

Moler's persuasive "last man standing" argument. It is virtually a certainty that Congress did not intend that result.

212. As Exelon has argued, it is reasonable and expected that regulatory decisionmaking on related issues will be conducted in parallel. One need not schedule actions sequentially, and await each decision in turn, in order to evaluate and exercise, if appropriate, exemption authority that may be required to remove certain identified barriers. Nor is it reasonable to expect the Commission to await a final decision from the states that have prohibited or prevented the voluntary coordination to date. As is more fully discussed above, one cannot reasonably expect the VSCC to reverse direction after its legislative advocacy campaign on behalf of extended moratoriums and unbundling to avoid federal "intrusion", and facilitate what it has argued so strenuously should be delayed or barred. Neither can one expect much from Kentucky, a state that has already rejected the proposed transfer of control required to obtain the voluntary coordination of electric utilities, and one whose regulatory agency is required to abide by the provisions of a state statute designed to protect its native load customers in curtailment situations. While the Commission could defer to the states in the months remaining before October 1, 2004, to complete their hearings and reach a decision before "pulling the exemption trigger", it does not appear likely that waiting will change the results. VSCC seems clearly on a course of delaying introduction of regional coordination, and Kentucky, even if it completes its review of KPC's transfer application before October, is still bound by the preferential curtailment statute. In order to effectuate the voluntary coordination of electric utilities contemplated by the AEP/PJM integration, the Commission may exercise its Section 205(a) authority without waiting any longer for completion of parallel state actions.

213. While I believe this finding and conclusion to be dispositive of this issue, in light of the significance of the action contemplated here, I will also consider the argument that other obstacles remain that might thwart the voluntary coordination of electric utilities, rendering unnecessary action under the Commission's Section 205(a) authority.

214. I will deal here with the issues that VSCC and its allies raised on brief. First among those is the claim that state regulatory approval in Indiana and Ohio are uncertain.

#### **a. Indiana**

215. VSCC, KPSC and allied state agencies claim that regulatory approval from the Indiana Utility Regulatory Commission remains uncertain. While acknowledging that AEP's application to transfer control of its Indiana operating company's transmission facilities to PJM has been approved by the IURC, the states claim that certain conditions imposed by the IURC remain unfulfilled. Exh. VCC- 29. They take comfort from AEP's Mr. Baker, who stated that many of the IURC conditions are beyond AEP's ability to control, for example, that there be a single dispatch for both PJM and MISO. Exh. AEP-1 at p. 14. As noted by PJM, however, the conditions imposed by the IURC are virtually identical to the conditions

imposed by the Commission in the July 31, 2002 Order, which are well underway to being satisfied, including the single dispatch condition. These issues, moreover, are under the control of the Commission, which obviously wants the integration to proceed apace. This fact and the clear statement of position from the IURC urging this Commission to proceed with the integration of AEP into PJM, render hollow VSCC's claim that the IURC presents an obstacle to implementation of the transfer of control over transmission facilities to PJM.

### **b. Ohio**

216. The VSCC and allied agencies suggest that Ohio has expressed significant concerns regarding AEP's proposal to join PJM, and it is uncertain whether the PUC Ohio will approve the application of AEP's Ohio-jurisdictional operating companies to join PJM. Exhs. VCC- 41 at p. 5; AEP-1 at p. 14. Ohio advocated allowing the states the opportunity to complete their deliberations consistent with state law. Exh. VCC-41 at p. 6. Even though this agency has pulled back from the strong position advocated by its Chairman in the Inquiry phase of his case, namely, that the Commission should "pull the trigger" and preempt the laws of Virginia and Kentucky that are impeding the integration of AEP into PJM, it nevertheless remains supportive of integration, as confirmed by AEP's Mr. Baker and by its somewhat schizophrenic *Post-hearing Brief*. Tr. at 870. PUC Ohio Initial Brief at p. 2. The PUC Ohio's positions are reconcilable, however, in that it is possible to favor integration of AEP into PJM, as it apparently does, but also object to the use of federal authority to accomplish that end. The fact that the PUC Ohio would prefer the alternative procedural approach suggested by AEP does not make it an opponent of integration, nor does it suggest that it has changed its mind and would oppose integration if it could only be achieved by use of preemptive federal authority. There is no evidence to suggest that it will become an obstacle to integration by withholding approval. In any case, there is the open question of whether Ohio law even requires such approval, in that other Ohio utilities (FirstEnergy and Cinergy) have joined other RTOs without seeking PUC Ohio approval. Tr. at p. 667. In sum, there is no evidence to support VSCC's contention that Ohio has significant concerns about AEP's joining PJM or that it would present an obstacle to integration that warrants serious worry.

### **c. Hold Harmless and JOA issues**

217. The Commission directed AEP, in its July 31, 2002 Order approving conditionally AEP's joining PJM, to propose a solution which will effectively hold harmless utilities in Michigan and Wisconsin from any loop flows or congestion that results from the proposed configuration. On December 31, 2003, AEP and ComEd filed with the Commission a proposal to deal with the financial aspects of this issue in Docket No. ER04-364-000, and the operational aspects in its JOA filing made the same day. VSCC and its allies point out that the financial filing was heavily protested, including the filing of a motion to reject the filing. Resolution of the financial aspects of this problem seems intractable, according to VSCC, and potentially an obstacle to completion of the integration of AEP into PJM.

218. This is among the issues that are within the control of the Commission. It is noteworthy that the condition imposed by the Commission, namely, filings to address these issues, has been satisfied. While these issues may be difficult for the Commission to resolve, the Commission is no stranger to difficult issues and has a pretty strong track record for resolving them in a timely manner. There is no reason to expect that these issues, which are under the Commission's control, cannot be satisfactorily resolved before October 1, 2004. I should add here that just because a Commission filing is contested, or that its resolution by the Commission may be subject to appeal, is certainly no reason to stop progress toward attainment of well-analyzed objectives that are designed to improve coordination of electric utilities and achieve the benefits attendant thereto.

#### **d. SECA**

219. VSCC, and KPSC note that the Commission ordered elimination of regional through and out rates in the MISO and PJM region and allowed the utilities to file a proposed mechanism to accomplish that, such as a Seams Elimination Charge/Cost Adjustment/Assignment," or "SECA," that would provide revenues no longer recovered through the regional through and out rates. On January 2, 2004, PJM and MISO filed revisions to their respective OATT to eliminate the through and out rates and settlement judge procedures have been established to facilitate resolution of the SECA. They note that the target date for elimination of the through and out rates and the implementation of the SECA has recently been extended to May 1, 2004. *Midwest Independent Transmission System Operator, Inc., et al.*, 106 FERC ¶ 61,106 (2004). VSCC sees the issue as being far from resolved and, by implication, a threat to the timely completion of the AEP/PJM integration.

220. Of course, one can just as easily look at the facts in the paragraph above and see the glass as half full, or even much more than half full, since the SECA filing has been made, a deadline established for completion of the task, and procedures established to facilitate and resolve remaining issues. I find and conclude that the elimination of through and out rates and implementation of SECA does not appear to be a very real obstacle to implementation of the AEP/PJM integration, given the current status of the issue. There is every reason to expect that the Commission will complete work on this matter before the target October 1, 2004 date for the AEP/PJM integration.

#### **e. Costs**

221. VSCC notes also AEP's concern about both the level and recoverability of integration-related costs. Exh. AEP-1 at p. 15. Also, VSCC contends, a PJM member company, PPL Electric Utilities Corporation, has expressed opposition to expansion of PJM and the attendant costs. Tr. at pp. 497-500. From this, VSCC concludes that concerns about integration costs may not be resolved sufficiently in order for AEP to become fully integrated into PJM.

222. This argument is simply unpersuasive. AEP's concern about implementation costs has not deterred it from developing systems and dedicating resources to become a member of PJM by October 1, 2004. AEP Initial Brief at p. 1. There is nothing to suggest that AEP views the magnitude and recovery of implementation costs as a genuine obstacle to integration into PJM. Certainly, one PJM member's concern about expansion of PJM, a concern apparently not shared by PJM management or by its many other members, does not rise to the level of an obstacle to AEP's integration into PJM. It is not as though a large number of PJM members have risen up to question the wisdom of this transaction and presented genuine issues that need to be resolved by PJM management and stakeholders before the integration can take place. In fact, the opposite is true. All systems to accommodate AEP are in place or will be in place before the scheduled October 1, 2004 target date. Exh. PJM-1 at p. 24. This simply is not an obstacle to completion of the planned integration.

223. Other asserted obstacles that were raised initially by VSCC and other parties similarly are not the kind of barriers that could stop the transaction unless resolved. Those identified in the twelve items raised by VSCC have been adequately addressed by Exelon in its rebuttal testimony, and need not be repeated here. The only item remaining is the pending remand of the SEC case dealing with the AEP/CSW merger. *National Rural Elec., supra*. That matter has been pending before the SEC for quite some time. It would not be prudent to withhold an otherwise desirable regulatory action awaiting a further decision from that agency.

224. In sum, the Commission is free to exercise its Section 205(a) authority without needing to resolve all other issues that might be pending before completion of the planned integration and without waiting final state regulatory action. This authority derives from the plain language of Section 205(a), and its exercise is not conditioned by law or affected by parallel regulatory inquiries, even if some of them may not yet be finally resolved.

**ISSUE NO. 3 - Whether the provisions of Kentucky and Virginia law or rule or regulation are neither (1) required by any authority of Federal law, nor (2) are designed to protect public health, safety or welfare, or the environment or conserve energy or are designed to mitigate the effects of emergencies resulting from fuel shortages, such that the Commission may exempt AEP from those provisions of Kentucky and Virginia law or rule or regulation.**

225. The third issue the Commission set for hearing is whether the laws, rules or regulations of Virginia and Kentucky are (1) required by any authority of Federal law; or (2) are designed to protect public health, safety or welfare, or the environment or conserve energy or are designed to mitigate the effects of emergencies resulting from fuel shortages. The Commission may not grant an exemption to AEP if it finds that the relevant provision of

state law, rule or regulation falls within the above exceptions in Section 205(a). AEP,<sup>54</sup> Cinergy, CMTC/PJMICC and PSE&G do not address this issue in their pre-filed testimony. AEP, Cinergy, Ohio Commission, Ormet and PSE&G do not address this issue in their briefs.

**A. Whether the laws, rules, or regulations of Virginia and Kentucky are required by any authority of Federal law within the meaning of Section 205(a)?**

**Positions of the Parties**

226. CMTC/PJMICC, EME, EPSA, Exelon, the North Carolina Parties, PJM, Staff and VSCC do not contend that the laws, rules, or regulations of Virginia and Kentucky at issue in this proceeding are "required by any authority of Federal law." Exh. EXE-1 at pp. 5 and 20, and Exh. EXE-90 at p. 10. KPSC's witness, Mr. Buechel, testifies that the Kentucky laws that are applicable to the KPSC's approval of the transfer of transmission facilities from AEP to PJM do not appear to be required by any authority of federal law. Exh. KYC-5 at p. 9.

227. WUTC/NMAG support the Joint Southern Commissions that while nothing in the federal law requires the Virginia or Kentucky's laws, rules or regulations, nothing in the federal law requires the preemption of the state laws at issue either.

**Discussion and Conclusion**

228. None of the parties claim that the Virginia and Kentucky actions in this proceeding are required by any authority of Federal law. Therefore, I agree with the Commission's preliminary finding that the state actions at issue do not fall under the exception of PURPA Section 205(a)(1).

**B & C. Whether the laws, rules, or regulations of Virginia and Kentucky are designed to protect public health, safety, or welfare, or the environment or conserve energy or are designed to mitigate the effects of emergencies resulting from fuel shortages?**

**1. Positions of the Parties**

**a. Generally**

229. According to CMTC/PJMICC, EME, EPSA, Exelon, PJM and Staff, the laws, rules, or regulations of Virginia and Kentucky at issue in this proceeding are not designed to

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<sup>54</sup> AEP's witness, Mr. Baker believes that the Commission's third question is most appropriately addressed by the representatives of state agencies that are parties to this proceeding.

protect the public health, safety or welfare or the environment or conserve energy or to mitigate the effects of emergencies resulting from fuel shortages within the meaning of Section 205(a)(2). Exh. EXE-1 at pp. 5-6, 20-25, Exh. EXE-90 at pp. 2, 10-15. Exelon Witness Moler argues that the state actions are based on economic protectionism and jurisdictional parochialism, and therefore are not the type of state interests that fall under the PURPA 205(a)(2) exception. Exh. EXE-1 at pp. 5-6. CMTC/PJMICC, EME, EPSA, Exelon, PJM and Staff contend that the actions of Virginia and Kentucky are designed to protect the economic interests of their ratepayers, protect the states' jurisdiction and allow the states to second-guess the Commission's decision. Exh. EXE-1 at pp. 20-24 and Exh. EME-15 at p. 13. These parties argue that these type of state interests cannot be protected under PURPA 205(a)(2) provision ("carve-out" or "savings clause"). Exh. EME-15 at pp. 7-15, Exh. EXE-1 at pp. 20-24, Exh. EXE-90 at pp. 10-15, Exh. PJM-1 at pp. 24-25 and Exh. PJM-4 at pp. 4-5.

230. In addition, Staff, Exelon, and PJM argue that the inquiry should be limited to whether the state laws at issue are designed to protect the public health, safety and welfare. They contend that the states did not seriously argue that the state actions at issue were designed to protect the environment, to conserve energy or to mitigate the effects of any emergency. Exh. EXE-90 at pp. 10-11.

231. While MISO states that it does not address the third issue, it believes that the evidence shows that AEP's participation in an RTO will contribute positively to the physical health, safety and welfare of the consumers served by AEP's affiliates in Kentucky and Virginia. Exh. MIS-1 at pp. 5-7. MISO contends that while Kentucky and Virginia may act properly to protect public health, safety and welfare of their citizens, their actions should not obstruct a proper federal objective or interstate commerce.

232. On the other hand, KPSC, the North Carolina Parties, VSCC, the Joint Southern Commissions and WUTC/NMAG argue that the laws, rules, or regulations of Virginia and Kentucky at issue in this proceeding are designed to protect the public health, safety or welfare or the environment or conserve energy or are designed to mitigate the effects of emergencies resulting from fuel shortages within the meaning of Section 205(a)(2). Exh. VCC-1, Exh. VCC-9 at pp. 24-5, Exh. KYC-5 at pp. 6-12 and Exh. KYC-7 at p. 5.<sup>55</sup> They contend that PURPA Section 205(a) cannot be used to override state laws that seek to protect the state ratepayers' ability to enjoy safe and reliable electric service at reasonable prices. *See* Exh. VCC-19 at p. 26, Exh. VCC-20 at p. 19, Exh. KYC-5 at pp. 10-12 and Exh. KYC-7 at p. 2-5.

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<sup>55</sup> States stated they had the burden with regard to Issue III. Tr. at 55-56.

### **b. Contentions that the Exception Must be Interpreted Narrowly**

233. Exelon and Staff argue that Congress passed PURPA §205(a) with the intent of expanding federal authority over the electric transmission system, thus preempting and altering the ways in which states behaved towards the interstate transmission system. *See* Exh. EXE-30 at p. 2 and Tr. at p. 291. To fulfill the federal policy of improving electric utility efficiency and wholesale electric energy distribution, Congress granted the Commission the authority to order utilities to interconnect, wheel power, and, in order to promote voluntary coordination, to exempt voluntary coordination from state interference. *See* Exh. EXE-30 at pp. 2-4. Therefore, CMTC/PJMICC, EME, EPSA, Exelon, PJM and Staff argue that Congress granted the Commission broad authority, but provided a narrow exception to the federal preemption under PURPA Section 205(a)(2). Otherwise, they argue that the exception will swallow the rule.

234. According to EME and Exelon, the savings clause and its legislative history do not discuss traditional state utility regulation, economic regulation or reliability, but these issues are addressed in other parts of the statute. They conclude, therefore, that these issues do not fall under the savings clause. Exh. EXE-30 at pp. 9-10, Exh. EXE-90 at p. 13 and Exh. EXE-100 at p. 4. CMTC/PJMICC, EME, EPSA, Exelon, PJM and Staff recommend reading the savings clause narrowly to mean "state siting laws, regulations under the Clean Air Act and zoning laws, among others," as stated in the Conference Report, *H.R. Conf. Rep. N. 95-1750*, at 95, *reprinted in* 1978 U.S.C.C.A.N. 7797, 7829. EME notes that Exelon Witness Sharp testified that Congress sought to ensure that Section 205(a) was not abused by utilities to avoid costly state regulations such as environmental siting and zoning laws, which do not threaten coordination. Tr. at pp. 306-8. At the oral argument, Exelon's counsel provided an illustrative example of a situation where the Commission cannot override a state law. A generator seeking the removal of a state law which limits its operation to 866 hours a year in San Diego, California, and thus interferes with voluntary coordination as well as economical utilization, cannot obtain relief from the Commission under PURPA Section 205(a)(2). Tr. at pp. 1240-1.

235. EME contends that the sole purpose of PURPA Section 205(a)(2) is to preempt state laws that would frustrate the congressional purpose to promote coordination of facilities and resources. Exh. EXE-1 at pp. 23-24, Exh. EXE-30 at p. 9, Exh. EXE-90 at p. 30 and Exh. EME-15 at pp. 11-12 and 14. Thus, EME along with CMTC/PJMICC, EPSA, Exelon, PJM and Staff, believe that Section 205(a)(2) cannot be read to shield state laws that second-guess the Commission's decisions regarding regional coordination for the improved operation of the transmission grid, especially if the laws are designed to capture economic benefits for the state's citizens, at the expense of another state's citizens.

236. Exelon Witness Moler maintains that PURPA Section 205(a) gives the Commission the authority to determine whether the state laws at issue are designed to protect the public health, safety and welfare. Exh. EXE-90 at p. 13.

237. Exelon Witness Moler contends that even if some traditional state utility regulation fell within this carve-out clause, the state efforts in this proceeding are not in that category because they constitute efforts to veto the Commission's decisions on bulk power transmission and wholesale markets. She then argues that even if any traditional state utility regulatory effort might be viewed as protecting the public health, safety and welfare, the Commission would have to know the context in order to determine whether the carve-out would apply. Exh. EXE-90 at p. 13. EME and EPSA support this contention.

238. While the North Carolina Parties argue that regulation of utilities is a state police power, PJM asserts that that exercises of the state police power should be limited to such local health and safety matters that are supplemental to, but not in conflict with, the overall goal of the statute. *PJM Post-hearing Brief* at p. 40.

239. CMTC/PJMICC, EME, Exelon, PJM, and EPSA disagree with the states' contentions that they are just engaged in traditional utility regulation which is always designed to protect the public health, safety, or welfare of the citizens of their states. EME, Exelon and CMTC/PJMICC note that the VSCC witness Walker testified during hearings that every Virginia law dealing with electric utility matters is designed to promote the public health, safety and welfare. Tr. at p. 774. They assert that such a reading would turn PURPA Section 205(a) into a nullity, because a broad carve-out would allow a state to frustrate other states' actions and nullify Commission's decisions regarding the coordination of utilities for the economical utilization of facilities by claiming that it was exercising its traditional authority. See Exh. EXE-90 at p. 13 and Exh. EME-15 at p. 14.<sup>56</sup> Exelon cites to a prior Section 205(a) case, where the Commission found that traditional state utility regulation is precisely what Congress intended to be subject to the Commission's exemption authority, even though the state authority may be otherwise legitimate.<sup>57</sup>

240. EME next argues that Section 205(a)(2) cannot be read to expand state authority beyond the restriction on state power imposed by the Supremacy Clause and Commerce Clause of the U.S. Constitution. Exh. EME-15 at p. 11, 14. EME argues that courts have struck down state laws that discriminate in favor of its own citizens because they pose an impermissible burden on interstate commerce and are invalid under the Commerce clause. *EME Post-hearing Brief* at p. 61 citing to, e.g., *New England Power Co. v. New Hampshire*, 455 U.S. 331(1982).

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<sup>56</sup> Exelon notes that courts have held that Congress is not presumed to have engaged in meaningless acts and statutory interpretations are rejected if they reduce a statute to a nullity. *Exelon Post-hearing Brief* at p. 70, citing to *Alaska Dep't of Env'tl. Conservation v. EPA*, 124 S. Ct. 983 at p.1002 (2004).

<sup>57</sup> See *Exelon Post-hearing Brief* at pp. 71-73, citing to *Central Power and Light Co.*, 8 FERC ¶ 61,065, *modifying order and denying reh'g*, 9 FERC ¶ 61,011 (1979), *reh'g denied*, 10 FERC ¶ 61,1311 (1980).

241. CMTC/PJMICC, Exelon and Staff argue that the states' concerns about reliability, while important, are not relevant when analyzing Section 205, because this factor is not listed under PURPA Section 205(a)(2). Exh. EXE-100 at pp. 4-5 and Tr. at p. 293. They note that while reliability is discussed in detail in both the PURPA language and its legislative history, it does not appear in the plain language of Section 205(a)(2), or in the legislative history of Section 205(a). Tr. at pp. 318-9 and Exh. EXE-100 at p. 4. Thus, Exelon and CMTC/PJMICC believe that Congress intentionally excluded reliability from the carve-out provision. These parties caution that this is another situation where a state could raise a potential reliability concern in any instance of voluntary coordination to prevent such coordination, thus turning PURPA Section 205(a) into a nullity.

242. Exelon and CMTC/PJMICC maintain that the Commission has the authority to address reliability concerns, because the bulk power market issues arising in the context of RTO integration fall exclusively under federal authority set in PURPA, and not under any state authority protected from exemption under section 205(a)(2). *See* Exh. EXE-100 at pp. 3-5, Exh. EXE-130 at pp. 10-14; Tr. at pp. 296, 318 and 1083-5. Exelon argues that, in Section 2, Congress assigns the "public health, safety and welfare" duty to federal, not state, authority. It surmises that such a duty requires the Commission to address among other issues the "increased efficiency in the use of facilities and resources by electric utilities," i.e., coordination and reliability. Thus, Exelon and Staff believe that while states may have a reliability concern, this does not grant them authority or any jurisdiction over the operation of the interstate transmission system.

243. Exelon and AEP both argue that AEP's integration into PJM will improve the reliability of the interconnected transmission grid. Exh. PJM-1 at pp. 18-20, Exh. EXE-40 at pp. 13-15, Exh. PS-1 at pp. 16-17, Exh. EME-1A at p. 12, Exh. IND-2 at pp. 8-9. AEP suggests that this benefit is not easily quantified but potentially is of significant value. *AEP Post-hearing Brief* at p. 4.

244. In addition, EME notes that VSCC characterizes the notion that SMD would eliminate Virginia's native load requirement and treat Virginia's customers like similarly situated customers located outside Virginia, as a reliability concern. *EME Post-hearing Brief* at p. 69. EME argues that such a concern conflicts with Order No. 888, is not a state concern and is a discriminatory interference with interstate commerce in violation of the Commerce Clause. Thus, EME contends such a concern cannot be protected under the savings clause at PURPA Section 205(a)(2).

245. Exelon's Witness Schnitzer testifies that any traditional state authority over aspects of reliability will be unaffected by AEP joining PJM. Exh. EXE-130 at pp. 10-14. Staff does not believe that the outcome of this proceeding will alter the states' jurisdiction over the areas they currently control. *See* Tr. at pp. 1085-6. EME notes that AEP is transferring control of Commission-jurisdictional transmission systems and the operation of such systems

is governed by a tariff filed with the Commission. EME, Exelon and PJM assert that the transfer will not shift any authority from state government to the federal government, thus Virginia and Kentucky will have the same ability to regulate their incumbent electric utilities after the integration as before. Exh. EXE-130 at p. 12.

246. EME, EPSA, Exelon, MISO and PJM assert that Congress granted the Commission exclusive jurisdiction over "the transmission of electric energy in interstate commerce" and "the sale of electric energy at wholesale in interstate commerce." *Federal Power Act*, Section 201, 16 U.S.C. § 824(b)(1). Exh. EXE-1 at p. 23. EME, then argues, that the U. S. Supreme Court has made it clear that exclusive federal authority over the transmission system extends even into areas in which states may have attempted to regulate in the past. *EME Post-hearing Brief* at p. 62, citing to *New York v. FERC*, 535 U.S. 1, 19-20 (2002). MISO argues that a regional approach to the operation of the transmission grid is a proper objective of federal regulatory authorities. Exh. MIS-1 at pp. 5-6.

247. EME, EPSA, Exelon and PJM conclude that PURPA Section 205(a)(2) cannot protect Virginia's and Kentucky's actions that prevent AEP's integration into PJM, because these state laws directly conflict with the Commission's approval of this integration. Exh. EME-15 at p. 11. They argue that the state actions attempt to usurp the Commission's authority by frustrating or second-guessing its interstate transmission policies. Exh. EXE-1 at pp. 23-24. Therefore, they argue that the state actions are preempted because the Commission exercises plenary authority over interstate transmission.

248. PJM cautions that if the exception is read broadly as suggested by the states, then the Commission would be powerless to enable the voluntary coordination of utilities in cases where two states pass conflicting laws, each in the name of public health, safety or welfare. Exelon and PJM argue that the dispute in this proceeding is not between the Commission and the states, but actually between Virginia and Kentucky on the one hand, and the other numerous states that support full integration of AEP into PJM. CMTC/PJMICC, Exelon, EME, PJM and Staff argue that this is exactly the type of situation PURPA Section 205 (a) is designed to address; it gives the Commission the authority and responsibility to resolve this interstate impasse so that certain states do not hold regional efficiencies hostage to their own interests. See Exh. EME-15 at p. 11, Exh. EXE-1 at pp. 23-24, Exh. EXE-30 at p. 9 and Exh. EXE-90 at p. 13.

### **c. Contentions that the Exception Must be Interpreted Broadly**

249. Joint Southern Commissions, KPSC, North Carolina Parties, VSCC, WUTC/NMAG argue that the Commission cannot limit the "public health, safety, or welfare" provision to "environmental and land use laws" based on the language in the Conference Committee Report. *Joint Southern Commissions Post-hearing Brief* at p. 42, *KPSC Post-hearing Brief* at p. 33, *North Carolina Parties Post-hearing Brief* at pp. 31-33, *VSCC Post-hearing Brief* at p. 51, and *WUTC/NMAG Post-hearing Brief* at p. 10. They argue that it is apparent from the

words “among others” and “include” used in the Conference Report that the list is a non-exclusive list of examples. *H.R. Conf. Rep. N. 95-1750*, at p. 95 (1978). VSCC, KPSC and WUTC/NMAG, further believe that if Congress intended to limit the protection for state laws to environmental and land use planning areas, it would have stated so explicitly in the statute.

250. WUTC/NMAG assert that Congress expressly relied on the “public health, safety, and welfare” standard in PURPA Section 2 to justify the broad purposes of PURPA, and therefore the Commission may not construe the phrase “public health, safety, or welfare” in Section 205(a)(2) narrowly.<sup>58</sup> KPSC and VSCC point out that Congress used the phrase “public health, safety and welfare” in Section 2 of PURPA to include equitable retail rates for electric consumers and the reliability of electric service.<sup>59</sup> KPSC, North Carolina Parties and VSCC assert, therefore, that the statutory language of PURPA makes it clear that Congress understood “the protection of the public health, safety and welfare” to encompass both economic considerations, such as ratemaking, as well as non-land use related matters, such as the reliability of electric service.

251. The Joint Southern Commissions, KPSC, North Carolina Parties, VSCC and WUTC/NMAG, refute the Commission’s conclusion that economic regulation is not the sort of protection of public welfare envisioned by Congress in PURPA Section 205(a). The Joint Southern Commissions and WUTC/NMAG assert that even if the regulations of Virginia and Kentucky were solely economic, such state actions should be protected from Commission exemption because the ratemaking authority of a state commission is exercised for the public welfare. *See Joint Southern Commissions Post-hearing Brief* at p. 42 and *WUTC/NMAG Post-hearing Brief* at p. 8, citing to *Arkansas Natural Gas Co. v. Arkansas R.R. Comm’n*, 261 U.S. 379, 383 (1983).

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<sup>58</sup> *See WUTC/NMAG Brief* at p. 9, citing to *Gustafson v. Lloyd*, 513 U.S. 561, 570 (1995) (When Congress uses the same words in the same act, those words are “intended to have the same meaning.”).

<sup>59</sup> The Congress finds that the protection of the public, health, safety, and welfare, the preservation of national security, and the proper exercise of congressional authority under the Constitution to regulate interstate commerce require –

(1) a program providing for increased conservation of electric energy, increased efficiency in the use of facilities and resources by electric utilities, and *equitable retail rates for electric consumers*,

(2) a program to improve the wholesale distribution of electric energy, the *reliability of electric service*, the procedures concerning consideration of wholesale rate applications before the Federal Energy Regulatory Commission, the participation of the public in matters before the Commission, and to provide other measures with respect to the regulation of the wholesale sale of electric energy . . .

16 U.S.C. § 2601 (emphasis added).

252. North Carolina Parties, KPSC and VSCC argue that proper statutory interpretation requires ascertaining congressional intent, and that the plain meaning of the term should be used to determine legislative intent.<sup>60</sup> They note that since the phrase “public health, safety or welfare” is not defined in PURPA, it must be interpreted in accordance with its plain meaning. They argue that the Black’s Law Dictionary defines “public welfare” as a broad concept which encompasses a number of elements, including economic elements.<sup>61</sup> Therefore, VSCC argues that Virginia’s actions in designing and enacting the Virginia Electric Restructuring Act to protect against adverse economic impacts from a Virginia utility’s decision to join an RTO cannot be preempted by the Commission. KPSC argues that its actions, similarly, cannot be preempted.

253. According to the North Carolina Parties, the U. S. Supreme Court has recognized that each state has police powers which broadly encompass public health, safety, morals and general welfare of the public.<sup>62</sup> North Carolina Parties maintain that the language of Section 205(a)(2) closely resembles the definition of a state’s police power, and that regulation of utilities is one of the most important components of a state’s police power. North Carolina Parties contend that because the U.S. Constitution protects a state’s exercise of police power, absent specific constitutional restrictions, Virginia and Kentucky are allowed to adopt the policies and the legislation if they believe are reasonably necessary to promote public welfare. Thus, North Carolina Parties argue that as long as the purpose of state law or decision appears to further public interest, the Commission lacks the authority under Section 205(a) to override a state law or decision because it disagrees with the state’s public interest determination.

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<sup>60</sup> See *VSCC Post-hearing Brief* at p. 51, citing to *Lamie v. United State Trustee*, 124 S. Ct. 1023 at p. 1030 (2004). See *North Carolina Parties Post-hearing Brief* at p. 28, citing to *Hartford Underwriters Insurance Company v. Union Planters Bank*, 530 U.S. 1, 6 (2000) and *FERC v. Martin Exploration Management Company*, 486 U.S. 204, 209 (1988).

<sup>61</sup> The prosperity, well-being, or convenience of the public at large, or of a whole community, as distinguished from the advantages of an individual or limited class. It embraces the primary social interests of safety, order, morals, economic interest, and non-material and political interests. In the development of our civic life, the definition of “public welfare” has also developed until it has been held to bring within its purview regulations for the promotion of economic welfare and public convenience.

*Black’s Law Dictionary* at p. 1109 (5th ed. 1979).

<sup>62</sup> *North Carolina Parties Post-hearing Brief* at p. 29 citing to *Nashville, Chattanooga & St. Louis Railway v. Walters, Commission of Highways*, 294 U.S. 405, 429 (1935); *Eubank v. City of Richmond*, 226 U.S. 137, 142 (1912); *Chicago, Burlington & Quincy Railway Company v. Illinois, ex rel. Drainage Commissioners*, 200 U.S. 561, 592 (1906).

254. The Joint Southern Commissions, KPSC, North Carolina Parties and VSCC believe that states have a legitimate interest in determining whether their citizens will receive economic benefits if jurisdictional utilities join an RTO. AEP states that the KPSC and VSCC have expressed concerns about the net benefits to their ratepayers of AEP joining PJM. It notes that both state commissions require AEP to demonstrate in state approval proceedings that the benefits to ratepayers of such participation will outweigh the costs that ratepayers will have to pay. *AEP Post-hearing Brief* at pp. 2 and 13. Joint Southern Commissions and KPSC maintain that if VSCC and KPSC approved AEP joining PJM without a full analysis of the costs and benefits to determine whether their jurisdictional utilities' membership into PJM is in the best interest of their ratepayers, the state commissions would be abdicating their responsibility. See *Joint Southern Commissions Post-hearing Brief* at p. 3, and *KPSC Post-hearing Brief* at p. 43 citing to KRS 278.030. They argue that the costs and benefits must include economic, as well as reliability, continuity of service, siting and environmental considerations, among others.

255. While the Muni-Coop Coalition offers no other argument on this issue, it believes that if LMP imposes unduly burdensome costs on consumers, the impacts may be relevant to the "public health, safety and welfare" issue. Exh. MCC-1 at p. 18. The Muni-Coop Coalition believes that appropriate steps would mitigate such impacts.

256. North Carolina Parties, Joint Southern Commissions, KPSC and VSCC argue that state actions motivated by concerns about the reliability of the electric transmission system are within the savings clause. Exh. VCC-1 at pp. 15-16, Exh. VCC-20 at pp. 17-19, Exh. KYC-7 at p. 9. They contend that Exelon's witnesses and EME Witness Mathis appear to concede that states have a role in the siting of transmission lines and certification of transmission facilities, and that it is proper for a state to consider reliability when deciding to issue a certificate of convenience and necessity for a transmission facility. Tr. at pp. 298-304, Tr. at pp. 418-420 and Tr. at pp. 683-685. VSCC points to Witness Sharp's testimony that there can be adverse impacts on public health, safety and welfare if electric service is not reliable. Tr. at pp. 313-4. It also highlights MISO Witness Svanda's statements that there is a link between reliability of electric service and the public health, safety and welfare. Tr. at pp. 451-452. The Joint Southern Commissions point to Witness Svanda's testimony to show that besides reliability, other state activities related to transmission lines such as planning, maintenance and operation, impact the public health, safety and welfare. Tr. at pp. 453-62. They conclude that state regulators, not the Commission, have the legal responsibility to ensure that their citizens continue to receive safe and reliable electric service at the lowest reasonable cost.

257. The WPSC/UPPC warns that the Commission's case may not survive judicial challenge, because the legislative history of PURPA Section 205(a) is sparse, and thus, a court may interpret the carve-out provision broadly to include state laws, rules and regulations that address reliability. *WPSC/UPPC Post-hearing Brief* at p. 8.

258. North Carolina Parties, KPSC, VSCC and WUTC/NMAG refute the argument that the carve-out provision should be narrowed to exclude state actions related to matters that are claimed to be within the Commission's exclusive jurisdiction. *North Carolina Parties Post-hearing Brief* at pp. 32-36, *KPSC Post-hearing Brief* at pp. 36-37, *VSCC Post-hearing Brief* at pp. 55-56 and *WUTC/NMAG Post-hearing Brief* at p. 10. The Joint Southern Commissions contend that FPA is the exclusive source of the Commission's power, and even that excludes matters that are subject to state regulation. *See* 16 U.S.C. § 824(a). *Joint Southern Commissions Post-hearing Brief* at p. 30 and *WUTC/NMAG Post-hearing Brief* at p. 10, citing to *Connecticut Light & Power Co. v. FPC*, 324 U.S. 515, 523-30 (1945). North Carolina Parties, KPSC and VSCC assert that the Commission has concurrent, not exclusive, jurisdiction over transmission facilities. Exh. VCC-19 at p. 6.

259. KPSC and VSCC argue that the Commission's exclusive jurisdiction under the FPA is limited to rates, terms and conditions of wholesale electric service in interstate commerce. *See KPSC Post-hearing Brief* at pp. 37-42 and *VSCC Post-hearing Brief* at pp. 56-59. KPSC and VSCC argue that the FPA preserves the states' broad authority over electric utilities operating within their borders and the facilities constructed within them.

260. North Carolina Parties, Joint Southern Commissions, KPSC and VSCC further argue that the Commission's authority over transmission is not exclusive, pointing out that the Commission lacks authority under the FPA to issue certificates for the construction, operation or abandonment of electric transmission lines. *North Carolina Parties Post-hearing Brief* at p. 35, *Joint Southern Commissions Post-hearing Brief* at pp. 36-37, *KPSC Post-hearing Brief* at p. 39, *VSCC Post-hearing Brief* at pp. 57-58. They note that states have been vested with the authority to regulate fundamental aspects of the facilities used in the wholesale transmission of electricity, including whether and what to build. In Kentucky, for example, public utilities need a certificate of public convenience and necessity from the Commonwealth of Kentucky to construct major transmission facilities within the state. *See* KRS 278.020(1) and KRS 278.027 (2002). Also, the right of eminent domain to construct utility property in Kentucky is a right granted by the Commonwealth under state law, not by the Commission under federal law. *See* KRS 416.130(2) and KRS 416.140 (2002). In Virginia, for instance, public utilities need a certificate of public convenience and necessity from the Virginia in order to construct, acquire or operate transmission facilities within the Commonwealth of Virginia. *See* Virginia Code Section 56-265.2A (VCS 56-265.2A). Also, the right of eminent domain to construct utility property in Virginia is a right granted by the Commonwealth under state law, not by the Commission under federal law. *See* VCS 56-49. VSCC points out that the November 25 Order recognizes the states' authority with regard to siting of bulk transmission facilities. November 25 Order at p. 125.

261. According to North Carolina Parties, state siting statutes require a determination of whether the public convenience and necessity requires the construction and operation of proposed transmission and generation facilities, which in turn requires an examination of issues relating to service adequacy and reliability and least cost integrated resource planning

concerns. See VCS 56-265.2 and 56-579 (Exh. VCC-18), KRS 278.218 and Exh. KYC-5 at pp. 5-6.

262. According to Joint Southern Commissions, North Carolina Parties, KPSC and WUTC/NMAG, transmission service associated with retail bundled service is excluded from the scope of Commission's jurisdiction, even when that transmission involves interstate commerce. *Joint Southern Commissions Post-hearing Brief* at pp. 32-34, *North Carolina Parties Post-hearing Brief* at p. 34, *KPSC Post-hearing Brief* at p. 37 and *WUTC/NMAG Post-hearing Brief* at p. 11. KPSC provides that, in Kentucky, retail service is provided on a bundled basis, i.e., there is no separate retail transmission service.

263. The Joint Southern Commissions and WUTC/NMAG assert that states have a compelling interest in the ownership or control of the transmission assets because such assets are crucial to a utility's public service obligations to provide intrastate services. *Joint Southern Commissions Post-hearing Brief* at p. 35 and *WUTC/NMAG Post-hearing Brief* at p. 10. They also believe that state commissions have full authority to approve any transfer of ownership or control of transmission assets that may be required for RTO participation.

264. The Joint Southern Commissions contend that Congress rejected the House version of PURPA that explicitly authorized the Commission to order utilities into power pooling arrangements, and Congress has not granted the Commission that authority since PURPA was enacted in 1978. Exh. EXE-30 at p. 8, Tr. at pp. 288-90. Thus, Joint Southern Commissions, North Carolina Parties and WUTC/NMAG argue that the Commission lacks the statutory authority to unilaterally approve RTOs, or require membership in such organizations and the Commission cannot preempt the state commissions' authority in this area. *Joint Southern Commissions Post-hearing Brief* at pp. 35-37, *North Carolina Parties Post-hearing Brief* at pp. 38-39 and *WUTC/NMAG Post-hearing Brief* at p. 11. Thus, Joint Southern Commissions conclude that any attempt by the Commission to force AEP into PJM RTO is beyond its authority under the FPA. *Joint Southern Commissions Post-hearing Brief* at p. 38.

#### **d. Virginia's Laws, Rules or Regulations**

265. According to VSCC, the plain text of the Virginia Electric Restructuring Act the legislative background of this statute<sup>63</sup> implementing regulations, as well as the application of those regulations, demonstrate that the laws, rules and regulations of Virginia challenged in this proceeding are not only focused on economics, but also on safety, reliability and adequacy of service, as well as environmental impacts, and fall under PURPA Section

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<sup>63</sup> VSCC witness Walker testifies at length to the legislative background of the statute enacted in 1999. Exh. VCC-1 at pp. 6-10. In 2003, the Virginia General Assembly passed HB 2453, which modified this statute.

205(a)(2). *See* Exh. VCC-1, Exh. VCC-10 at 10-21, Exh. VCC-11 at p. 11, Exh. VCC-12, Exh. VCC-20 at pp. 11-12, and Exh. VCC-26.

266. VSCC, the Joint Southern Commissions and WUTC/NMAG argue that the relevant Virginia statutes qualify for protection because they require the VSCC to determine that any transfer of a utility's transmission assets to an RTO "will promote safe and reliable systems, and will generally promote the public interest," and the VSCC may only delay a transfer of transmission assets on the basis of "reliability, safety ... or market power considerations." VCS 56-579(A)(2)(a)(1)-(2) and (A)(2)(d). *See also* Exh. VCC-1 at pp. 9-11.

267. VSCC notes that the Virginia Electric Restructuring Act, as amended, requires the VSCC to address consumers' needs for economic and reliable transmission in conjunction with its review of utilities' functional control transfer applications. It provides that in addition, utilities requesting VSCC authorization to transfer functional control of their transmission assets to an RTO must provide to the VSCC a study of the comparative costs and benefits of such a transfer, including a description of the economic effects on consumers and the effects of any such transfers on transmission congestion costs. VSCC may approve such proposed transfers if it determines that the conditions in the Act are satisfied. VSCC concedes that the Virginia legislature was, and continues to be concerned with actions which might have adverse economic impacts detrimentally affecting the public welfare, however, it argues that the Virginia legislature's concern was, and continues to be, the safety, reliability and adequacy of electric service. Exh. EXE-92 at pp. 13, 19, and 25; *see also* Exh. VCC-1 and Exh. VCC-19.

268. VSCC witness Spinner concludes that a reasonable reading of the savings clause is that Congress knew that there were valid state interests better known to states and reasonably protected by them, and if the Commission were to exempt an electric utility from an applicable state requirement, that state requirement would first have to be shown to serve "no validly applicable protectable state interest." Exh. VCC-19 at pp. 23-24.

269. Furthermore, VSCC Witness Walker argues that even the rules and regulations implementing VSC 56-579 are designed to promote public health, welfare and safety because the VSCC requires utilities to satisfy the following five criteria to be allowed to participate in an RTO: reliability practices, pricing and access policies, independent governance, consistency with Commission policy, and fair compensation to the transferor.<sup>64</sup> Mr. Walker testifies that the VSCC, while developing rules in accordance with VCS 56-579, considered the impact of RTO development on reliability, construction, planning and operation of transmission facilities, market power monitoring, environmental issues, and geographic

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<sup>64</sup> *Regulations Governing Transfer of Transmission Assets to Regional Transmission Entities*, 20 Va. Admin. Code § 5-320-10 *et seq.* (2003). *See also* 20 VAC 5-320-40, 5-320-50 and 5-320-60 (Exh. VCC-12).

scope and access to markets.<sup>65</sup> He contends that such consideration was in the interest of protecting the public interest and public welfare. Moreover, he believes that the regulatory filing requirements imposed on a utility seeking to participate in an RTO or sell its transmission assets are also intended for the protection of the public interest and public welfare.<sup>66</sup> He notes that the VSCC adopted the regulations after finding that portions of the Virginia Electric Restructuring Act pertaining to RTOs were not preempted by federal law.<sup>67</sup> Exh. VCC-1 at pp. 12-19.

270. On the other hand, CMTC/PJMICC, EME, Exelon, EPSA, MISO, PJM and Staff assert that the statutory language, the legislative history of HB 2453, and VSCC's orders pursuant to the amended VCS 56-579 demonstrate that the state's actions were designed only to protect the economic interests of Virginia ratepayers because the states sought to shield their consumers from the impact of SMD and maintain the preferential treatment for their consumers in the operation of an interstate transmission grid by second-guessing the Commission's decisions on RTOs as well as preserve the state's jurisdiction against intrusion by this Commission. Exh. EME-15 at pp. 5-12, Exh. EXE-1 at pp. 5-6 and 20-22, and Exh. EXE-90 at pp. 11-14. They argue that that the 2003 amendments to VCS 56-579 added a moratorium against Virginia utilities joining an RTO to protect economic interests within the state and to preserve Virginia's jurisdiction. Exh. EME-15 pp. 3-12, Exh. EXE-1 at pp. 14-24. They assert that the other amendments to VCS 56-579 are also economic in nature and include: requiring an evaluation of a cost-benefit analysis as part of the application process; VSCC's duty to report on economic effects on consumers; elimination of the requirement that VSCC must further the successful development of RTOs; require VSCC to ensure that consumers' needs for economic and reliable transmission are met. Exh. VCC-1 at pp. 10-11. These parties argue that the legislative history of HB 2453, which includes the LTTF Report, the VSCC's December 30 Report, as well as the floor debates, demonstrate that the Virginia General Assembly was preoccupied with economic impacts. Exh. EME-15 at pp. 7-10, Exh. EME-17, Exh. EME-18, Exh. EXE-1 at pp. 22-23, Exh. EXE-90 at pp. 11-12, Exh. EXE-92 at pp. 3, 5, 15-16, 18, 21-22, & 24-26, Exh. EXE-92, Exh. S-1, Exh. S-2 and Exh. S-3.

271. Staff clarifies that the Commission is not being asked to preempt those portions of the Virginia Electric Restructuring Act which are not implicated by AEP's effort to integrate into PJM. *Staff Post-hearing Brief* at p. 67. Exelon Witness Moler advocates that "the Commission exempt AEP from complying with the state laws, rules and regulations at issue

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<sup>65</sup> *Order Establishing Investigation and Inviting Comments, Ex Parte: In the matter concerning participation of incumbent electric utilities in regional transmission entities*, Case No. PUE-1999-00349 (1999) (Exh. VCC-10 at pp. 10-21).

<sup>66</sup> 20 VAC 5-320-100 and 5-320-110 (adequate service to the public at just and reasonable rates will not be impaired") (Exh. VCC-12 at p. 16).

<sup>67</sup> *Final Order, Ex Parte: In the matter concerning participation of incumbent electric utilities in regional transmission entities*, Case No. PUE-1999-00349 (1999) (Exh. VCC-11 at p. 11).

to the extent needed to allow AEP to fully integrate with PJM.” Exh. EXE-90 at 14. In its *Post-hearing Brief* at p. 77, Exelon argues that because the VSCC's regulations implementing VCS 56-579 track the Commission's RTO requirements, they give the VSCC a chance to second-guess the Commission's RTO decisions, and therefore should be preempted. *See* Exh. VCC-20 at pp. 13-23 and Exh. VCC-26 at p. 4.

272. Finally, CMTC/PJMICC, EME, Exelon and Staff advocate the preemption of the VSCC orders on AEP's application because they focus on economic interests. *See* Exh. EXE-20 at p. 3. MISO argues that the VSCC delayed taking any substantive action on AEP's application to transfer control of its transmission assets to PJM and encouraged the Virginia General Assembly to pass legislation aimed at preserving the state's jurisdiction over matters subject to federal control. Tr. at pp. 630 and 676-77.

#### e. Kentucky Laws, Rules and Regulations

273. KPSC witness Buechel argues that KRS 278.218 (quoted *infra.*) and the orders pursuant to this statutory section are designed to protect the public health, safety and welfare. Exh. KYC-5 at p. 9. According to KPSC, the state commission can only approve the transfer of control of transmission facilities after the two requirements of KRS 278.218 are fulfilled: the transferring utility demonstrates that the assets will continue to be used to provide the same or similar level of service; and the transfer of control is for a “proper purpose” and is consistent with “public interest.” Exh. KYC-5 at pp. 5-6. KPSC admits that the statute does not define public interest, thus it has developed a definition of public interest in recent orders,<sup>68</sup> and that the analysis is a two-step process. Exh. KYC-3 at pp. 4-5. KPSC witness Buechel admits that the public interest analysis includes an economic analysis, but he opines that the KPSC August 25, 2003 Order's reference to both “service” and “rates” indicates that the KPSC's analysis of public interest under KRS 278.218 implicates non-economic issues, including, among other things, reliability and adequacy of service. Exh. KYC-7 at pp. 3-4 discussing KYC-3 at p. 4. He notes that the second step in the public interest inquiry focuses upon the transaction's benefits, if any, to the public. KYC-7 at pp. 3-4. Witness

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[A]ny party seeking approval of a transfer of control must show that the proposed transfer will not adversely affect the existing level of utility service or rates or that any potentially adverse effects can be avoided through the Commission's imposition of reasonable conditions on the acquiring party. The acquiring party should demonstrate that the proposed transfer is likely to benefit the public through improved service quality, enhanced service reliability, the availability of additional services, lower rates, or a reduction in utility expenses to provide present services. Such benefits, however, need not be immediate or readily quantifiable.

KYC-6 at p. 9-10 (footnotes omitted).

Buechel contends that there is no indication that KPSC's analysis of benefits will focus exclusively on economic issues, because by stating that "[s]uch benefits need not be immediate or readily quantifiable," the KPSC must have contemplated addressing non-quantifiable benefits and these generally include reliability and adequacy of service. Exh. KYC-2 at p. 2, Exh. KYC-3 at p. 5 and Exh. KYC-7 at pp. 3-4.

274. Another example that KPSC provides to show that it considers economic and non-economic factors, is the data requests that the KPSC Staff made of Kentucky Power in Case No. 2002-00475. KPSC suggests that a review of these requests demonstrates that it examines matters related to reliability, quality of service, environmental compliance, and public welfare. For example, Item Nos. 9, 12 and 13 of the KPSC Staff's First Set of Data Requests deal with matters directly related to reliability. Exh. KYC-8 at pp. 1-3. Item Nos. 8 and 9 of the KPSC Staff's Supplemental Data Requests delve into environmental compliance matters. Exh. KYC-8 at pp. 10-11.

275. KPSC answers the argument that it is engaging in revisionist history for litigation purposes in contending that state's laws fall within the PURPA Section 205 carve-out by noting that KRS 278.218(b)(2) was enacted by the Kentucky General Assembly of Kentucky in 2002. Exh. EXE-1 at p. 20; Exh. KYC-2 at p. 1. It notes that the public interest standard KPSC applied in the AEP proceeding was refined in the May 20 Order, Exh. KYC-6 at pp. 9-10, issued in 2002. *Id* at p. 2, n.2. KPSC states that AEP submitted its application on December 19, 2002. The suggestion that PURPA Section 205 might be used to preempt Kentucky's consideration of AEP's application did not appear until February 28, 2003. Tr. at pp. 391-2. It points out that finally, the Exelon motion seeking Commission action under PURPA Section 205 was not filed until March 17, 2003. November 25 Order at P 127, n. 144. See *KPSC Post-hearing Brief* at pp. 45-46.

276. Both Joint Southern Commissions and WUTC/NMAG assert that KRS 278.218(2) imposes a public interest requirement on the transfer of ownership or control of transmission assets of a public utility, which includes maintaining reasonable rates and the reliable and safe transmission of electricity to the citizens of those states. WUTC/NMAG asserts that states use the public interest standard for public utility regulation, which always includes consideration of public health, safety, or welfare.<sup>69</sup> The Joint Southern Commissions support the KPSC denial of AEP's application on that basis that the transfer was not in the public interest because the application failed to show any demonstrated or quantifiable benefits to Kentucky ratepayers.

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<sup>69</sup> See *WUTC/NMAG Post-hearing Brief* at p. 8, citing to *General Motors Corp. v. Tracy*, 519 U.S. 278, 306 (1997) (The parties argue that the Court's finding that state regulation of natural gas sales to consumers served important interests in health and safety, is applicable to electricity.).

277. CMTC/PJMICC, EME, Exelon, EPSA, PJM and Staff argue that KRS 278.218, is designed to protect the economic interests of Kentucky ratepayers, to address reliability of the bulk power transmission system, and to protect the jurisdiction of the KPSC. Exh. EME-15 at pp. 12-15, Exh. EXE-1 at pp. 20-22, Exh. EXE-90 at p. 14 and Exh. KYC-2 at pp. 19-21. According to Exelon, the KRS 278.218 does not indicate on its face that it falls within the carve-out of PURPA Section 205(a). Staff asserts that the statutory phrases “public interest” and “proper purpose” are not defined in the statute, and could be interpreted broadly to stretch the narrow exemption of that PURPA provision so greatly that it would become the general rule. Staff argues that under KRS 278.218, KPSC admits that an application that meets the public interest standard could fail the overbroad “proper purpose” requirement. Tr. at pp. 1012-13. At oral argument though, KPSC’s counsel submitted that the public interest test used by KPSC includes both public interest as well as proper purpose. Tr. at pp. 1161-3. He pointed out that the July 17 Order was the KPSC’s opportunity to reject AEP’s application for failure to meet the proper purpose test, but it did not. Tr. at p. 1163.

278. Exelon, EME and Staff argue that the term “public interest”, as defined in KPSC’s May 30 Order, Exh. KYC-6 at 9-10, is designed to address only two objectives: economic impacts and reliability. CMTC/PJMICC and Staff also assert that in denying Kentucky Power’s application, the KPSC did not proclaim a public health, safety, or welfare basis for its decision.

279. Exelon, PJM and Staff maintain that KPSC's use of this standard in the orders addressing AEP's application demonstrates that KPSC only sought to retain or obtain economic benefits for Kentucky ratepayers and protect its jurisdiction. *See* Exh. KYC-2 at pp. 17-18.<sup>70</sup> KPSC denied Kentucky Power’s application because it failed to show that the benefits will exceed the costs if AEP joins PJM. KPSC concluded that “it appears that

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<sup>70</sup> It is argued that the following cites from KPSC’s July 17 Order show that KPSC was engaged in only an economic evaluation when considering AEP’s application to join PJM: Exh. KYC-2 at pp. 14-16 (Kentucky Power has to quantify the benefits of membership); Exh. KYC-2 at p. 16 (“Kentucky Power will receive minimal, if any, benefits from joining PJM, but will be required to pay at least \$3 million annually for membership.”), *see also* Exh. KYC-2 at p. 17; Exh. KYC-2 at p. 17 (a Kentucky-specific analysis is needed to make a public interest determination); Exh. KYC-2 at p. 17 (FERC has not conducted a review to determine the reasonableness of RTO costs incurred by AEP or PJM.); Exh. KYC-2 at 17-8 (PJM markets and congestion management system would bring no discernible benefits to Kentucky’s retail customers); Exh. KYC-2 at p. 18 (LMP will bring no benefits because there is no unreliable transmission service or congestion problem); Exh. KYC-2 at p. 18 (Creating a larger wholesale market from Mid-East to Mid-Atlantic region will not bring cheaper power to Kentucky.); and Exh. KYC-2 at pp. 18-19 (Generation in Kentucky one of the lowest-cost ones, therefore no quantifiable benefit to Kentucky Power if joined PJM.).

Kentucky customers would subsidize the cost of PJM membership for other AEP-East utilities. The record demonstrates that Kentucky will receive minimal, if any, benefits in return for its \$3 million annual membership fee.” Exh. KYC-2 at p. 19. The KPSC’s August 25 Order granting rehearing of the July 17 Order explained that the public interest “standard establish[ed] a two-step process: first, there must be a showing of no adverse effect on service or rates; and, second, there must be a demonstration that there will be some benefits.” Exh. KYC-3 at 4.<sup>71</sup> The order found that Kentucky Power had “failed the first step due to its inability to show that the transfer would not adversely affect its rates [and had it] been able to quantify benefits of at least \$3 million annually, it would then have been able to [] proceed to the next step.” Exh. KYC-3 at 4. KPSC continues that while under step two benefits need not be immediate or quantifiable, they “must be demonstrated after satisfying the first step by a showing of no adverse effect on service or rates.” Exh. KYC-3 at p. 3-4 (emphasis in original). This rehearing order allowed Kentucky Power to submit an analysis quantifying the benefits of membership into PJM. Exh. KYC-3 at p. 3.

280. PJM agrees with the Commission that economic benefits of coordination are not a matter left to the states under the section 205(a)(2) exception, *see* November 25 Order at PP 124-5. PJM argues that to the extent that Kentucky is examining economic benefits for customers, Kentucky is seeking to reconsider the Commission’s decision to approve the regional coordination, and deny the resultant benefits to the larger region. It maintains that the Commission has the final say when the KPSC and the Commission have differing views regarding the benefits of AEP’s integration into PJM, to pursue regional coordination. PJM argues that the KPSC’s decision should not fall under the savings clause because it interprets the exception to swallow the rule. *See* Exh. EXE-90 at p. 13 and Exh. EME-15 at pp. 12-15. Therefore, EME, Exelon, CMTC/PJMICC and Staff argue that economic protectionism is not protected by the savings clause.

281. In its order, KPSC expressed its “grave concern at the prospect of surrendering even a portion of our authority to protect Kentucky Power’s customers.” Exh. KYC-2 at p. 19.<sup>72</sup>

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<sup>71</sup> The May 20 Order by KPSC defining public interest provided the following examples of potential benefits: “improved security of utility facilities, increased availability of capital for infrastructure improvement, and greater employee training opportunities, and enhanced research and development opportunities.” Exh. KYC-6 at p. 10 n.13.

<sup>72</sup> The KPSC filed comments on the Commission’s RTO Initiative, SMD, identifying its concerns that the proposed rule would harm Kentucky and its electric customers. These concerns included state’s loss of jurisdiction, an extension of the Commission’s jurisdiction, transfer of authority from state commission to RTOs on who pays for transmission upgrades and expansions necessary to facilitate wholesale bulk power transfers; no review of RTOs’ increasing expenses, Commission’s finding that exclusive territories for retail suppliers is discriminatory, Commission policy conflicts with Kentucky’s requirement that retail ratepayers have priority for curtailment purposes;

PJM asserts that under PURPA, Congress provided for federal preemption, which by its very nature will limit a state's jurisdiction over some matters. Thus, KPSC's fear that it will lose jurisdiction is not a basis for allowing its actions under the savings clause, according to PJM.

282. KPSC states that KRS 278.214, quoted *infra*, is another Kentucky statute relevant to AEP's application to transfer control of its transmission system. It notes that legal challenges to this statute are pending. Exh. KYC-5 at p. 7. KPSC used KRS 278.214 in its decision as a basis to deny Kentucky Power's application to join PJM. Exh. KYC-2 at p. 11. KPSC explains that by requiring that retail electric service be the last to be interrupted, the curtailment statute shows that the Kentucky legislature sought to ensure that the public health, safety and welfare is maintained. It notes that witnesses have conceded that health, safety and welfare concerns arise during periods of electricity interruption. Tr. at pp. 313-4 and Tr. at pp. 451-2. KPSC argues that helping to ensure reliability and continuation of uninterrupted electric service are part of the public interest. Exh. KYC-5 at p. 10.

283. EME maintains that KRS 278.214 does not address RTOs and does not forbid a utility from joining an RTO. Staff, EME, EPSA, Exelon and PJM argue that Kentucky's curtailment law is not protected under PURPA Section 205(a)(2). Exh. EXE-1 at p.14, Exh. EXE-90 at p. 14, and Exh. EME-15 at pp. 13-14. These parties contend that KRS 278.214 conflicts with the Commission's curtailment policies under Order No. 888, and they note that this issue is currently under appeal. They also note that, regardless of whether AEP or PJM (when AEP joins PJM) operates AEP's transmission system, they both must operate pursuant FERC jurisdictional tariffs and the curtailment practices stated in them. Thus, they assert that the conflict between the state statute and the Commission's regulations will remain, and KRS 278.214 is immaterial to AEP's request to join PJM. PJM points out that the KPSC witness Buechel conceded that refusing to approve AEP's application to join PJM does not change state or federal law concerning curtailment priorities or affect the outstanding legal dispute in anyway. Tr. at p. 1004.

284. Furthermore, Exelon argues that KRS 278.214 addresses reliability, a factor which does not trigger the carve-out for the following reasons: reliability of the bulk power transmission grid is the Commission's concern, Kentucky's claims are speculative and contradicted by record evidence that reliability will be improved if AEP joins PJM. *Exelon Post-hearing Brief* at pp. 83-84.

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lack of certainty that retail ratepayers will retain the right to use the transmission facilities they have already paid for. Exh. KYC-2 at pp. 7-8.

## 2. Discussion and Conclusion

### a. Virginia

285. The principal issue is whether the laws, rules or regulations of Virginia are designed to protect public health, safety or welfare, or the environment, or conserve energy or are designed to mitigate the effects of emergencies resulting from fuel shortages, and, therefore, are not subject to the Commission's exemption authority. The parties that support the Commission's exercise of PURPA Section 205(a) to allow an exemption to state laws argue that Virginia's laws, rules or regulations are designed to protect the state's ratepayers from higher prices and protect Virginia's jurisdiction from federal intrusion. Virginia and its supporters argue that the state's laws, rules or regulations are designed to protect the ratepayers' ability to enjoy safe, adequate and reliable electric service at reasonable prices. As discussed below, the language and the legislative history of the 2003 amendments to the Virginia Electric Restructuring Act demonstrate that Virginia modified its statute essentially for the purpose of preventing AEP's Virginia operating company from joining PJM, rather than for the purpose of protecting the public health, safety or welfare of its ratepayers. Furthermore, if the savings clause is interpreted broadly as urged by the state, PURPA Section 205(a) would be nullified. Accordingly, AEP should be exempted from the amendments to the Virginia Electric Restructuring Act to the extent required to permit the voluntary coordination of electric utilities (by integration into PJM) to proceed.

286. VSCC argues that under the rule of statutory construction one begins with the interpretation of the statute using its plain meaning. *See Lamie v. United States Trustee*, 124 S. Ct. 1023 at p. 1030 (2004). But, when the plain meaning leads to an unintended or absurd result, one must examine the context to determine Congressional intent. *Id.* If the plain meaning of "public health, safety or welfare" is read as broadly as the states argue, the savings clause swallows the rule. Under the principles of statutory construction, an exception cannot be allowed to swallow the rule. *See Commissioner of Internal Revenue v. Clark*, 489 U.S. 726, 739 (1989); *John Hancock Mut. Life Ins. Co. v. Harris Trust & Savs. Bank*, 510 U.S. 86, 97 n.12 (1993); *Consarc Corp. Consarc Eng'g, Ltd. v. United States Treasury Dep't.*, 71 F.3d 909, 915 (D.C. Cir. 1995); *Fidelity Fed. Savs. Loan Assoc. v. De La Cuesta*, 458 U.S. 141, 163 (1982).<sup>73</sup> The VSCC and allied parties have no satisfactory answer to this dilemma. The interpretation they advocate cannot be credited because it cannot sensibly be implemented in the context of the entire statute.

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<sup>73</sup> *See also Alaska Dep't of Env'tl. Conservation v. EPA*, 124 S. Ct. 983 at p. 1002 n.13, quoting from *TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001) ("a cardinal principle of statutory construction that a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or work shall be superfluous, void, or insignificant.")

287. VSCC and its state allies contend that the Congress' use of the words "include" and "among others" indicates that the list of examples in the Conference Committee Report is non-exclusive. An examination of the Conference Report, i.e., the legislative history of PURPA Section 205(a), and Witness Sharp's testimony demonstrates, however, that Congress intended a narrow reading of the savings clause because the report provides an illustrative list of examples of state laws and regulations which the Commission was prohibited from overriding. The Conference Committee Report listed, as examples of the types of state regulations that the Commission could not preempt, "[s]tate siting laws, regulations under the Clean Air Act, and zoning laws, among others." *H.R. Conf. Rep. No. 95-1750, at 95*. Witness Sharp persuasively argued that the purpose of the savings clause was to prevent entities from asking the Commission to exempt them from state regulations such as environmental regulations or safety regulations that were not economically beneficial to them. *Tr. at pp. 306-8, see also Tr. at pp. 1240-1*. Furthermore, a broad reading as advocated by the states would render PURPA Section 205 null. Thus, it is more appropriate to interpret the carve-out narrowly, which is consistent with the examples listed in the Conference Report.

288. VSCC and its state allies believe that the savings clause should be read broadly to include traditional state utility regulation (which is a state police power), economic regulation and reliability issues. According to them, the statutory language, the legislative history, the regulations and the VSCC's orders pursuant to VSC 56-579, all lead to the conclusion that this statutory section was designed to protect public health, safety and welfare. Neither the statutory language of PURPA Section 205(a) nor its legislative history lists traditional state utility regulation, economic regulation or reliability as state activities that are protected from preemption by the Commission. In a prior case, the Commission found that it was allowed to exempt state utility regulation that affected voluntary coordination. *Central Power and Light Co.*, 8 FERC ¶ 61,065, *modifying order and denying reh'g*, 9 FERC ¶ 61,011 (1979), *reh'g denied*, 10 FERC ¶ 61,131 (1980) ("CP&L"). As is discussed above and demonstrated repeatedly below, reading the savings clause broadly to include traditional state utility regulation and all of its elements allows the exception to swallow the rule.

289. In this proceeding, we are concerned with the 2003 amendments of HB 2453, because the record demonstrates that Virginia wanted to change the focus of the Virginia Electric Restructuring Act essentially to prevent the integration of AEP into PJM. Among the several witnesses that testified, Witness Mathis demonstrated that the Virginia General Assembly, with the encouragement and support of the Governor of Virginia and the VSCC, intended to delay the integration of AEP into PJM for several reasons. *See* Exh. EME-15 at pp. 2-12, Exh. EME-16, Exh. EME-17, Exh. EME-18, Exh. EME-19 and Exh. EXE-92. I find and conclude that the amendments were designed to protect the economic interests of Virginia ratepayers by shielding them from the impact of the Commission's Standard Market Design; maintain the preferential treatment for Virginia consumers in the operation of an interstate transmission grid by securing an opportunity to second-guess the Commission's decisions on

RTOs; and preserve the state's jurisdiction against intrusion by this Commission. *See* Exh. EME-15 at pp. 8-12, Exh. EME-16 at pp. 5-6, Exh. EXE-1 at pp. 5-6 and 20-24 and Exh. EXE-90 at p. 13.

290. VSCC next argues that PURPA Section 2, which has language similar to the savings clause, includes economic interests and reliability in its discussion of "public health, safety and welfare." Therefore, VSCC asserts that Congress intended to protect the state's consideration of economic and reliability issues from preemption. However, Section 2 of PURPA, as pointed out by Exelon, assigns responsibility for the protection of the public health, safety and welfare to the federal government. Thus I cannot agree with VSCC that the saving clause must be interpreted broadly.

291. It is important to note that Virginia and its allies have no satisfactory answer to the argument that a broad reading of the savings clause will nullify PURPA Section 205(a). In fact, VSCC Witness Walker's testified that all provisions of the law and regulations governing Virginia's regulation of electric utilities are designed to protect public health, safety or welfare. Tr. at p. 774. Then, when the VSCC counsel was asked when this Commission could ever exercise its authority under PURPA Section 205(a), he failed to provide a satisfactory answer. Tr. at pp. 1226-31. The state's argument leads to the conclusion, as CMTC/PJMICC points out, that PURPA Section 205(a) could never exempt any Virginia laws that prevented voluntary coordination.

292. VSCC does not dispute that it is engaged in economic regulation under VCS 56579, but provides several arguments to show that economic regulation falls under "public welfare" concerns. VSCC, in its quest to prove that economic regulation falls under the savings clause, uses the Black's Law Dictionary definition of "public welfare" to obtain the plain meaning. Even if VSCC's argument was persuasive, such a reading renders PURPA Section 205(a) a nullity. If a state's economic regulation could not be prevented under the savings clause, the Commission could not exempt state laws that seek to protect the economic interests of their ratepayers at the expense of other states' ratepayers and allows losing regional efficiencies. While parties disagree over whether Congress intended a massive or a limited expansion of federal authority over regulation, no one disputes that Congress sought an "increased efficiency in the use of facilities and resources by electric utilities." PURPA Section 2(2).

293. VSCC believes that reliability concerns are state concerns that fall under the carve-out. While some parties dispute this contention by arguing that PURPA and its legislative history show that reliability of the interstate grid is a federal rather than a state concern, other parties also argue that while states may have an interest in reliability, this interest does not give them jurisdiction over interstate coordination policy. Exelon presents the testimony of Witness Schnitzer to show that the state's current authority over reliability will not be changed if AEP joins PJM. This evidence shows that reliability will be improved if AEP joins PJM and leads to the conclusion that jurisdiction over reliability is not a concern in this

proceeding. *See* Exh. PJM-1 at pp. 18-20, Exh. EXE-40 at pp. 13-15, Exh. PS-1 at pp. 16-17, Exh. EME-1A at p. 12, Exh. IND-2 at pp. 8-9. It is also important to note again that, if the states were allowed to include reliability in the carve-out, then the exception could not be applied without nullifying the rule.

294. Several parties point out that this is actually a dispute between different groups of states rather than between the Commission and Virginia and Kentucky. Thus, if two states passed conflicting laws arguing that their laws were designed to protect public health, safety or welfare, an impasse would be created. This is precisely the type of situation where PURPA Section 205(a) is applicable. Under PURPA Section 205(a), the Commission has the authority to break the impasse for voluntary coordination that results in economical utilization of facilities.

295. EME argues that when AEP joins PJM, Virginia and Kentucky will have the same ability to regulate their incumbent electric utilities as they did before the integration. This conclusion is based on Exelon Witness Schnitzer's testimony that AEP will be simply transferring control of Commission-jurisdictional transmission system operated under a Commission-jurisdictional tariff to PJM, an entity that is also operated under a Commission-jurisdictional tariff. Exh. EXE-130 at p. 12, Tr. at p. 1004; *see also* Tr. at pp. 1249-50. Virginia and Kentucky fail to explain how the transfer of AEP integration into PJM will change their current authority over their incumbent utilities. Exempting AEP from Virginia's laws to allow it to join PJM will not interfere with the state's current authority over siting, issuing certificates of public convenience and necessity for transmission and generation facilities, the ability to set retail rates, or to manage distribution. *See* Tr. at pp. 1249, 1253-55. Therefore, I am not persuaded by the arguments that an exemption should not be allowed on this ground.

296. Virginia and Kentucky's contention that a court, not the Commission, should determine whether the states' laws, rules or regulations fall under the savings clause is contradicted by the language of PURPA Section 205(a). The statutory provision reads: "[n]o such exemption may be granted *if the Commission finds* that such a provision of State law, or rule or regulation – (2) is designed to protect public health, safety or welfare, or the environment, or conserve energy or is designed to mitigate the effects of emergencies resulting from fuel shortages." (emphasis added). Witness Sharp testified that the Commission was to "make the predicate findings concerning the use of voluntary pooling arrangements to enhance the economic utilization of utility resources." Exh. EXE-30 at p. 11. Thus, I find and conclude that PURPA Section 205(a) authorizes the Commission to determine whether state laws, rules or regulations fall under the savings clause, subject to review by the courts.

297. The states further argue that the Commission does not have the authority to mandate participation in RTOs under the FPA. However, the Commission is not here ordering AEP to

join PJM, but, as shown above, facilitating a voluntary coordination of electric utilities. Thus, the states' argument on this point carries no weight.

298. Another related argument by the states is that the Commission has concurrent not exclusive jurisdiction over transmission facilities and thus cannot order AEP to transfer its facilities without state approval. PURPA Section 205(a) gives the Commission authority to exempt utilities from state laws, rules or regulations which obstruct voluntary coordination by utilities. As discussed above, Virginia's amendments to the Virginia Electric Restructuring Act do not qualify under the carve-out. The Commission can, therefore, exempt these amendments and the provisions of the orders implementing these amendments to the extent required to allow AEP to join PJM.

299. VSCC contends that in *CP&L*, to prevent the states from using the savings clause as a defense to their unconstitutional laws, the Commission chose to interpret the PURPA Section 205(a) narrowly so that it did not apply to a state law that was unconstitutional. *See* Tr. at pp. 1233 and 1235-7. Then, it contends that the Commission does not have the authority to preempt the state laws under PURPA Section 205(a). But for VSCC's argument to be correct, it must admit that the Virginia laws are unconstitutional and must be preempted (just not by this Commission but the courts). Furthermore, VSCC's counsel argues that Congress intended to give a state the authority to determine whether it was a loser in a multi-state situation. *See* Tr. at p. 1237. VSCC's reading of the savings clause directly conflicts with the plain language of PURPA Section 205(a), which is intended to prevent a state from holding regional efficiencies hostage to its own interests. *See* Exh. EME-15 at p. 11, Exh. EXE-1 at pp. 23-24, EXE-30 at p. 9 and Exh. EXE-90 at p. 13. Again, because VSCC's reading would render PURPA Section 205(a) a nullity, it cannot be credited.

300. Several parties argue that Virginia's economic regulation violates the Supremacy clause and Commerce Clause of the U.S. Constitution, because the state seeks to protect its customers at the expense of other states' customers. While this is a valid concern if the state actions hinder interstate commerce, I believe that this issue is beyond the scope of this inquiry which is limited to determining whether state laws, rules or regulations can be exempted under PURPA Section 205(a).

301. For the above reasons, I find and conclude that the amendments to VCS 56-579 pursuant to HB 2453, and the VSCC's orders thereunder, are not designed to protect the public health, safety or welfare or the environment or conserve energy or are designed to mitigate the effects of emergencies resulting from fuel shortages, and are therefore subject to the Commission's exemption authority under PURPA Section 205(a).

#### **b. Kentucky**

302. With regard to Kentucky, the principal issue is whether the Kentucky statutes KRS 278.218 and KRS 278.214, and the proceedings pursuant to these statutory provisions, are

designed to protect public health, safety or welfare, or the environment, or conserve energy or are designed to mitigate the effects of emergencies resulting from fuel shortages.

303. Several parties including CMTC/PJMICC, EPSA, EME, Exelon, PJM and Staff, argue that KPSC's actions are driven by economic protectionism and an attempt to preserve the state's jurisdiction from federal intrusion. KPSC and its supporters argue that the state's laws, rules or regulations are designed to protect the ratepayers' ability to enjoy safe, adequate and reliable electric service at reasonable prices. As discussed below, the statutory language, the public interest standard developed by KPSC and KPSC's orders demonstrate that KPSC precluded AEP from joining PJM because it believed that there would be no economic benefits to the Kentucky ratepayers. Furthermore, if the savings clause is interpreted broadly as urged by the state, PURPA Section 205(a) would be nullified. The provisions in the KPSC's orders that implement these statutory provisions should be subject to the Commission's exemption authority.

304. KPSC attempts to equate its public interest standard to the public health, safety or welfare standard in PURPA Section 205(a)(2). It further argues that AEP's application to transfer control of its transmission facilities to PJM was rejected because KPSC found that AEP failed the first step of the public interest standard. KPSC asserts that KRS 278.218 and its decisions pursuant to this section fall under the savings clause and therefore, cannot be exempted by this Commission. But the public interest standard used by the KPSC is not the standard used by Congress in the savings clause or discussed in the legislative history. The definition of public interest adopted by KPSC, Exh. KYC-6 at pp. 9-10, and the application of the public interest standard in the KPSC's orders, focus primarily on economic concerns and secondarily on preserving the state's jurisdiction in the event the Commission's SMD effort is implemented. *See* Exh. KYC-2 at pp. 17-19. This demonstrates that the KPSC had different concerns than the ones suggested in the statute and its legislative history. Reading the savings clause any more broadly would, in any event, swallow the rule, and thus allow it to prevent voluntary coordination designed to obtain economical utilization of facilities and resources.

305. In order to approve the transfer of functional control of its transmission facilities to PJM, KPSC states that under KRS 278.218, AEP must demonstrate that the transmission assets will continue to be used to provide the "same or similar level of service"<sup>74</sup> and such transfer is in the public interest. Exh. KYC-5 at pp. 5-6. KPSC asserts that its public interest analysis is a two-step process; "first, there must be a showing of no adverse effects on service or rates; and, second, there must be a demonstration that there will be some benefits." Exh. KYC-3 at p. 4, *see also* Exh. KYC-5 at pp. 2-5.<sup>75</sup> It asserts, as does VSCC, that economic

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<sup>74</sup> KPSC argues that the statutory phrase "same or similar service" means "the same level of reliability and quality of service." *KPSC Post-hearing Brief* at p. 47.

<sup>75</sup> But the KPSC found that KPC failed the first step of the public interest standard because it failed "to show that the transfer would not adversely affect its rates" and

regulation falls under the definition of public welfare. KPSC admits that it is concerned with adverse economic impacts of the transfer of ownership or control of utility assets; however, it also claims to be concerned with the non-economic impacts of such a transfer. *KPSC Post-hearing Brief at p. 45*. The attempts by KPSC Witness Buechel to parse out the public interest definition to show that the state commission contemplated addressing non-economic issues are unconvincing. He contends that the reference to both “service” and “rates” in the public interest analysis implicates non-economic issues. Exh. KYC-7 at pp. 3-4 discussing Exh. KYC-3 at p. 4. Next, he opines that there is no indication that KPSC’s analysis of benefits will focus exclusively on economic issues, because by stating that “[s]uch benefits need not be immediate or readily quantifiable,” the KPSC must have contemplated addressing non-quantifiable benefits and these generally include reliability and adequacy of service. KYC-7 at pp. 3-4 discussing Exh. KYC-2 at p. 2, and Exh. KYC-3 at p. 5. KPSC asserts that its statute, KRS 278.218 and the public interest standard mentioned in the statutory provision should be read to include public health, safety or welfare. The record in this proceeding demonstrates, however, that the primary reason KPSC denied AEP’s application to join PJM was the KPSC’s belief that costs to Kentucky’s ratepayers would increase. *See* Exh. KYC-2 at p. 19.<sup>76</sup> KPSC’s denial of AEP’s application to transfer functional control of transmission assets from AEP to PJM was largely based upon AEP’s alleged failure to show that Kentucky ratepayers would receive any benefits from such transfer. *See* Exh. KYC-2 at p. 19. As explained above, while economic regulation may be a valid exercise of traditional state utility regulatory authority, in this proceeding, such state regulatory actions cannot be allowed to fall under the savings clause because those actions would prevent the voluntary coordination that is the purpose of PURPA Section 205(a). Thus, AEP may be exempted from the application of KRS 278.218 by the KPSC, to the extent required to permit the voluntary coordination of electric utilities envisioned by its planned integration into PJM.

306. The other important reason for KPSC’s decision was its concern that it would lose jurisdiction to the Commission if the Standard Market Design was implemented. *See* Exh. KYC-2 at p. 19. As discussed above, such a concern cannot serve as a basis for not exempting electric utilities from state actions that interfere with voluntary coordination. Otherwise, the states could nullify the statutory purpose of PURPA Section 205(a).

307. KPSC reiterates VSCC’s arguments that: the consideration of public welfare includes economic elements; PURPA Section 2 evidences a congressional intent to include economic issues and reliability issues within the meaning of public health, safety and welfare; and the plain meaning of public welfare includes economic regulation. It also repeats the arguments

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therefore, there was no need to proceed to the next step of demonstrating benefits. Exh. KYC-3 at pp. 4-5.

<sup>76</sup> In the August 25 Order, KPSC stated that “Kentucky Power failed the first step due to its inability to show that the transfer would not adversely affect its rates” but does not find that service will be adversely affected. Exh. KYC-3 at p. 4.

that the list of examples in the Conference Report is non-exclusive. It asserts that the Commission's exclusive jurisdiction is limited to rates, terms and conditions of interstate transmission service, and that the Commission has concurrent jurisdiction over transmission facilities with the states. KPSC asserts that states have broad authority over electric utilities operating within their borders and the facilities constructed within the borders because the states have the authority to issue certificates for the construction, operation or abandonment of electric transmission lines, *see* KRS 278.020(1) and 278.027, and the authority to grant the right of eminent domain to construct utility property in the state. *See* KRS 416.130(2) and 416.140. These arguments are addressed above, and will not be repeated here.

308. KRS 278.214 does not address RTOs and does not forbid a utility from joining an RTO. In its July 17 Order, KPSC implicated this statutory provision by claiming that if the state commission granted AEP's application, this action would be "tantamount to acquiescence in violation of KRS 278.214." Exh. KYC-2 at p. 21. KPSC's Witness Buechel states that KRS 278.214 falls into the savings clause because it requires that native load customers of jurisdictional utilities to get the highest priority in the event of curtailment or interruption of service. Exh. KYC-5 at pp. 9-10 and Exh. KYC-2 at pp. 20-21. Parties argue that, in fact, regardless of whether AEP or PJM (after the transfer) controls the transmission assets, the assets are and will continue to be operated under a tariff that is under the Commission's jurisdiction. Therefore, some parties argue that KRS 278.214 violates Commission's policy, and that this violation will continue regardless of who controls AEP's transmission facilities. Thus, they believe that KPSC's argument is irrelevant to the transfer. While reliable service is important, there is evidence in this case that reliability will be improved after AEP's integration into PJM. Therefore, without deciding the validity of the curtailment law, and as discussed *infra*, AEP should be exempted from the effect of the Kentucky decision precluding AEP's transfer of functional control of its facilities to PJM. *See* PURPA Section 205(a) (Commission can exempt AEP "in whole or in part" from the state law.)

309. For the above reasons, under the authority granted to the Commission by PURPA Section 205(a), AEP may be exempted from the KPSC's orders that implement KRS 278.218 and KRS 278.214, to the extent required to complete the planned voluntary integration, because those laws, as enforced by the KPSC, are not designed to protect the public health, safety or welfare or the environment or conserve energy or are not designed to mitigate the effects of emergencies resulting from fuel shortages.

## CONCLUSION

310. The record demonstrates that the questions set for hearing by the November 25 Order are to be answered as follows:

1. AEP's voluntary commitment to join PJM is designed to obtain economical utilization of facilities and resources in the Midwest and Mid-Atlantic regions.

2. The laws, rules, or regulations of Virginia and Kentucky are preventing AEP from fulfilling both its voluntary commitment in 1999, as part of merger proceedings, to join an RTO, and its application to join an RTO pursuant to the Commission's Order No. 2000.

3. The aforementioned provisions of Kentucky and Virginia law or rule or regulation (a) are not required by any authority of Federal law, and (b) are not designed to protect public health, safety, or welfare, or the environment or conserve energy or are designed to mitigate the effects of emergencies resulting from fuel shortages.

311. AEP should be exempted from the requirements of the Virginia and Kentucky laws, rules or regulations, as described in the text of this decision, to the extent required to consummate its timely integration into PJM.

It is so **ORDERED**.

**William J. Cowan**  
**Presiding Administrative Law Judge**