

105 FERC ¶ 61, 251  
UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;  
William L. Massey, and Nora Mead Brownell.

The New PJM Companies	Docket Nos. ER03-262-007
American Electric Power Service Corp.	ER03-262-008
On behalf of its operating companies	ER03-262-009
Appalachian Power Company	
Columbus Southern Power Company	
Indiana Michigan Power Company	
Kentucky Power Company	
Kingsport Power Company	
Ohio Power Company, and	
Wheeling Power Company	
Commonwealth Edison Company, and	
Commonwealth Edison Company of Indiana, Inc.	
The Dayton Power and Light Company, and	
PJM Interconnection, LLC	

American Electric Power Company	Docket Nos. EC98-40-000
and	ER98-2770-000
Central and South West Corporation	ER98-2786-000

ORDER MAKING PRELIMINARY FINDINGS AND GIVING PUBLIC NOTICE  
AND SETTING MATTER FOR PUBLIC HEARING UNDER PURPA  
SECTION 205(A)

(Issued November 25, 2003)

1. In this order, the Commission takes the following actions:

(A) Pursuant to Section 203(b) of the Federal Power Act (FPA),<sup>1</sup> in  
supplement to its orders approving the merger of American Electric

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<sup>1</sup>16 U.S.C. § 824b (2000).

Power Company with Central and South West Corporation (CSW),<sup>2</sup> the Commission finds that, to secure the maintenance of adequate service and the coordination in the public interest of facilities subject to the jurisdiction of the Commission, American Electric Power Company-East (AEP or AEP-East)<sup>3</sup> must fulfill its voluntary commitment to join a Regional Transmission Organization (RTO), namely, PJM Interconnection, LLC (PJM).

- (B) The Commission makes a preliminary finding that 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 the Public Utility Regulatory Policies Act (PURPA).<sup>4</sup>
- (C) The Commission makes a preliminary finding that 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.<sup>5</sup>
- (D) The Commission makes a preliminary finding that 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

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<sup>2</sup> See American Electric Power Co., et al., Opinion No. 442, 90 FERC ¶ 61,242 (2000), order on reh'g, 91 FERC ¶ 61,129 (2000) (affirming in relevant part), appeal denied sub nom. Wabash Valley Power Association v. FERC, 268 F.3d 1105 (D.C. Cir. 2001) (Opinion No. 442) (denying petition for review).

<sup>3</sup> "AEP-East" is the name usually given to American Electric Power Company as it was before the merger with CSW. Henceforth in this order, "AEP" will denote AEP-East.

<sup>4</sup> 16 U.S.C. § 824a-1(a) (2000).

<sup>5</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).

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.

- (E) The Commission provides public notice and notice to the Governors of the states within the Eastern Interconnection, and sets for public hearing, sets for public hearing its preliminary findings in paragraphs (B), (C) and (D) above.

## I. **BACKGROUND**

### A. **Merger Orders**

2. On April 30, 1998, AEP and CSW (jointly, Applicants) filed an application to consolidate their jurisdictional assets through a merger.<sup>6</sup> Prior to the merger, AEP was a registered public utility holding company under the Public Utility Holding Company Act of 1935 (PUHCA)<sup>7</sup> and had seven electric utility operating subsidiaries operating in Indiana, Kentucky, Michigan, Ohio, Tennessee, Virginia, and West Virginia.<sup>8</sup> CSW was a registered public utility holding company under PUHCA with four electric utility operating subsidiaries with operations in Arkansas, Louisiana, Oklahoma, and Texas.<sup>9</sup>

3. Several intervenors raised concerns as to the market power that the merged entity would be able to hold, and urged the Commission to dismiss the merger application because Applicants had not made a meaningful commitment to join an Independent System Operator (ISO) of sufficient size or scope to mitigate their market power, while other intervenors asked the Commission to condition approval of the merger on

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<sup>6</sup> See Opinion No. 442.

<sup>7</sup> 15 U.S.C. §§ 79 - 79z-6 (2000).

<sup>8</sup> The seven subsidiaries were Appalachian Power Company (APCO), Columbus Southern Power Company (CSP), Indiana Michigan Power Company (I&M), Kentucky Power Company (KPCO), Kingsport Power Company, Ohio Power Company (OPCO), and Wheeling Power Company.

<sup>9</sup> The four companies were Central Power and Light Company, Public Service Company of Oklahoma (PSCO), Southwestern Electric Power Company (SWEPCO), and West Texas Utilities.

Applicants joining a large, fully functional, regional ISO.<sup>10</sup> In order to address this issue, on May 24, 1999, Applicants and Commission Trial Staff filed a stipulation in which Applicants made a voluntary commitment to join a Commission-approved RTO and transfer to the RTO functions related to transmission service, transmission security and reliability, and control area responsibilities.<sup>11</sup>

4. In an Initial Decision issued on November 23, 1999, the Administrative Law Judge (ALJ) found that AEP's commitment (as evidenced in the May 24, 1999 Stipulation) to join a Commission-approved RTO eliminated the possibility of AEP using transmission to frustrate competition or favor its marketing affiliates.<sup>12</sup>

5. On March 15, 2000, the Commission issued Opinion No. 442 affirming in part and reversing in part the Initial Decision. The Commission concluded that Applicants had not carried their burden of establishing that the proposed merger would not adversely affect competition. Thus, the Commission conditioned its approval of the merger upon the adoption of certain mitigation measures. The Commission accepted Applicants' proposal to join a Commission-approved RTO and required that the transfer of operational control of their transmission facilities to such an RTO be completed by December 15, 2001.<sup>13</sup> The Commission also stated that "[i]n the event that Applicants accept these conditions but subsequently do not comply with them, we will use our authority under Section 203(b) of the FPA to address any concerns, and order further procedures as appropriate."<sup>14</sup> The Commission directed Applicants to notify the Commission within 15 days from the date of the order whether they accepted the merger approval and conditions.<sup>15</sup>

6. On March 27, 2000, Applicants notified the Commission that they accepted the conditions. On May 31, 2000, the Commission modified its order and reiterated the

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<sup>10</sup> See Opinion No. 442 at 61,780.

<sup>11</sup> See Stipulation of American Electric Power Co., Central and South West Corp., and Commission Trial Staff at 2-4, Docket Nos. EC98-40-000, et al. (May 24, 1999) (May 24, 1999 Stipulation).

<sup>12</sup> See American Electric Power Co., et al., and Central and South West Corp., 89 FERC ¶ 63,007 at 65,032 (1999) (Initial Decision).

<sup>13</sup> Opinion No. 442 at 61,786-90.

<sup>14</sup> Opinion No. 442 at 61,789-90 (footnote omitted).

<sup>15</sup> See id. at 61,789.

requirement that Applicants must transfer operational control of their transmission systems to fully-functioning, Commission-approved RTOs by December 15, 2001.<sup>16</sup> The effective date of the merger was June 15, 2000.<sup>17</sup>

7. On January 18, 2002, the U.S. Court of Appeals for the District of Columbia ruled that the Securities and Exchange Commission (SEC) failed to prove that the merger met the requirements of PUHCA and remanded the case to the SEC for further review.<sup>18</sup> The court specifically told the SEC to revisit its conclusion that the merger met PUHCA requirements that the utilities be "physically interconnected" and confined to a "single area or region."<sup>19</sup> The SEC has not yet acted on the remand.

### **B. Merger Benefits**

8. In Opinion No. 442, the Commission noted that the Missouri Public Service Commission, the Public Utilities Commission of Ohio (Ohio Commission), and the Michigan Public Service Commission had reached settlements with the Applicants and/or withdrawn any objections they had to the merger.<sup>20</sup> Each of these state commissions settled or withdrew after the filing of AEP's commitment to join an RTO. Opinion No. 442 also noted that the Louisiana Public Service Commission (Louisiana Commission), the Arkansas Public Utilities Commission (Arkansas Commission), the Indiana Utility Regulatory Commission (Indiana Commission), the Kentucky Public Service Commission (Kentucky Commission), the Oklahoma Corporation Commission (Oklahoma Commission) and the Public Utility Commission of Texas (Texas Commission) conditionally approved the merger, pending the outcome of the FERC proceeding and final action by other relevant authorities.<sup>21</sup> Under the settlements reached between AEP and the various state commissions, the merger provided the following benefits to customers:

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<sup>16</sup> See American Electric Power Co. and Central and South West Corp., 91 FERC ¶ 61,208 (2000).

<sup>17</sup> Date noted in rate schedules submitted as part of settlement accepted by Commission order. See American Electric Power Co., et al., 100 FERC ¶ 61,346 (2002).

<sup>18</sup> National Rural Electric Coop. Ass'n, et al. v. SEC, 276 F.3d 609 (D.C. Cir. 2002).

<sup>19</sup> Id. at 611.

<sup>20</sup> See Opinion No. 442 at 61,778-79.

<sup>21</sup> Id. at 61,779.

- Kentucky: The settlement guaranteed AEP customers \$28.4 million in rate reductions in the first eight years after the merger.
- Texas: The settlement guaranteed combined rate reductions totaling \$221 million over six years.
- Indiana: The settlement guaranteed approximately \$60 million in rate reductions for customers over six years. It also provided for additional annual deposits of \$5.5 million in the Indiana Nuclear Decommissioning Trust Funds in the years 2001 through 2003.
- Arkansas: The settlement calls for CSW affiliate SWEPCO to reduce rates through a net merger savings rider for its retail customers by amounts totaling approximately \$6 million over five years.
- Oklahoma: AEP and CSW agreed to share net merger savings with customers of CSW subsidiary PSCO; not to increase PSCO's base rates above the level at that time prior to January 1, 2003; to file to join an RTO by December 31, 2001; and to implement additional quality-of-service standards for PSCO.
- Louisiana: AEP and CSW agreed to share with SWEPCO's customers an estimated \$18 million merger savings over eight years. The settlement also included: (1) sharing of the benefits from off-system sales; (2) establishment of conditions for affiliate transactions with other AEP and CSW subsidiaries; (3) provisions to ensure continued quality of service; and (4) provisions to hold SWEPCO's Louisiana customers harmless from adverse effects of the merger, if any.<sup>22</sup>

### C. Order No. 2000

9. On May 13, 1999, prior to AEP's stipulation with Commission Staff in the merger proceeding, the Commission issued a Notice of Proposed Rulemaking (NOPR)

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<sup>22</sup> The Virginia State Corporation Commission (Virginia Commission) did not have approval authority over the merger, and thus did not participate in a settlement with AEP. However the Virginia Commission was a party in the Commission's merger proceeding, and stated that it planned to assert jurisdiction (indirectly) over this merger because any disposition of transmission assets by the merged company to an RTO would require approval from the Virginia Commission. See Initial Brief of Virginia State Corporation Commission, Docket No. EC98-40-000 (Aug. 31, 1999).

in Docket No. RM99-2.<sup>23</sup> In the NOPR, the Commission noted that the nation's electric transmission networks were showing signs of strain under the traditional means of management and might be inadequate to provide the efficient and reliable operation that is needed for continued development of competitive energy markets. The NOPR proposed to require that public utilities owning, operating, or controlling facilities for the transmission of electric energy in interstate commerce consider forming and participating in an RTO.

10. The Commission proposed minimum characteristics and functions that a transmission entity must satisfy to be an RTO. Among the proposed functions was ensuring the development and operation of market mechanisms to manage transmission congestion. The Commission suggested that "markets that are based on LMP [Locational Marginal Pricing] and financial rights for firm transmission services provide a sound framework for efficient congestion management."<sup>24</sup> The Commission also proposed that an "RTO must ensure that its transmission customers have access to a real-time balancing market. The RTO must either develop and operate such markets itself or ensure that this task is performed by another entity that is not affiliated with any market participant."<sup>25</sup>

11. On December 20, 1999, the Commission issued Order No. 2000, which codified most of the requirements set forth in the NOPR, including the requirements that RTOs utilize market-based mechanisms to manage congestion and provide real-time imbalance service. Among other things, the Commission sought a collaborative process "whereby transmission owners, market participants, interest groups, and government officials can attempt to reach mutual agreement on how best to establish RTOs in their respective regions."<sup>26</sup> The Commission stated that as a result of this voluntary approach, it expected public utilities to form RTOs. If the industry failed to form RTOs under this approach, the Commission stated that it would reconsider what further regulatory steps were in the public interest.<sup>27</sup> All public utilities were required to file,

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<sup>23</sup> Notice of Proposed Rulemaking, Regional Transmission Organizations, FERC Stats. & Regs. ¶ 32,541 (1999).

<sup>24</sup> Id. at 33,742.

<sup>25</sup> Id. at 33,746. See also Pennsylvania-New Jersey-Maryland Interconnection, 81 FERC ¶ 61,257 (1997).

<sup>26</sup> Order No. 2000 at 31,221.

<sup>27</sup> Id. at 30,993.

by October 15, 2000, either a proposal to participate in an RTO or an alternative filing describing efforts and plans to participate in an RTO.<sup>28</sup>

**D. AEP's Attempt to Fulfill Its Obligations under the Merger Orders and Order No. 2000**

**i. The July 31 Alliance Order**

12. Initially, AEP and other companies, including Commonwealth Edison Company (ComEd) and Dayton Power and Light Company (DP&L), proposed to form the Alliance RTO. The Commission, however, ruled on December 20, 2001 that the Alliance proposal lacked sufficient scope to exist as a stand-alone RTO.<sup>29</sup> The Commission further required the companies that had planned to join Alliance instead to make filings notifying the Commission of their choices as to which RTOs they intended to join.<sup>30</sup>

13. On July 31, 2002, the Commission accepted filings by AEP and other companies (collectively, New PJM Companies) in which those companies stated their intent to join PJM.<sup>31</sup> The Commission also noted the commitment by AEP to join PJM through participation in an Independent Transmission Company (ITC) managed by National Grid USA (National Grid).<sup>32</sup> The companies stated that they were filing this commitment to supplement filings by other of the Alliance Companies<sup>33</sup> that indicated

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<sup>28</sup> Id. at 31,226.

<sup>29</sup> Midwest Independent Transmission System Operator, Inc., 97 FERC ¶ 61,326 (2001).

<sup>30</sup> Id. at 62,531 ("We note that numerous Alliance Companies, as a result of merger conditions or commitments made in merger proceedings, are required to join an RTO. . . . Alliance Companies are directed to file a statement of their plans to join an RTO, including the timeframe, within 60 days of the date of this order.") (footnotes omitted).

<sup>31</sup> Alliance Companies, et al., 100 FERC ¶ 61,137 at P 35 (2002) (July 31 Order).

<sup>32</sup> July 31 Order at P 13-14.

<sup>33</sup> Ameren Services Company (Ameren), FirstEnergy Corporation (FirstEnergy), and Northern Indiana Public Service Company (NIPSCO).

their intent to form another ITC, GridAmerica LLC (GridAmerica), within the RTO adjacent to PJM, the Midwest Independent Transmission System Operator (Midwest ISO).

14. In its acceptance of AEP's filing, the Commission noted that several parties had concerns about the effect of splitting the former Alliance Companies between Midwest ISO and PJM:

The Midwestern State Commissions are concerned that the seams between the Midwest ISO and PJM created by the Alliance Companies' choices may adversely affect reliability and markets, given that utilities with transmission systems within one RTO's so-called footprint will become members of another RTO. . . . They urge the Commission to take steps to eliminate the inter-RTO seams, and in particular to ensure that a seamless common market (with no rate pancaking and standardized market rules) be established.<sup>34</sup>

15. To address these concerns, the Commission first stated that the companies' RTO choices, standing alone, "appear to produce unjust and unreasonable rates, terms and conditions" but that the rates, terms and conditions could be rendered just and reasonable through conditions which the Commission then imposed.<sup>35</sup>

16. The Commission ordered PJM and Midwest ISO to form a "functional common market" across the two organizations by October 1, 2004.<sup>36</sup> To address the reliability concerns raised by the parties, the Commission required PJM and Midwest ISO to file reliability plans with the North American Electric Reliability Council (NERC) and its regional councils, the Mid-America Interconnected Network (MAIN) and the East Central Area Reliability Coordination Agreement (ECAR). Additionally, the Commission initiated an investigation with regard to the rates for through and out service under the Midwest ISO and PJM tariffs, and ordered Midwest ISO, PJM, AEP, and the other new entrants to address loop flow and connectivity problems resulting from the new proposed configuration of PJM in such a way as to hold harmless customers in Wisconsin and Michigan.<sup>37</sup>

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<sup>34</sup> July 31 Order at P 26. See also P 27-30 (noting similar concerns of other state commission, utilities, and customer groups).

<sup>35</sup> Id. at P 35.

<sup>36</sup> Id. at P 40.

<sup>37</sup> Id. at P 50, 53. On November 17, 2003, the Commission issued orders relating  
(continued...)

ii. **The New PJM Companies Proceeding**

17. On December 11, 2002, the New PJM Companies made a filing with the Commission to integrate their facilities into PJM in phases. Initially, AEP and ComEd proposed to transfer functional control of their transmission facilities to PJM, so that PJM would begin providing transmission service over those facilities on either February 1 or March 1, 2003. DP&L proposed to transfer control of its transmission facilities to PJM when it and AEP were integrated into the PJM Interchange Energy Market (PJM Market), which was at that time expected to happen in May 2003.

18. On April 1, 2003, the Commission accepted AEP's and ComEd's filings to transfer control of their facilities to PJM.<sup>38</sup> However, AEP's transfer of its transmission facilities to PJM's control has been blocked by the following state actions. The Virginia General Assembly enacted legislation providing that.

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, and without obtaining, following notice and hearing, the prior approval of the [Virginia] Commission, as hereinafter provided. However, each incumbent electric utility shall file an application for approval pursuant to this section by July 1, 2003, and shall transfer management and control of its transmission assets to a regional transmission entity by January 1, 2005, subject to [Virginia] Commission approval as provided in this section.<sup>39</sup>

19. In its February 28, 2003 report, AEP stated that its applications for approval to participate in an RTO were still pending (and were at different stages) before the

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to the question of through and out rates in Docket Nos. EL02-111-004, et al., and EL03-212-000, et al., and anticipates further compliance filings in those proceedings. The operational aspects of the hold harmless issue is anticipated to be addressed by the Midwest ISO and PJM in a future filing of their joint operating agreement. The financial aspects of the hold harmless issue was part of discussions among the parties in EL02-65-000 et al. To date, these discussions have not produced a filed settlement. Resolution of AEP's status should return the parties to their discussion of the financial aspect of the hold harmless issue.

<sup>38</sup> American Electric Power Service Corp., et al., 103 FERC ¶ 61,008 (2003) (April 1 Order).

<sup>39</sup> Va. Code Ann. § 56-579, Regional transmission entities, A.1 (2003).

following state commissions: the Virginia Commission, the Louisiana Commission, the Arkansas Commission, the Kentucky Commission, and the Indiana Commission.<sup>40</sup> According to AEP, the Ohio Commission issued an order stating that there were too many outstanding issues beyond its jurisdiction for it to meaningfully review this issue at this time.<sup>41</sup>

20. On March 27, 2003, the Kentucky Commission stated that it was currently reviewing a Kentucky Power Company application to determine whether the public interest would be served by its joining PJM.<sup>42</sup> Subsequently, the Kentucky Commission rejected AEP's bid to transfer control of its transmission facilities in the state to PJM,<sup>43</sup> although it has since granted rehearing of that decision to allow parties to introduce additional evidence.<sup>44</sup>

21. AEP, ComEd, and DP&L continue to assert their desire to transfer their

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<sup>40</sup> See Report on Compliance with Transmission-related Merger Conditions at 9-12, Docket No. EC98-40-000, et al. (Feb. 28, 2003).

<sup>41</sup> See id. at 11-12.

<sup>42</sup> See Response of the Kentucky Commission to Joint Comments and Motion for Relief of the Michigan Public Service Commission, the Public Utilities Commission of Ohio, and the Pennsylvania Public Utility Commission at 5 and n.6 (citing 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, L.L.C, Pursuant To KRS 278.218 (PSC Docket No. 2002-00475), Docket No. EC98-40-000, et al. (Mar. 27, 2003)).

<sup>43</sup> See 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, L.L.C, Pursuant To KRS 278.218 (PSC Docket No. 2002-00475) (issued July 17, 2003). Kentucky Commission argues that FERC cannot require a utility to join an ISO or RTO, citing Atlantic City Electric Co., et al. v. FERC, 295 F.3d 1 (D.C. Cir. 2002), where the court found that FERC, under section 203 of the FPA, cannot require a utility to seek its approval before withdrawing from an RTO.

<sup>44</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, L.L.C., Pursuant to KRS 278.218 (PSC Docket No. 2002-00475), order on reh'g (issued Aug. 25, 2003).

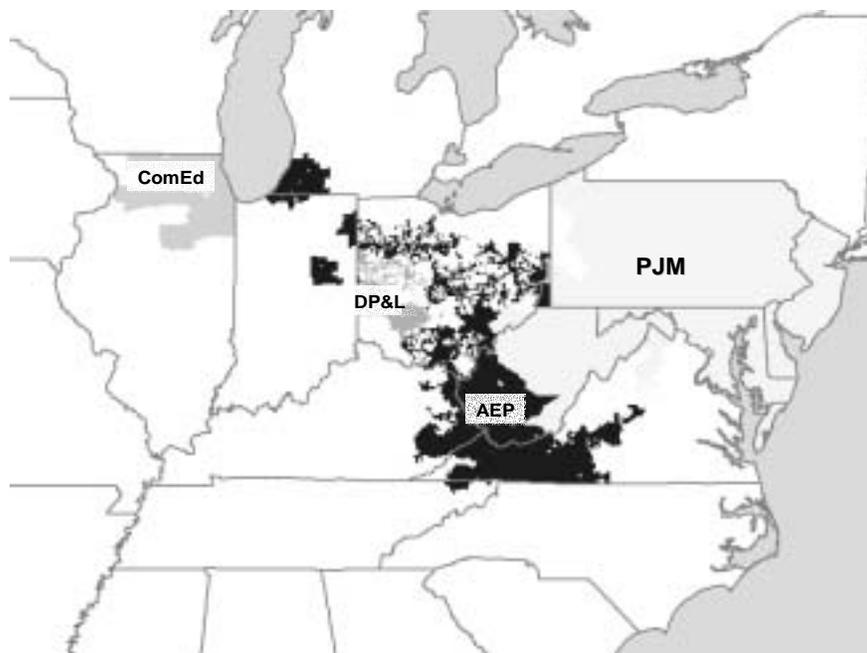
transmission facilities to PJM's control. Because of the geographic location of the parties, however – AEP is located between the service territory of the classic PJM companies to the east of AEP and ComEd's and DP&L's service territory to the west of AEP<sup>45</sup> – parties object to ComEd's participation in PJM without AEP,<sup>46</sup> and DP&L states that the regulatory and legal uncertainty delaying AEP's integration into PJM also delays DP&L's integration into PJM.<sup>47</sup> Petitions for rehearing and/or clarification of the April 1 Order also remain pending.

### **E. Inquiry**

22. On September 12, 2003, the Commission announced that it would hold an inquiry into RTO issues related to Midwest ISO and PJM to be conducted by the Commissioners and an administrative law judge. The inquiry would, in part, facilitate the gathering of sufficient information to move forward in addressing the obstacles to

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<sup>45</sup> See map below.



Source: PowerMap

<sup>46</sup> See Supplemental Comments of Edison Mission Energy, et al., dated October 23, 2003.

<sup>47</sup> Transcript of September 29-30 Inquiry (Tr.) at 5.

the fulfillment of the voluntary commitment made by AEP, among other companies, to join an RTO.<sup>48</sup>

23. AEP cites as such obstacles the following: (1) legal and regulatory considerations that are impeding its participation in PJM; (2) lack of progress on two conditions imposed by the Commission in connection with its approval of the RTO choices of AEP, ComEd, and DP&L to join RTOs;<sup>49</sup> and (3) delay caused by channeling resources to the evaluation of the reliability aspects of AEP's proposed actions.<sup>50</sup> It states that since at least September 1999, it has been continuously and conscientiously pursuing membership in an RTO. However, it states that until the Commission and the states can resolve their differences, it is reluctant to pursue RTO membership further and the Commission should not expect it to attempt to do so. AEP states that the Commission has authority under Section 205 of PURPA to exempt electric utilities from any state rule or regulation that prohibits the voluntary coordination of electric utilities, including any agreement for central dispatch. AEP states, however, that it would be reluctant to see the Commission invoke this remedy and presumes the Commission views reconciliation as a much better outcome than compulsion. AEP also states that a scenario under which its system would be split raises numerous technical, legal, contractual, political, and regulatory complications, which would be costly and difficult to resolve. While AEP continues to seek full integration into PJM, it did suggest, as a compromise solution, that it might integrate partially into PJM. Under this proposal, AEP would transfer functional control of its east zone transmission facilities to PJM, but would not become integrated into PJM's voluntary markets.<sup>51</sup>

24. DP&L witness Patricia K. Swanke states that current legal and regulatory uncertainty is delaying AEP from joining PJM, which in turn is delaying DP&L's integration into PJM, because DP&L's interconnection with PJM is through AEP, and actions by the state of Virginia have caused the complete transfer of functional control over DP&L's transmission facilities to be delayed.

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<sup>48</sup> Order Announcing Commission Inquiry into Midwest ISO-PJM RTO Issues, 104 FERC ¶ 61,274 (2003) (Inquiry Order).

<sup>49</sup> See Alliance Companies, et al., 100 FERC ¶ 61,137 (2002).

<sup>50</sup> Prepared Direct Testimony of Susan Tomasky and J. Craig Baker of AEP, filed on September 23, 2003, Ex. AEP-2, at 6-7.

<sup>51</sup> Id. at 30-31.

25. Detroit Edison witness Terry S. Harvill states that to enhance the reliability of the transmission system in the Eastern Interconnection and to reduce the risk of recurrence of the August 14, 2003, power outage, it is imperative that the former Alliance companies participate in a rationally configured RTO. According to Detroit Edison, the Commission must adhere to those policies and goals that are in the public interest, and should not attempt to accommodate the individual business interests of vertically integrated monopoly transmission owners at the expense of reliability and the public interest.

26. Edison Mission Energy, Edison Mission Marketing & Trading, Inc. and Midwest Generation EME, LLC (jointly, EME) states that it strongly supports the Commission's efforts to develop competitive and reliable energy markets in the Midwest and that the current process will yield a fragmented transmission grid in the Midwest that institutionalizes or worsens the impediments to a well-functioning wholesale market and creates unnecessary risks to reliable operation of the grid. EME contends that ComEd's proposal to address the fact that AEP will not be part of PJM by creating a contractual connection with PJM through the use of a 500 MW bi-directional transmission path across AEP's transmission system,<sup>52</sup> raises many reliability, efficiency, and gaming concerns.

27. EME states that a full integration of AEP's facilities into PJM is desirable. However, if this is not possible, the Commission should attempt to establish a settlement that achieves the partial integration of AEP's facilities into PJM. Finally, EME states that the Commission should strictly enforce the prior conditions it imposed on the RTO choices of the former Alliance companies and require that any settlement obligate the settling parties to drop all challenges to the implementation of those conditions.<sup>53</sup>

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<sup>52</sup> Joint Testimony of John P. Mathis and Reem J. Fahey on behalf of EME, filed on September 23, 2003, at 15 ("To overcome its lack of physical interconnection, ComEd proposes a 'virtual' interconnection with PJM through the use of a 500 MW bi-directional transmission path across AEP's transmission system (a path that already exists and is currently reserved by ComEd's affiliate, Exelon Generation).").

<sup>53</sup> Subsequently, on August 13, 2003, EME and its wholly owned subsidiaries, Midwest Generation and EME Marketing & Trading wrote a letter to the Commissioners expressing "deep concern about the direction that recent events regarding RTO development in the Midwest are taking, both in matters pending before the Commission and external to such proceedings." It stated that the events pose threats to the stability and viability of competitive wholesale electricity markets in the Midwest. It goes on to list a number of events and recommends a reexamination of the current direction. It proposes that the Commission convene a conference of all affected parties to receive a complete and accurate update of all relevant developments.

28. Electricity Consumers Resources Council (ELCON) states that the Commission must order AEP to join an RTO and thereby improve reliability in the Midwest and avoid disintegration of the Commission's RTO initiatives.

29. Exelon Corporation and ComEd (collectively, Exelon) believe that the most effective action the Commission can take to establish a joint and common market would be to require AEP to satisfy its merger condition and join PJM, its chosen RTO, by March 1, 2004. Exelon's witness Elizabeth A. Moler also states that the Commission should invoke its authority under the FPA and PURPA to require AEP to satisfy its merger condition. In this regard, Exelon states that the Commission has exclusive jurisdiction under the FPA to regulate interstate transmission. Therefore, requiring AEP to satisfy its merger condition and join an RTO is within the Commission's exclusive domain.<sup>54</sup>

30. Exelon argues that New York v. FERC<sup>55</sup> is controlling here, and that the foundation of the Commission's assertion of jurisdiction in this case is Order No. 2000, governing development of RTOs. Order No. 2000, like Order No. 888 (affirmed by the Supreme Court in New York v. FERC) applies to transmission in interstate commerce. Order No. 2000 encourages utilities that own and operate transmission systems to turn over operations to independent operators to remedy the inherent incentive to discriminate in favor of the transmission owners' generating facilities and traditional customers. According to Exelon, state regulatory proceedings that purport to prohibit AEP from joining PJM are directly and deliberately impeding federal policy over interstate transmission and development of competitive wholesale markets. Even if the state actions could be considered valid under state law, Exelon maintains that the Commission has the power to exempt AEP from compliance with that state action under PURPA.

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<sup>54</sup> Pre-filed Testimony of Elizabeth A. Moler on behalf of Exelon and ComEd, filed on September 23, 2003, at 19-20.

<sup>55</sup> Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities, FERC Stats. & Regs., Regs. Preambles, Jan. 1991-June 1996, ¶ 31,036, 61 Fed. Reg. 21540 (1996), order on reh'g, Order No. 888-A, FERC Stats. & Regs. ¶ 31,048 (1997), order on reh'g, Order No. 888 -B, 81 FERC 61,248 (1997), order on reh'g, Order No. 888 -C, 82 FERC ¶ 61,046 (1998), aff'd in relevant part sub nom. Transmission Access Policy Study Group, et al. v. FERC, 225 F.3d 667 (D.C. Cir. 2000), aff'd sub nom. New York v. FERC, 535 U.S. 1 (2002).

31. The Indiana Commission maintains that the public interest is best served by having AEP as a member of an RTO. The Indiana Commission therefore urges the Commission to ensure AEP and its several operating companies comply with the settlement agreements and various orders of the Commission, the Indiana Commission, and other state commissions. The Indiana Commission maintains allowing AEP to remain outside of an RTO denies consumers the benefits of a more efficient market. In addition, the Indiana Commission believes it is in AEP's best interest to participate in an RTO. Furthermore, according to the Indiana Commission, AEP's lack of participation in an RTO is inconsistent with its statutory obligation to the citizens of Indiana to provide reliable service. The Indiana Commission does, however, recognize that states such as Virginia and Kentucky have statutory authorities that must not be ignored. In this regard, the Indiana Commission urges the Commission to order AEP to have its operating companies that are located in states that have approved their participation to join an RTO immediately.

32. In addition, the Indiana Commission recognizes the legitimacy of AEP's concern that there may have to be changes, perhaps temporarily, in its Operating Agreement to ensure that all states served by AEP are treated equitably. To this end, the Indiana Commission pledges its support to find an equitable result for all parties. However, if the effort to reach accord is unsuccessful in a relatively short period of time, the Indiana Commission would urge the Commission to give consideration to ordering changes to the relevant agreements, at least on an interim basis, to permit AEP to move expeditiously toward completing its inclusion into an RTO in those states which have approved the transfer of functional control.

33. PPL Electric Utilities Corporation (PPL) supports the Commission's goal for open and competitive wholesale markets and properly configured independent RTOs. However, PPL expresses concern with the speed at which the Commission aims to achieve the expansion of PJM. In particular, PPL witness John F. Sipics believes that the current pace for expansion leaves no time to effectively consider cost, to conduct careful analysis, or to consider alteration of the basic institutions and chemistry that have made PJM work. Moreover, PPL states that the current proposed expansion of PJM will not result in a stable, reliable, and efficient RTO. PPL states that there may be other ways to achieve benefits without the reliability risks and costs of transforming PJM into a huge non-contiguous RTO in the Midwest.<sup>56</sup>

34. The North Carolina Utilities Commission (North Carolina Commission) states that the Commission does not have exclusive jurisdiction over transmission assets. The

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<sup>56</sup> Direct Testimony of John F. Sipics of PPL filed on September 23, 2003, at 3-11.

North Carolina Commission cites Atlantic City Electric Co. v. FERC<sup>57</sup> to support its position that the Commission's Section 203 authority does not extend to proposed transfers of control of transmission assets, as opposed to the transfer of the assets themselves. The North Carolina Commission also states that the voluntary commitment by AEP to join an RTO, which the Commission describes as being a condition of its approval of the merger of AEP and CSW, does not preclude a state from blocking one or more of AEP's utility subsidiaries from participating in an RTO. According to the North Carolina Commission, the Commission acknowledged the authority of states in this regard in its merger policy statement, noting that when the Commission conditions approval of a merger of electric utilities on market power mitigation, some, and maybe all, of the possible remedies to market power require the approval of other Federal, state, and local authorities. In addition, the North Carolina Commission believes that the Commission does not have the authority under the FPA to override the legitimate exercise of a state legislature or a state commission's authority to protect retail ratepayers. It notes that the Commission explicitly acknowledged the authority of states in this regard in the Merger Policy Statement. It also notes that Order No. 2000 observed that most states must approve the participation by their utilities in an RTO.

35. On September 24, 2003, the Virginia Commission filed a motion for leave to file one day out of time, a statement of position and motion for reconsideration. The Virginia Commission objects to a number of statements made by the Commission in the September 12, 2003 Order. The Virginia Commission states that the order characterizes Virginia's "valid exercise of sovereign authority" as an "impediment" to the expansion of PJM. It requests that the Commission take no action in the inquiry that would in any way preempt, hamper or otherwise impair the Commonwealth's undeniable authority under the Constitution, the FPA, and other laws to exercise its independent jurisdiction.

36. The Virginia Commission also states that the September 12, 2003 order fails to give proper recognition to the multitude of complex issues that can be properly resolved only on the basis of a complete record in which all parties have had a full and fair opportunity to conduct discovery, present responsive testimony and cross-examine the witnesses of other parties. The Virginia Commission states that it would "vigorously oppose any attempt to reach a decision based on an inadequate record or to preempt, the Virginia Commission's ability to fulfill its statutory mandate and complete its review of AEP affiliate APCO's application to transfer control of its transmission facilities within Virginia to PJM.

37. On September 24, 2003, the Kentucky Commission filed comments in response to the September 12, 2003 Order. It states that it has grave concerns about the tone of

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<sup>57</sup> 295 F.2d 1 (D.C. Cir. 2002).

the order, as well as the speed with which FERC intends to act. Because it has open cases concerning whether certain utilities subject to its jurisdiction should be members of specific RTOs, it states that its participation in the inquiry would be inappropriate. It also supports the comments of Virginia Commission.

38. On September 23, 2003, the North Carolina Commission and the Public Staff-North Carolina Commission, and the Attorney General of the State of North Carolina (collectively, North Carolina) filed an intervention and comments. The comments stress the legal limitations that exist with respect to FERC's authority to take action to move the Midwest ISO and PJM expansions forward in the absence of approval by the relevant state commissions of the proposed transfers of control over transmission to Midwest ISO or PJM. North Carolina contends that the voluntary commitment by AEP to join an RTO does not preclude a state from blocking one or more of AEP's utility subsidiaries from participating in an RTO. It notes that the Commission explicitly acknowledged the authority of states in this regard in the Merger Policy Statement. It also notes that Order No. 2000 observed that most states must approve the participation by their utilities in an RTO.<sup>58</sup>

39. After the September 29 and 30 inquiry, parties submitted additional comments supporting particular solutions to the problems identified there.<sup>59</sup>

40. Multiple parties argue that the best solution to the problems addressed at the inquiry would be for the Commission to order AEP to integrate fully into PJM. Midwest ISO states that to enable PJM and Midwest ISO to operate a joint and common market (with day-ahead and real-time markets for energy, centralized security constrained dispatch, the use of LMP for congestion management, and the use of Financial Transmission Rights (FTRs)<sup>60</sup> for hedging instruments), AEP must be fully

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<sup>58</sup> Order No. 2000 at 30,993.

<sup>59</sup> The Commission hereby accepts all late-filed submissions and motions for intervention submitted between the September 29 and 30 inquiry, and the date of issuance of this order.

<sup>60</sup> FTRs (alternatively called "financial transmission rights," "firm transmission rights," or "fixed transmission rights") are financial instruments that entitle the holder to a stream of revenues or charges based on the hourly energy-price differences across the transmission path in the Day-Ahead Market. The FTRs provide a hedging mechanism that can be traded separately from transmission service. This gives all market participants the ability to gain price certainty when delivering energy across an RTO. See <http://www.pjm.com/markets/fttr/fttr.html>.

integrated into PJM. Midwest ISO also submits an affidavit from its independent market advisor, Dr. David Patton, who asserted that permitting AEP to remain unaligned with any RTO will create a non-market area (AEP) sandwiched between two market areas, thus increasing the potential for gaming and inefficiencies.

41. Cinergy states that AEP's RTO status is "the most important domino that can trigger the chain reaction" necessary to bring about a joint and common market between PJM and Midwest ISO, and that that common market will only be possible if AEP participates in an LMP-based market.<sup>61</sup> Cinergy points out that once AEP joins PJM, ComEd and DP&L will be able to follow unhindered, Midwest ISO and PJM will move toward a market-to-market interface, and rate pancaking issues will be dramatically simplified. Cinergy's witness Dr. Richard Tabors further states that Transmission Loading Relief Procedures (TLRs), upon which AEP would rely to manage congestion absent membership in an RTO, are a much less efficient congestion management mechanism than LMP,<sup>62</sup> and that leaving AEP as a stand-alone company would also prevent most economic redispatch for congestion management purposes. Dr. Tabors also states that AEP is the linchpin of the PJM/Midwest ISO common market: its 2200-mile 765-kv system is the central backbone in the Midwest, and it is the largest low-cost energy supplier in the region. He describes AEP as not just a seam between PJM and Midwest ISO but rather as the glue that holds them together.<sup>63</sup>

42. Constellation, Consumers, Midwest ISO Transmission Customers, and EME support the full integration of AEP into PJM. EME also notes that the Commission had required the RTO that the former Alliance companies joined to include a balancing market, and PJM has effective balancing markets, while none of the proposed alternatives to full integration would achieve efficient balancing markets throughout AEP.<sup>64</sup> DP&L states that its ability to join PJM, which it still wishes to do, has been

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<sup>61</sup> Cinergy Post-Inquiry Comments Supporting Tabors Rebuttal Testimony at 1-2.

<sup>62</sup> LMP is a market-based method for congestion management that is currently used to manage congestion in the regional markets run by both PJM and the New York Independent System Operator. Under LMP, the price to transmit energy between any receipt point and delivery point reflects the marginal cost (including the marginal opportunity cost) of such transmission service, and the price of energy at each location reflects the marginal cost (as reflected in participants' bids) of producing energy and delivering it to that location.

<sup>63</sup> Rebuttal Testimony of Richard Tabors, filed on October 10, 2003, at 9-10.

<sup>64</sup> EME Post-Inquiry Comments at 7.

stymied by AEP's inability to join PJM. PSEG supports integration of AEP, ComEd, and DP&L into PJM as quickly as possible, and states that there are no reliability concerns that would prevent such action. The PHI Companies challenge PPL's testimony that the integration of new members into PJM should be delayed pending resolution of reliability concerns. PJM states that its stakeholders would not consider partial integration of AEP into PJM, absent a firm commitment as to a date for full integration, and would do so only as a step forward.

43. AEP states that, of the options that have been suggested, its system should not be split. It also suggests that its merger commitment does not necessarily require participation in PJM's sophisticated LMP-based market mechanisms. Further, AEP states that whether it is integrated into PJM or not, its lowest cost generation will serve AEP's native load rather than serve to relieve transmission congestion, that AEP already engages in economic dispatch (as it would if it joined PJM), and that having another entity conduct AEP's dispatch will produce needless cost and complexity. AEP also asserts that there has been no evaluation of the monetary value of the efficiencies of the proposed integration into PJM.

44. Many parties point to the need for stability, and the fact that only the Commission can achieve that stability by ordering AEP to join PJM. Midwest ISO states that instability is the greatest impediment to RTO development in the Midwest. It points out that since 1998, every time a significant change has occurred in the Midwest, several parties reevaluate their RTO choices. Midwest ISO maintains that this continuing instability has undermined reliability, connectivity, and the financial credibility of RTOs. Midwest ISO asserts that, although RTO membership is voluntary, once a company has made an RTO choice (as AEP did in 2002), the Commission must step forward and enforce that choice, and achieve closure for all parties.<sup>65</sup> Baltimore Gas and Electric Company (BG&E) states that the Commission alone can address conflicts between state and federal jurisdiction over RTO membership, and that until it acts to do so, state agencies will continue to raise barriers to RTO membership and "target dates will become moving targets."<sup>66</sup> Cinergy warns that if AEP does not join PJM, other transmission owners will similarly seek to opt out of RTO membership.

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<sup>65</sup> In fact, Southern Illinois Power Cooperative stated in its comments that if Ameren and Illinois Power were to withdraw from Midwest ISO and join PJM, as is now possible, Southern Illinois would also have to consider following their lead. The MISO Transmission Owners additionally argue that if the Commission allows AEP to join an RTO in part but not in full, it must offer that same option to other transmission owners.

<sup>66</sup> BG&E Post-Inquiry Comments at 6.

45. EME states that any solution that permitted utilities to opt out of requirements imposed by the Commission because a state governmental authority adopted a position contrary to those requirements would set a precedent that could unravel the Commission's RTO policies and weaken the Commission's ability to carry out its jurisdictional responsibilities under the FPA. ELCON points out that even after July 2004, AEP may not be permitted by the state of Virginia to join an RTO, since the Virginia Commission has recently recommended that the state continue its ban on RTO membership.<sup>67</sup>

46. Detroit Edison and PPL<sup>68</sup> state that AEP's partial RTO position would not resolve the conditions set out in the July 31 Order. Exelon, in the rebuttal testimony of its witness Elizabeth A. Moler, states that partial integration of AEP into PJM would keep AEP exempt from many of the features of RTO membership, including LMP congestion management, Installed Capacity (ICAP) requirements, the balancing market, and market monitoring of generation. Exelon also states that AEP's proposal does not meet AEP's merger commitments. International Transmission states that AEP's proposal is troubling in light of the August 14, 2003 blackout, in that AEP does not propose to participate in PJM's security constrained dispatch, which would protect against line overloads.

47. EME, in supplemental comments, states that the full integration of AEP into PJM has significant support, while partial integration has little support. EME also states that competition in Midwest markets would be harmed by the partial integration solution, because AEP would benefit from lower transaction costs in PJM markets, whereas generators located outside AEP could serve load within the AEP area only by making higher cost bilateral sales and making transmission arrangements. It also asserts that absent full integration, AEP could withhold capacity from the market without any oversight by the PJM market monitor. EME also notes that state commissions may

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<sup>67</sup> ELCON Post-Inquiry comments at 7. See Commonwealth of 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 Pursuant to Section 56-596 of the Code of Virginia, August 29, 2003 (2003 Status Report) ([http://www.state.va.us/scc/caseinfo/reports/2003\\_1.pdf](http://www.state.va.us/scc/caseinfo/reports/2003_1.pdf)).

<sup>68</sup> PPL also, however, states that the Commission should perform a cost-benefit analysis of the impact of RTO choices before permitting AEP, ComEd, and DP&L to join PJM, and that ComEd should not be integrated into PJM before October 2004.

similarly not approve AEP's partial integration plan, similarly to their view of full integration, and thus the partial integration proposal will not obviate the need for preemption.

48. Some parties asserted that it would be necessary for additional events to occur before AEP can be integrated into PJM. Ameren notes that AEP has not filed an agreement with ComEd, Illinois Power and National Grid to form an ITC within PJM, as required by the July 31 Order. Michigan and Wisconsin Stakeholders state that AEP's proposal for partial integration would add new complications to resolution of the question of how to hold Michigan and Wisconsin customers harmless from the Alliance companies' RTO choices. The Virginia and Kentucky Commissions asserted that many difficult, fact-specific, unresolved issues and concerns remain with regard to joining the PJM and Midwest ISO RTOs.

49. Some state commissions supported the full integration of AEP into PJM. The Ohio Commission states that the August 14, 2003 outage demonstrates that it is time for the Commission to act to resolve differences in the Midwest by ensuring creation of a complete joint and common market between PJM and Midwest ISO, and recommends use of the ITC mechanism (GridAmerica on the Midwest ISO side, and another ITC managed by National Grid on the PJM side). The Pennsylvania Public Utility Commission (Pennsylvania Commission) specifically criticizes AEP's partial integration solution, stating that this proposal will create a seam between PJM and Midwest ISO for the foreseeable future, and should be rejected. The Illinois Commerce Commission (Illinois Commission) stated that it joins the Indiana, Michigan, and Pennsylvania Commissions in urging FERC to require AEP to fulfill its merger conditions and promptly join an RTO.<sup>69</sup>

50. Other state commissions, however, did not. The Kentucky Commission notes that it continues to have an open docket as to the question of whether Kentucky Power Company (an AEP affiliate) may join PJM, and is waiting for a cost-benefit analysis of such action to be filed in December of 2003. The Muni-Coop Coalition also states that state commissions have legitimate concerns about the benefits that LMP will produce for their state's retail customers, but that these concerns must not be allowed to permit AEP special rights (*i.e.*, rights different than those of other companies) to determine its level of RTO participation.

51. The Virginia Commission states that the Commission's inquiry has focused on the wrong factors (namely, how to address the impediments to AEP's integration into PJM), and that the Commission instead should seek to determine whether the terms and

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<sup>69</sup> Illinois Commission Post-Inquiry Comments at 2.

conditions proposed by AEP and the other New PJM Companies are just and reasonable. The Virginia Commission further states that the testimony presented demonstrates that this question is still not answered, and that it still requires cost-benefit analysis. Additionally, the Virginia Commission asserts that, because the Commission could not require AEP to merge with CSW, but was simply approving a voluntary merger between the two entities, it may not then assume the authority to require AEP to join an RTO, solely to facilitate that merger. The Virginia and Kentucky Commissions again assert that FERC has no legal basis to preempt state commissions and cannot compel RTO membership, and Virginia's Restructuring Act is not an impediment or obstacle to federal policy but rather actually furthers such policy. They also state that the Commission's ultimate goal should not be simply RTO expansion, but rather, providing net benefits to ratepayers while enhancing reliability and safety. They further assert that the September 29-30 hearing provides an inadequate record for decision because it did not resolve all the issues regarding the PJM expansion.

52. The North Carolina Commission states that the Commission's actions here are premature, since in addition to the actions of Virginia and Kentucky, several other factors (including the failure to meet the conditions set out in the July 31 Order, the pending status of the Commission's order on through and out rates, and PJM's announcement of a delayed schedule for the integration of ComEd into PJM pending investigation into the August 14, 2003 blackout) make AEP unable to join an RTO. The North Carolina Commission further asserts that the Commission has no authority to preempt state legislative or regulatory decisions. In later comments, the North Carolina Commission similarly asserts that the Commission does not have exclusive jurisdiction over transmission assets but rather concurrent jurisdiction with the state commissions, that the Commission's Section 203 authority does not extend to proposed transfers of control of such assets, and that some remedies to market power require the approval of other federal, state, and local authorities.

53. The Wisconsin Public Service Corporation (Wisconsin Commission) states that the future of Midwest ISO is placed at risk by the continually changing RTO choices of the former Alliance Companies, and suggests that the Commission direct PJM and Midwest ISO to enter into merger discussions with the objective of forming a single RTO across the Midwest and Mid-Atlantic States. The Wisconsin Commission states that any solution to the question of whether AEP joins PJM must encompass the "hold harmless" problem, and that AEP should not be permitted to join PJM until the conditions of the July 31 Order are met.

54. The Illinois Municipal Electric Agency (IMEA) states that, from the perspective of a customer, the greatest need is for certainty and for a resolution to seams problems. IMEA states that it is currently negotiating for part ownership of a generating plant in Kentucky, and as part of that transaction must arrange for transmission of that generation to its customers in Illinois, but cannot do so with certainty until the contours

of Midwest ISO and PJM are settled, and so runs the risk that appropriately-priced transmission may not be available to IMEA when it needs it. IMEA also argues that, to avoid seams problems within RTOs, the best resolution would be for all Illinois utilities to be within a single RTO.

## II. PROBLEM CONSIDERED AND SIGNIFICANT FACTORS

55. Based on its review of the proceedings discussed above, and the information elicited in its inquiry, the Commission has determined that it must resolve the problem of how AEP can fulfill its commitment to join a Commission-approved RTO. In addressing this question, we are guided by the following considerations.

### A. Necessity of Fulfilling AEP's Merger Commitment to Address Market Power Concerns

56. AEP and CSW were able to obtain Commission approval of their merger proposal because they agreed that the merged company would join a Commission-approved RTO. The market power concerns present at that time that required that merger commitment are still present now. As the Commission stated in Opinion No 442:

Applicant's witness, Dr. William H. Hieronymus, presents testimony regarding the competitive implications of consolidating generation controlled by CSW and AEP. Applicants identify nonfirm energy and short-term capacity as the relevant products and use, among other measures, economic capacity as a proxy for supplier's ability to participate in the relevant product market. . . . He evaluates pre- to post-merger changes in market concentration over ten time periods. Dr. Hieronymus reports increases that exceed the thresholds specified in the Merger Policy Statement in numerous time periods.<sup>70</sup>

57. Additionally, parties raised concerns regarding the incentive for the merged company to exercise vertical market power where such vertical market power did not exist pre-merger, and the extent to which the merger would create or enhance the ability of the merged company to exercise vertical market power. One party asserted that the merged company could strategically operate generation facilities so as to reduce available transmission capacity and so keep out competitors.<sup>71</sup>

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<sup>70</sup> Opinion No. 442 at 61,780-81 (footnotes omitted).

<sup>71</sup> Id. at 61,781-83.

58. Until AEP fulfills its commitment to join an RTO, these potential market power concerns will remain unaddressed. The Commission is concerned that, until the merged entity's ability to exercise market power is mitigated, we cannot ensure that rates, terms, and conditions of service are just and reasonable and not unduly discriminatory or preferential, as required by the FPA.

**B. Benefits of RTOs to Energy Customers**

59. As the Commission stated in Order No 2000, RTOs will address the existing impediments to efficient transmission grid operation and competition and will benefit customers through lower electricity rates resulting from a wider choice of services and service providers. In addition, substantial cost savings are likely to result from the formation of RTOs.<sup>72</sup> Regional institutions will address more efficiently the operational and reliability issues now confronting the industry, and eliminate any residual discrimination in transmission services that will occur when the operation of the transmission system remains in the control of a vertically integrated utility.

60. While we acknowledge that the level of RTO benefits may vary by operating company within states, the Commission believes that benefits from RTOs will accrue to all customers. These benefits include: increased efficiency through regional transmission pricing and the elimination of rate pancaking; improved congestion management; more accurate estimates of Available Transmission Capacity (ATC); more efficient management of parallel path flows; more efficient planning for transmission and generation investments; increased coordination among state regulatory agencies; reduced transaction costs; facilitation of the success of state retail access programs; facilitation of the development of environmentally preferred generation in states with retail access programs; improved grid reliability; and fewer opportunities for discriminatory transmission practices. All of the improvements to the efficiencies in the transmission grid will help improve power market performance, which ultimately will result in lower prices to the nation's electricity customers.<sup>73</sup>

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<sup>72</sup> Introduction & Summary section of Order No. 2000, Final Rule, FERC Stats. & Regs. ¶ 31,089 at 30, 993 (1999) (footnote omitted). See also Economic Assessment of RTO Policy, prepared for Federal Energy Regulatory Commission by ICF Consulting, February 26, 2002 (<http://www.ferc.gov/industries/electric/indus-act/rto/cost/02-26-02-report.pdf>).

<sup>73</sup> Order No. 2000 at 31,024.

61. For these reasons, we continue to believe that AEP's customers will be best served by the integration of AEP into an RTO. In response to the concern of states such as Virginia and Kentucky that RTOs could result in exports of some states' low cost power to other states, we do not believe that RTO membership will cause AEP to sell its lowest cost power out of state.<sup>74</sup> Where there is no retail choice, the fact that a utility joins an RTO does not affect a state commission's authority to require a utility to sell its lowest cost power to native load. We point out that, if the utility's transmission is operated by an RTO and its higher cost power can be sold more readily to new, more distant customers, this will lead to recovery of more capital costs and lower retail rates. In the longer term, low cost states should benefit from an RTO that facilitates expanded access to wholesale electricity markets, increasing the choice of low cost resources available to utilities as they acquire new power resources.<sup>75</sup>

### C. Reliability and Connectivity Issues

62. The need to address the reliability of the region's interconnected transmission grids and to create market structures that encourage investment in transmission has only become more evident since the blackout that occurred on August 14, 2003.<sup>76</sup> The investigation into the cause of this blackout is ongoing<sup>77</sup> – thus, the actions we take here can not and are not intended to address the specific causes of the blackout. However, through this order, we can preserve the integrity of AEP's transmission system and promote resolution of seams issues, as discussed in Order No. 2000.<sup>78</sup> Before

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<sup>74</sup> AEP has stated in its October 22, 2003 Reply Comments that "AEP's lowest cost generation, whether or not AEP is integrated into PJM's markets, will be dedicated to serving AEP's native load customers." Id. at 4.

<sup>75</sup> Order No. 2000 at 31,210.

<sup>76</sup> The blackout affected an area extending from New York, Massachusetts, and New Jersey west to Michigan, and from Ohio north to Toronto and Ottawa, Ontario. Approximately 50 million customers were affected, and the economic costs will be staggering. See [http://www.electricity.doe.gov/2003\\_blackout.htm](http://www.electricity.doe.gov/2003_blackout.htm).

<sup>77</sup> On November 19, 2003, the U.S.-Canada Power System Outage Task Force released its Interim Report on the Causes of the August 14th Blackout in the United States and Canada, <http://www.ferc.gov/cust-protect/moi/blackout-report.pdf>.

<sup>78</sup> See Order No. 2000 at 31,083:

We note that a number of commenters make the point that, at least for some purposes and functions, the scope of an individual RTO is less important if it is part of a  
(continued...)

discussing these issues, we will briefly review significant characteristics of AEP's system.

63. AEP East Generation. AEP's electric utility operations extend from Tennessee to Michigan and from Virginia to Indiana through its operating subsidiaries, Appalachian Power Company (APCO), Columbus Southern Power Company (CSP), Indiana Michigan Power Company (I&M), Kentucky Power Company (KPCO), Kingsport Power Company, Ohio Power Company (OPCO), and Wheeling Power Company.<sup>79</sup> The following table compares the nameplate capacity of AEP's aggregate generation with that of RTOs and ISOs in the Eastern Interconnection, other than Midwest ISO:

Nameplate capacity (MW)

PJM	New York ISO	ISO New England	AEP
76,000 <sup>80</sup>	37,093 <sup>81</sup>	31,000 <sup>82</sup>	22,398 <sup>83</sup>

64. AEP states that integrated planning and operation of its system are provided for in several agreements, including the AEP Interconnection Agreement, the AEP

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group of RTOs that have adequately eliminated the negative effects of "seams" between itself and the other RTOs. NERC identifies two seams issues: reliability practices across seams and market practices across seams.... Thus, the concept of large "seamless trading areas" for power emerges as a "scope" issue that is distinct from the scope of the region for organizing the transmission functions of an RTO.

<sup>79</sup> See Opinion 442 at 61,776.

<sup>80</sup> See <http://www.pjm.com/about/glance.html>.

<sup>81</sup> See source material at [http://www.nyiso.com/services/documents/planning/pdf/nyca\\_generators\\_2003.xls](http://www.nyiso.com/services/documents/planning/pdf/nyca_generators_2003.xls).

<sup>82</sup> See <http://www.iso-ne.com/>

<sup>83</sup> See <http://www.eia.doe.gov/cneaf/electricity/page/capacity/existing2002.xls> for source material.

Transmission Agreement, the Interim Allowance Agreement and certain joint power plant ownership agreements which govern facilities in the East Zone.<sup>84</sup>

65. APCO has approximately 30 operational generating units located in Virginia amounting to just over 1,700 MW in nameplate capacity;<sup>85</sup> however it also provides service and owns facilities in West Virginia. In addition to its AEP system interconnections, APCO is also interconnected with the following unaffiliated utility companies: Carolina Power & Light Company, Duke Energy Corporation, and Virginia Electric and Power Company. APCO is also interconnected with the Tennessee Valley Authority (TVA) and has entered into agreements with TVA under which APCO and TVA interchange and transfer electric power over portions of their systems.<sup>86</sup>

66. KPCO has two operational generating units amounting to just over 1,000 MW.<sup>87</sup> In addition to its AEP system interconnections, KPCO is interconnected with the following unaffiliated utility companies: Kentucky Utilities Company and East Kentucky Power Cooperative Inc. KPCO is also interconnected with the TVA.<sup>88</sup> In addition to its AEP system interconnections, KPCO is interconnected with the following unaffiliated utility companies: Kentucky Utilities Company and East Kentucky Power Cooperative Inc.

67. AEP East Transmission. AEP's transmission assets serve to deliver wholesale electric power in interstate commerce. For example, the net realization from off-system sales for the AEP east operating companies during the last three years are as follows:<sup>89</sup>

(In Millions)

Company	APCO	KPCO	I&M	OPCO	CSP
3 Yr Total	\$399	\$98	\$353	\$335	\$231

<sup>84</sup> AEP's June 25, 2000 Response to June 10, 2003 Data Requests.

<sup>85</sup> See Energy Information Administration, Inventory of Electric Utility Power Plants in the United States 2000 (EIA 2000 Inventory) at 104.

<sup>86</sup> AEP 2002 Form 10K/A, pt. 1.

<sup>87</sup> See EIA 2000 Inventory at 104.

<sup>88</sup> AEP 2002 Form 10K/A, pt. 1.

<sup>89</sup> AEP October 10, 2003 Response to Request No. 6. This information includes the net margin from all AEP System sales-for-resale associated with the 447 account, except to full requirements customers specific to an operating company.

68. AEP's President and CEO, Dr. Linn Draper, describes its physical transmission system as follows:

We have, as you know, a 765 kV system that runs from Michigan down to Virginia; that's the backbone of our system and really provides much of the strength of the eastern interconnect. Beneath that we have a 345 [kV] system.<sup>90</sup>

69. Commenting on the need to retain the current system's physical integrity, Dr. Draper also said, "It seems to me that to take a physically strong system of that type...and split it up in some way along state lines or otherwise is a huge mistake if we're concerned about the physical reliability of the physical transmission system."<sup>91</sup>

70. AEP describes the management of its system as follows:

At present, the AEP [high voltage interstate transmission] System is operated as an integrated system under the AEP Interconnection Agreement; AEP dispatches its generating units in real time on a single system economic basis to ensure that the System's energy and ancillary service requirements are met at the lowest possible cost in a reliable manner. Congestion in the AEP East zone is managed through control devices, dispatch and redispatch, and TLRs on an integrated basis.<sup>92</sup>

71. Issues Arising from AEP's Existing Management of Its System. However, it appears that reliability problems may be created by the fact that AEP uses TLRs, a non-market mechanism, to manage congestion, while PJM manages congestion on its system through the use of LMP and Midwest ISO will adopt LMP when its markets progress to the next phase of operation. Mr. Joseph Bowring of PJM's Market Monitor Unit (PJM MMU), states that "there are currently significant loop flows at the PJM-AEP seam that could be better managed if AEP fully integrates with PJM's markets."<sup>93</sup>

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<sup>90</sup> Tr. at 40.

<sup>91</sup> Id.

<sup>92</sup> AEP Response to Data Request Nos. 3 and 6 (footnote added).

<sup>93</sup> PJM Market Monitor's Assessment of AEP Proposal for Limited Integration with PJM at 3-5. Mr. Bowring also noted that "loop flows reflect the fact that power flows on the high voltage electric transmission system in the Eastern Interconnect do not respect the boundaries that demarcate the system operators," id. See also U.S.-Canada

72. Mr. Bowring presents analysis on facilities in PJM and AEP on which congestion results from flows that cannot be managed by internal redispatch under the current configuration and that are frequently managed by TLRs rather than redispatch. Mr. Bowring states that these flowgates<sup>94</sup> are “in the top ten facilities, by frequency of occurrence, for which TLRs have been called in 2003 to date.” Illustrating the significant loop flows between PJM and AEP, Mr. Bowring notes that “the volume of TLRs in PJM and AEP used to manage constraints has constituted 19 percent of all TLRs implemented in the U.S. since 1998.”<sup>95</sup>

73. As to the consequences of employing a TLR system in an area surrounded by LMP systems, International Transmission Company's Mr. Richard states: "If [an area using a TLR system is] intertwined with an LMP system, some of the internal loop flows related to the companies within the LMP market, do not appear in the TLR system, so therefore they're not accounted for and cannot be properly reflected in any actions that need to be taken [for reliability]."<sup>96</sup>

74. Similarly, commenting on the need to resolve any inconsistencies regarding how Midwest ISO and PJM will operate or run their markets, Midwest ISO's Mr. Torgerson testified that Midwest ISO could live with the RTO choices of the former Alliance Companies so long as the conditions of the July 31 Order are met,<sup>97</sup> and that of those conditions, the establishment of a joint and common market is considered by Midwest ISO as a critical condition that can be truly satisfied only with AEP's integration into the PJM market structure.<sup>98</sup> Midwest ISO states that the Joint Operating Agreement (JOA) recently negotiated between itself and PJM represents a substantial improvement in

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Power System Outage Task Force's November 2003 Interim Report, supra, at 38-39.

<sup>94</sup> A flowgate is a particular transmission facility or group of facilities. See Standard Market Design, Notice of Proposed Rulemaking, FERC Stats. & Regs. ¶ 32,563 at P 246.

<sup>95</sup> PJM Market Monitor's Assessment of AEP Proposal for Limited Integration with PJM at 5.

<sup>96</sup> Tr. at 327.

<sup>97</sup> Tr. at 266.

<sup>98</sup> Midwest ISO Post-Inquiry Comments at 4.

reliability, and is capable of addressing a market-to-non-market situation. Nevertheless, argues Midwest ISO, if AEP operates within PJM on a non-market basis, the reliability enhancement envisioned by the joint and common market will be undermined.<sup>99</sup>

75. Parties state that the markets are needed for reliability and, in the case of PJM, markets have already improved reliability. The PJM MMU's Mr. Bowring states that seams arising from loop flows are easier to manage when transparent, LMP-based markets exist on both sides of such boundaries and redispatch agreements exist to ensure efficient LMPs on both sides of the boundaries.

76. Furthermore, PJM points out that since the implementation of its markets, approximately 6750 MW of generation have been added into the PJM region and generator availability in PJM improved from 81.4 percent in 1994 to 86.3 percent in 2002, while generator forced outage rates declined nearly 35 percent. PJM states that this improved availability of generation is equivalent to the addition of 1,500 MW to the system. PJM also points to the positive impact on reliability from the introduction of ancillary service markets, stating that it has exceeded the North American Reliability Council's generation control performance standard related to matching generation and load instantaneously. Finally, through its regional planning process, PJM has directed the addition of more than \$725 million of transmission enhancements in the PJM region since 2000, an 11 percent increase in transmission assets. Thus, it appears that implementation of markets in PJM has spurred investment in generation and transmission, improved generation availability, and enhanced the ability of PJM to match generation to load.

77. The Commission therefore finds that, to maximize reliability and connectivity throughout the Midwest and Mid-Atlantic regions, AEP must expeditiously fulfill its voluntary merger commitment and voluntary Order No. 2000 RTO commitment by fully integrating AEP into PJM. Due to AEP's sizeable service territory and strategic location between current PJM, Midwest ISO, and ComEd, AEP's integration into PJM would allow the benefits of enhanced reliability that arise through RTO membership to extend seamlessly across the Mid-West and Mid-Atlantic regions.

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<sup>99</sup> Midwest ISO Post-Inquiry Comments at 12.

**D. Market and Gaming Issues**

78. We are also concerned that AEP's exclusion from PJM's markets and its inability to fulfill its voluntary commitment would result in 1) market dysfunctions, 2) opportunities for gaming, or 3) perceptions in the marketplace that market dysfunctions or gaming exist, because any of these will interfere with both developing and existing competitive electricity markets, which is a stated goal of Order No. 2000.<sup>100</sup>

79. Dr. David Patton, the independent market advisor to Midwest ISO, discusses market efficiency and the potential for gaming in the context of AEP's not being a full RTO participant. He first describes how Midwest ISO and PJM are currently addressing market efficiency issues and the potential for gaming through a JOA that will contain procedures including coordination in managing congestion on their respective systems. Dr. Patton explains that previously he believed that the provisions in the JOA substantially would address the efficiency and gaming concerns raised by the irregular configuration of the RTOs in the Midwest; however, that belief was based in part on an assumption that AEP would be a full RTO participant.<sup>101</sup>

80. Dr. Patton then presents analysis regarding the electrical interaction between PJM and Midwest ISO and concludes that:

it is evident that the current configuration results in substantial electrical interactions between AEP, the Midwest ISO and PJM. These interactions raise significant efficiency concerns if the markets are not well-coordinated.<sup>102</sup>

81. Dr. Patton discusses how this inefficiency could create conditions where the RTO incurs a revenue shortfall (i.e., where the congestion revenue collected from the participants is less than its financial obligation to the FTR holders).<sup>103</sup>

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<sup>100</sup> See Order No. 2000 at 31,015. We noted that perceptions of undue discrimination can also impede the development of efficient and competitive electric markets.

<sup>101</sup> Affidavit of Dr. David Patton attached to Midwest ISO Post-Hearing Comments (Patton Affidavit) at 3-4.

<sup>102</sup> Id. at 5-6 (emphasis added).

<sup>103</sup> Id. at 6

82. He then explains how poor configuration can create gaming opportunities that would not otherwise exist within the markets.

[A] generation owner in one RTO can dispatch its units to cause congestion in a neighboring RTO. Having dispatched its units to create this congestion, the supplier could then schedule transactions across the neighboring system that would apparently relieve the congestion and be compensated accordingly. These concerns arise because the prices in the first RTO will not reflect the congestion occurring on the second RTO.<sup>104</sup>

83. Dr. Patton then states:

More broadly, it is my opinion that the efficiency and gaming concerns that I expressed in the Annual Report apply even more strongly in the case where AEP is not participating in an RTO. In this case, the RTOs operating markets in the Midwest would not have the authority to monitor or redispatch AEP generation when it is inefficiently causing congestion in the RTO market areas. The ability to increase congestion on various PJM or Midwest ISO flowgates could provide AEP with a number [of] gaming opportunities.<sup>105</sup>

84. Likewise, in the PJM MMU's Assessment of AEP Proposal for Limited Integration with PJM, Mr. Joseph Bowring states that "[t]he best way to address the gaming and market power issues at system seams is to implement transparent, LMP-based markets as quickly and widely as possible. The best solution, from a markets perspective, would result from AEP's joining PJM on a fully integrated basis as soon as possible."<sup>106</sup>

85. In its reply comments, AEP notes that Midwest ISO has recently delayed its market initiative, and that if AEP is integrated into PJM's market, the same issues raised by the parties who favor AEP's immediate participation in LMP-based markets will exist at the new PJM/Midwest ISO interface. AEP further states that a Midwest ISO/PJM solution would still leave a number of major AEP interfaces such as Duke,

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<sup>104</sup> Id.

<sup>105</sup> Id. at 7 (emphasis added).

<sup>106</sup> PJM Market Monitor's Assessment of AEP Proposal for Limited Integration with PJM at 1.

TVA, Carolina Power & Light and Dominion Virginia Power (Dominion) in a "market to non-market" position. AEP also argues that its integrated operations includes economic dispatch and that it has a market monitor, so that it would not deviate from economic dispatch to conduct the types of gaming mentioned by various parties.<sup>107</sup>

86. AEP's comments address only the status quo, and do not consider the broader market efficiency concerns that arise from the existence of substantial electrical interactions between AEP, Midwest ISO, and PJM, the lack of coordination between AEP, PJM and Midwest ISO, and the lack of a market-based congestion management system run by an independent entity. Further, we are not convinced that the potential for gaming by AEP is nonexistent. While not all non-market to market interfaces would be resolved immediately with AEP's full integration into PJM, this is no reason for AEP not to fulfill its merger obligation presently, so that the economic and reliability benefits arising from progress toward regional coordination can be enjoyed.<sup>108</sup>

#### **E. Need for Certainty**

87. As testimony and comments in this inquiry show, markets in the Midwest and Mid-Atlantic are in a state of significant uncertainty as a result of conflicting state views and shifting decisions by companies as to which RTO to join. Absent some definitive resolution, both states and affected companies will continue to reevaluate the choices of utilities to join or not join an RTO, and which RTO to join. Under such conditions, RTOs will never fully deliver their potential benefits to customers. Ohio Commission Chairman Alan Schreiber concluded:

The overwhelming message that has come through in this proceeding is that this stuff can go on and on and on, a classic clash between public policy and private interests . . . .

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<sup>107</sup> AEP Reply Comments at 4-5.

<sup>108</sup> In a study conducted to estimate the impact of implementing a larger regional RTO market on the regional spot market price over several years, PJM found that the potential annual savings to wholesale load serving entities in the AEP service territory is between \$61 and \$80 million, assuming that PJM, PJM West (Allegheny Power's transmission system that is functionally controlled by PJM), AEP, DP&L and Dominion control areas are included in a single RTO operating a single energy market. The overall potential annual savings to wholesale load serving entities in PJM, AEP and Dominion is estimated to be \$932 million. See Post-Hearing Comments of PJM Interconnection, LLC, dated October 9, 2003, Attachment at 8-9.

...

[T]here's plenty of disagreement within each category as we've heard yesterday and today and it's a little bit disheartening to see that the overwhelming message is that this could go on and on. I don't think it's going to be resolved in negotiations. . . .

...

Now I have to tell you it's time to pull the trigger. I implore you to do that very quickly, because this will go on for a very, very long time otherwise.<sup>109</sup>

88. Similarly, Midwest ISO stated in its post-inquiry comments:

Since 1998, when the MISO was approved, every time a significant event occurs, a substantial number of participants reevaluate their options. Indeed, the possibility of another round of potentially crippling reevaluations was announced during the hearings themselves. Continuing flux undermines reliability, prejudices justifiable reliance interests, undermines the financial credibility of RTOs and threatens basic connectivity, which is central to the very purpose of RTOs.

...

It could be said that the Commission's raison d'être under the FPA is to balance institution stability and voluntary choices. Indeed, a fundamental predicate of the FPA is the concept that public utilities should be free, in the first instance, to order their affairs through voluntarily negotiated agreements. The fruits of those voluntary choices, however, must be found by the Commission to be in the public interest and produce results that are just and reasonable. Order No. 2000 itself was built upon this paradigm.

...

At the end of the day, however, there must be a decision. That decision may not please all interests, but it should be one that provides the greatest good for the greatest number. The record established in the September 29-30, 2003 hearing was nearly unanimous; AEP should be integrated into

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<sup>109</sup> Tr. at 286-90.

PJM, and PJM and the MISO should move forward to implement a joint and common market.<sup>110</sup>

89. In his testimony at the inquiry, Midwest ISO president James P. Torgerson stated:

My concern there is, again, if people are given an option every time something changes, to change their decision on what RTO they are going to be in, it creates a lot of uncertainty.

...

I mean, Wall Street is going to be wondering what's going on. At least from the Midwest ISO's perspective, we're doing financings, and then to have things change again where there's more uncertainty, that's going to create a problem for me. . . .<sup>111</sup>

90. Some parties, in fact, suggested that the problems of delay and uncertainty were so severe that the Commission should actually remove individual utilities from the RTO decision making process, and conduct that process itself. Detroit Edison witness Terry Harvill stated:

A voluntary approach to RTO formation will result in excessive delays in the process of moving transmission owning electric utilities into appropriately constituted RTO's. There's already been too much delay. The Commission must remove transmission owners from the RTO driver's seat as soon as possible. The Commission should act as the driving force to require the provision of a nondiscriminatory transmission service under properly structured and appropriately constituted RTOs.<sup>112</sup>

91. Thus, the Commission finds that the solution to the issues before it will not only enable customers to receive the benefits of RTO participation, but will also provide certainty to all parties. The Commission has sought to bring about this certainty through a voluntary approach, but, since that approach has failed, must now consider more decisive actions, so as to enable the broad spectrum of parties in the region who seek

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<sup>110</sup> Midwest ISO Post-Inquiry Comments at 15 (footnotes omitted).

<sup>111</sup> Tr. at 271-272.

<sup>112</sup> Tr. at 292-93.

certainty through AEP's fulfillment of its merger commitment by entering PJM, to proceed with their own RTO formation. Absent such decisive action on the part of the Commission, the benefits of RTOs will flow to customers in a delayed and highly truncated fashion.

### **III. PROPOSED SOLUTIONS**

92. The Commission solicited and was presented with a variety of solutions to the concerns here. One possible solution is AEP's proposal to fully integrate with PJM.<sup>113</sup> Another possibility is for AEP to separate its transmission facilities from its generators and place its transmission facilities into PJM;<sup>114</sup> alternatively, AEP could separate its transmission facilities from its generators and place its generators into PJM, excluding those generators in Virginia and Kentucky.<sup>115</sup> A more recent alternative suggested by AEP, as discussed above, requires that AEP's entire transmission system be placed under PJM's control, while AEP's generation remains outside of PJM's markets.<sup>116</sup> Another possible solution requires (1) a JOA among PJM, Midwest ISO, and AEP; (2) greater oversight by PJM's MMU; and (3) full transparency of AEP redispatch.<sup>117</sup> Finally, a phased approach was proffered, under which AEP would initially join Midwest ISO and later migrate to PJM.<sup>118</sup>

#### **A. Full Integration of AEP into PJM**

93. The Commission finds that full integration of AEP into PJM best addresses the considerations set forth above.

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<sup>113</sup> AEP Compliance Filing at 2, Docket No. EL02-65-004 (May 28, 2002). AEP's plan initially anticipated that AEP would transfer functional control of its transmission assets to PJM by December 2002, and complete the integration of AEP into PJM energy markets by May 2003.

<sup>114</sup> Staff Data Request to AEP, dated June 10, 2003.

<sup>115</sup> October 9, 2003 Comments of Midwest ISO at 14-15.

<sup>116</sup> Tomasky and Baker Testimony at 30-32.

<sup>117</sup> PJM MMU October 10, 2003 Assessment of AEP Proposal for Limited Integration with PJM at 9-14.

<sup>118</sup> October 9, 2003 Supplemental Comments of Ameren at 7-9.

94. First, under this solution, AEP will fulfill the voluntary commitment it made to alleviate concerns regarding the market power of the merged entity at the time that AEP and CSW merged. Given the extensive benefits that merger has already provided through settlements with affected states (see above), it would be undesirable at this point to seek to undo the merger. It is, therefore, necessary to require AEP to follow through on the commitments it made to mitigate its market power. If AEP does not follow through on these commitments, it will be able to continue to hold the additional market power it gained in the merger, without having taken appropriate steps to mitigate AEP's ability to exercise that market power. Such a result would be contrary to the requirement of Section 203 of the FPA that a merger must be consistent with the public interest. It would also be inequitable to the intervenors to the merger proceeding, who may have dropped their objections to the merger because of AEP's commitment to join a Commission-approved RTO.

95. Second, if AEP joins PJM, the benefits of RTO membership will begin to flow to AEP's customers and those in the entire region, including the benefits of PJM's fully-functioning, robust markets. As parties testified, AEP's full integration into PJM will enhance reliability and connectivity, eliminate seams, enable the management of congestion on AEP's system through LMP pricing rather than through TLRs, and reduce opportunities for gaming in the Eastern Interconnect. Additionally, as can be seen from the chart in P 67 above, AEP made approximately \$1.4 billion worth of off-system sales for the last three years. The opening up of this level of energy sales to a greater level of competition would provide significant benefits to customers.

96. Third, requiring AEP to fulfill its merger commitment will provide certainty to all parties, and to the marketplace in these regions. AEP first indicated its desire to join an RTO in 1998,<sup>119</sup> and to join PJM, and to fully integrate its system into PJM, in 2000. We have concluded that it is now necessary to take steps to facilitate that choice. The full integration of AEP into PJM will grant certainty not only to AEP and its customers, but to ComEd and DP&L and their customers as well, as those companies will now be able to proceed with their plans to join PJM. As discussed above, there can be no certainty in the Midwest and the Mid-Atlantic States, and RTO development in that area cannot proceed, when no party can rely on the makeup of PJM and Midwest ISO staying constant. As witnesses testified at the inquiry, this ongoing state of uncertainty has caused utilities to continuously re-evaluate their participation in an RTO, trying to determine whether they (and their shareholders and customers) can obtain better terms by switching RTOs. This lack of certainty has undermined the process of RTO development by hindering investment and impeding development of solutions to

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<sup>119</sup> Joint Application for Authorization and Approval of Merger, dated April 30, 1998, at 18; May 24, 1999 Stipulation at 2-4.

reliability and connectivity issues. Customers in the Midwest and Mid-Atlantic region cannot receive the benefits of RTOs unless those RTOs are permitted to form with finality. Absent a definitive decision, this process could continue indefinitely, thus forestalling or denying the benefits of RTOs to customers.

97. No other proposed solution provides all of these benefits, or provides them to as great an extent. For this reason, and because the other proposed solutions all contain more serious flaws, the Commission will take steps to require the full integration of AEP into PJM. For the sake of completeness, however, we will provide our evaluation of the other possible alternatives.

**B. Proposal to Separate Transmission and Generation**

98. In its June 10, 2003 data requests, Staff requested comments on a proposal whereby AEP-East would turn operational control of its transmission facilities to PJM except for those facilities which cannot be transferred due to state restrictions, while AEP-East continues to control, plan, operate, and maintain those remaining facilities. The Commission rejects this proposal. First, this proposal would require that the non-transferred facilities be placed into a new control area, certified by ECAR and NERC. To add an additional control area to those present now would reduce, not improve, reliability and market efficiency, as it would require additional coordination among control area operators. Second, splitting the AEP system would create new seams among transmission organizations where none existed before. Finally, this scenario requires the greatest expense and the longest lead time to implement.<sup>120</sup>

**C. Proposal to Separate Transmission and Generation and Place Generators into PJM, except those Generators Located in Virginia and Kentucky**

99. Midwest ISO proposes to fully integrate AEP into PJM with the limited exception of those generation assets owned or controlled by Appalachian Power that are dedicated to serving native load in Virginia or Kentucky. The Commission rejects this proposal because it would create a seam between generation within PJM and the excluded generation (e.g., in PJM, congestion would be managed by allowing transmission to be used by those entities that value it the most – through LMP; whereas in the excluded area, faced with congestion, operators would rely on transmission

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<sup>120</sup> PJM Response to Data Request No. 2.

loading relief procedures). Also, according to AEP, if the Virginia portion of APCO were to operate outside of PJM, the generation facilities in the non-transferred (Virginia) area would not be adequate to meet generation capacity and ancillary service requirements.<sup>121</sup>

#### **D. Proposal to Transfer Partial Control of AEP's System to PJM**

100. While originally proposing full integration into PJM, AEP now proposes a second solution in which AEP would transfer functional control of its east zone transmission facilities to PJM, but PJM's functions would be limited to those required by Order No. 2000. Under this proposal, AEP would not become integrated into PJM's voluntary markets although it could participate in PJM markets on a bilateral basis. PJM would have: (1) independent functional control of AEP's transmission system, (2) independent tariff administration, with transmission service provided under PJM's Open Access Transmission Tariff (OATT), and (3) independent control of access to transmission, including calculation of ATC and Total Transmission Capacity. In addition, PJM would serve as AEP's Reliability Coordinator and Market Monitor. PJM would also provide for regional transmission planning and seams coordination. However, AEP would not be part of PJM's performance of (1) the administration of day-ahead and real-time energy and ancillary service markets or (2) locational marginal price congestion management.

101. The proposal to transfer partial control will still leave significant impediments to reliability and efficiency. By not having AEP's generation participate in PJM's real-time, day-ahead, and ancillary service markets, there will still be economic inefficiencies. Further, the proposal would not comply with AEP's merger commitment, in that AEP would not be turning over control area functions such as balancing to an RTO.<sup>122</sup> Additionally, 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. Additionally, the potential for gaming will remain. Finally, this proposal would not address the need to manage loop flows effectively; and therefore does not promote enhanced reliability for the region.

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<sup>121</sup> AEP June 25, 2003 Response to June 10, 2003 Data Request No. 6.

<sup>122</sup> AEP witness Craig Baker testified that in 1999, AEP voluntarily committed to having an RTO performing control area balancing, but that as part of this proposal, AEP was not proposing that an RTO immediately begin performing that function (Tr. 411-13).

### **E. Joint Operating Agreement**

102. The PJM MMU proposes a modification to the proposal to transfer partial control, which is intended to reduce the potential for gaming and market power, address seams issues and result in more efficient markets in the context of an interim period. Under the PJM MMU's proposal, there would be a detailed market to market JOA among PJM, AEP, and Midwest ISO. In addition, the PJM MMU's proposal calls for detailed market monitoring of (1) transmission and generation data, (2) transmission system operations, and (3) generation unit status. Finally, the PJM MMU's proposal calls for full transparency of AEP redispatch and operation, or direct oversight, by PJM of AEP's internal centralized security-constrained dispatch.

103. The Commission rejects this proposal because AEP's generation would not be fully integrated into PJM's least cost dispatching program, so that its generation would not be dispatched in the merit order of all of PJM's generation. Further, under this proposal, PJM's market monitor would have monitoring responsibilities as to AEP's actions, but would not have the same enforcement tools (for example, the ability to compel the production of information under certain circumstances) available to it that it has when it monitors PJM members.

### **F. Phased Approach**

104. Ameren proposes that AEP, ComEd, and DPL initially be included in the Midwest ISO and then migrate to PJM when the issues involving state authorizations, a JOA, NERC-approved reliability plans, regional through and out rates, and the Michigan-Wisconsin flow have been resolved. The Commission rejects this proposal. This proposal would contravene the goal of reducing uncertainty by delaying AEP's integration into PJM. Further, since Kentucky and Virginia have placed obstacles in the way of the AEP member companies joining any RTO, not just PJM, this solution would do nothing to address that difficulty.

## **IV. COMMISSION FINDINGS AND ACTIONS**

### **A. The Commission Finds that, to Address the Market Power Problems that Would Otherwise Be Created by its Merger with CSW, AEP Must Fulfill its Commitments to Join PJM.**

105. As noted above, when AEP and CSW filed their merger application, multiple parties raised concerns about the market power that the merged entity would be able to exercise. Parties asserted that the proposed AEP/CSW merger would create a concentration of market power. For example, Cinergy Services, Inc. and Commonwealth Edison co-sponsored the testimony of Dr. Peter Fox-Penner, who stated that this merger may create or enhance the ability and incentive for Applicants to use

transmission to frustrate competitors' access to relevant markets,<sup>123</sup> and that Applicants failed to adequately examine how expanded post-merger control of transmission could be used to frustrate competitors' access to relevant markets. These parties asserted that the Commission could not conclude that without additional mitigation measures there would be no significant increase in vertical market power due to the proposed merger,<sup>124</sup> and Dr. Fox-Penner also opined that independent operation of the combined transmission system would be necessary to remove Applicants' increased ability to exercise market power.<sup>125</sup>

106. As the Commission noted, "the merger may create or enhance the ability and incentive for AEP and/or CSW to use transmission to frustrate competitors' access to relevant markets. Such action could constrain competition and thereby raise electricity prices in markets in which the merged firm can sell."<sup>126</sup> To address this problem, AEP committed to join an RTO and transfer to it functions related to transmission service, transmission security and reliability, and control area responsibilities. The Commission then approved the merger on the basis that the stipulation would constitute "an adequate remedy to the market power concerns arising from the proposed merger."<sup>127</sup> Thus, if AEP had not agreed to join an RTO, the existence of these unresolved market power concerns could have caused the Commission either to disapprove the merger or place restrictive conditions on AEP's ability to operate. The merged AEP/CSW company is now operating without being a member of an RTO, and will continue to do so, if AEP is now unable to fulfill its RTO commitment in the foreseeable future.

107. Under these circumstances, pursuant to its authority under Section 203(b) of the FPA, which allows the Commission to impose "such terms and conditions as it finds necessary or appropriate to secure the maintenance of adequate service and the coordination in the public interest of facilities subject to the jurisdiction of the Commission," and, if necessary, make further orders "supplemental to" orders made under this section, we preliminarily find that unless AEP is able to fulfill its commitment to join an RTO, it will be operating in a manner that may allow for the

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<sup>123</sup> Fox-Penner Testimony at 9 (citing American Electric Power Co., et al., 85 FERC ¶ 61,201 at 61,819 (1998)).

<sup>124</sup> Fox-Penner Testimony at 9-10.

<sup>125</sup> Id. at 10.

<sup>126</sup> Opinion No. 442 at 61,778 (citation omitted).

<sup>127</sup> Id. at 61,788.

exercise of significant market power through its control of transmission, through which AEP could frustrate the ability of competing generation to reach customers. AEP has sought to fulfill its commitment by filing an application to transfer its facilities to PJM, and the Commission granted that application in its April 1 order. We hereby preliminarily find that, because we propose to exercise our authority under PURPA to override the provisions of Kentucky and Virginia law that prevent AEP from responding to the directive of our April 1 Order,<sup>128</sup> AEP will be required to proceed with integrating its transmission facilities into PJM by October 1, 2004.

**B. The Commission Preliminarily Finds that AEP's Application to Join PJM Is "Designed to Obtain Economical Utilization of Facilities and Resources" in the Midwest and Mid-Atlantic Areas Within the Meaning of Section 205(a) of PURPA.**

108. PJM is an RTO, as contemplated by Order No. 2000. As the Commission noted in Order No. 2000, RTO formation is designed to bring about, among other things, increased efficiency through regional transmission pricing; improved congestion management; more accurate estimates of ATC; more effective management of parallel path flows; more efficient planning for transmission and generation investments; reduced transaction costs; and fewer opportunities for discriminatory transmission practices of the type that would prevent full utilization of the national transmission grid by the lowest-priced seller. The Commission also stated in Order No. 2000 that RTOs will bring about the undisputed "benefits of a marketplace where service quality and availability are uniform, where users of the network are treated equally, and where commercially important data are readily available to all."<sup>129</sup>

109. As can be seen from the above, through ensuring congestion management by means of market mechanisms, RTO formation will enable customers to make more efficient purchasing decisions. Through providing improved estimates of ATC and improved management of parallel path flows, RTOs will allow more efficient utilization of transmission resources than would be the case absent the RTO structure. By diminishing the opportunities for discrimination, RTOs will similarly enable the lowest-cost generation to reach buyers, thus ensuring a more efficient use of the transmission grid. Thus, we preliminarily find that the gains in efficiency that will result from RTO

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<sup>128</sup> See infra discussion.

<sup>129</sup> Order No. 2000 at 31,024.

formation fall within PURPA's requirement that a utility's commitment to join an RTO is a "voluntary coordination" that is "designed to obtain economical utilization of facilities and resources" in the RTO area.<sup>130</sup>

**C. The Commission Preliminarily Finds that Laws, Regulations or Rules of Virginia and Kentucky Are Preventing AEP Both from Fulfilling its Merger Commitment to Join an RTO, and from Complying with Order No. 2000.**

110. As discussed above, AEP has attempted to comply with its merger commitment to join an RTO.

111. In addition, in Order No. 2000, the Commission ordered all public utilities (with the exception of those participating in an approved regional transmission entity that conforms to the Commission's ISO principles) that own, operate, or control interstate transmission facilities to file with the Commission by October 15, 2000, either a proposal for an RTO, to be operational by December 15, 2001, or, alternatively, a description of efforts to participate in an RTO, any existing obstacles to RTO participation, and any plans to work toward RTO participation.<sup>131</sup> AEP initially sought to comply with this directive by joining with the former Alliance companies to form the Alliance RTO. After the Commission found that Alliance would not provide sufficient scope to be an RTO, on May 28, 2002, AEP made a filing stating that it had entered into a Memorandum of Understanding with PJM to participate in PJM.<sup>132</sup>

112. AEP alleges that it cannot fully join PJM because of the Virginia legislature's prohibition on any incumbent utility joining an RTO until July 1, 2004 (and, as noted above, the state of Virginia may continue this prohibition further), and similar state actions, such as the Kentucky Commission's initial decision (now pending rehearing) rejecting AEP's bid to transfer control of its transmission facilities in that state to PJM.

113. While Virginia and Kentucky assert that they are not preventing their incumbent utilities from joining RTOs, but rather are simply seeking to exert control over the

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<sup>130</sup> At the inquiry, Commissioner Massey asked AEP's chairman Linn Draper whether making the commitment to enter PJM "would provide for an economical coordination of facilities in your region?" Mr. Draper replied, "We thought it would." Tr. 44.

<sup>131</sup> Id. at 30,994 (footnotes omitted).

<sup>132</sup> July 31 Order at P 11.

process,<sup>133</sup> it appears that Virginia's and Kentucky's actions have erected virtually insuperable barriers to the entry of AEP's member companies into PJM or any other RTO.

114. As to Kentucky, under Kentucky Revised Statutes (KRS) § 278.218(b)(2) (2002), the Kentucky Commission approves applications to transfer ownership or control of utility assets "if the transaction is for a proper purpose and is consistent with the public interest." In its order granting rehearing of KPCO's petition to transfer its facilities to PJM,<sup>134</sup> however, the Kentucky Commission made plain that it would take a narrow reading of that public interest standard. It stated that the standard provided that

the proposed transfer will not adversely affect the existing level of utility service or rates or that any potential adverse effects can be avoided through the Commission's imposition of reasonable conditions on the acquiring party. The acquiring party should also demonstrate that the proposed transfer is likely to benefit the public through improved service quality, and 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.<sup>135</sup>

115. Although this standard would seem to permit first a showing of adverse impact, and then a showing of offsetting benefits even if those benefits are not "immediate or readily quantifiable," the Kentucky Commission then stated with regard to KPCO's petition that:

This standard establishes a two-step process: first, there must be a showing of no adverse effect on service or rates; and, second, there must be a

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<sup>133</sup> Reply Comments of the Virginia Commission and the Kentucky Commission at 7-11.

<sup>134</sup> In re Application of Kentucky Power Company d/b/a American Electric Poswer 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 (Docket No. 2002-00475), order on reh'g (issued August 25, 2003).

<sup>135</sup> Id. at 3 (citing Application for Approval of the Transfer of Control of Kentucky-American Water Company to RWE Aktiengesellschaft and Thames WaterAqua Holdings GMBH, Docket No. 2002-00018 (May 30, 2002) at 7-8 (emphasis in original)).

demonstration that there will be some benefits. In this case, Kentucky Power failed the first step due to its inability to show that the transfer would not adversely affect its rates. In fact, membership in PJM was acknowledged to cost an additional \$3 million per year, thus resulting in an adverse impact on rates. Had Kentucky Power been able to quantify benefits of at least \$3 million annually, it would then have been able to satisfy the first step of the "public interest" standard, and then proceed to the second step. . . . The second step of the "public interest" standard is that there "should also [be a] demonstrat[ion] that the proposed transfer is likely to benefit the public. . . . Such benefits, however, need not be immediate or readily quantifiable." Thus, while the standard does not require benefits to be immediate or readily quantifiable, the benefits referred to therein are what must be demonstrated after satisfying the first step by a showing of no adverse effect on service or rates.<sup>136</sup>

116. In other words, under the Kentucky Commission's position, KPCO must demonstrate that although membership in PJM would cost its customers \$3 million per year, there would be immediate offsetting annual benefits of \$3 million – an instant dollar-to-dollar match of benefits to costs – before it may even proceed to demonstrate that membership in PJM will, in future years, provide "improved service quality, and service reliability, the availability of additional services, lower rates, or a reduction in utility expenses to provide present services"<sup>137</sup> – i.e., all the longer-term benefits that RTO membership is likely to bestow on KPCO's customers.

117. In Virginia, the current state legislation provides that no incumbent electric utility shall transfer ownership, control, or operational responsibility for its transmission system in Virginia prior to July 1, 2004, and must obtain the approval of the Virginia Commission before doing so; however, it also requires each utility to file an application by July 1, 2003 to transfer assets to an RTO, and shall transfer management and control of its transmission assets to an RTO by January 1, 2005.<sup>138</sup>

118. The Virginia legislation has already prevented AEP from integrating its facilities into PJM at the time the Commission accepted its application, on April 1, 2003. However, on August 29, 2003, the Virginia Commission issued a recommendation to the state legislation stating that "the [Virginia Commission] believes that it is in the

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<sup>136</sup> Id. at 4-5 (emphasis added).

<sup>137</sup> Id. at 3.

<sup>138</sup> Va. Code Ann. § 56-579, Regional transmission entities, A.1 (2003).

public interest to suspend portions of [the Virginia state electric restructuring act] by re-bundling rates and continuing the moratorium on the transfer of control of Virginia's electric transmission systems to federally-regulated regional transmission entities."<sup>139</sup>

119. The Virginia Commission further noted that it was concerned that, once rates were fully unbundled within Virginia and control of utilities' transmission assets was transferred to an RTO, the state would no longer be able to exercise jurisdiction over Virginia matters, and recommended suspension of the mandate to transfer transmission assets to a federally-regulated RTO "as long as necessary to provide Virginia policy makers a reasonably clear view of the likely nature of the transformed industry."<sup>140</sup> The Virginia Commission staff stated its concern that implementation of FERC's Standard Market Design (SMD) rules might cause "the elimination of native load preferences, [problems caused by] the questionable ability of FERC to oversee market monitoring efforts, the potential exercise of market power by wholesale suppliers, increased costs resulting from the use of locational market pricing in transmission-constrained areas, and regional resource adequacy requirements."<sup>141</sup> Thus, it appears that, until the Virginia Commission's concerns regarding the market design for RTOs are fully satisfied, no Virginia utility will be permitted to transfer its transmission assets to an RTO's control.

120. We preliminarily find that the actions of Virginia and Kentucky here, if permitted to stand unchallenged, would have the effect of (1) preventing AEP from complying with its merger commitment to join an RTO in order to mitigate market power concerns associated with the merger, and (2) preventing the AEP companies (both in Virginia and Kentucky, and in other states whose state commissions want the AEP companies to enter an RTO) from joining RTOs in the foreseeable future.

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<sup>139</sup> 2003 Status Report: The Development of a Competitive Retail Market for Electric Generation within the Commonwealth of Virginia, Executive Summary and Overview at ii (August 29, 2003) (emphasis added).

<sup>140</sup> Id., Part III, Recommendations to Facilitate Effective Competition in the Commonwealth, at 20-21.

<sup>141</sup> Id. at 21.

**D. The Commission Preliminarily Finds that the Kentucky and Virginia Laws, Rules or Regulations discussed Above Are Not Within the Exceptions to Section 205(a) of PURPA.**

121. 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 the affected States 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 economical utilization of facilities and resources in any area.

122. Section 205(a) sets forth two exceptions to the Commission's authority to exempt utilities from state law. The Commission may not grant an exemption if it finds that the relevant provision of state law, rule, or regulation is either: (1) required by any authority of Federal law; or (2) 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.

123. As to the first exception, the Virginia and Kentucky actions here are not required by any authority of Federal law.

124. Similarly as to the second action, there is no showing that Virginia and Kentucky are seeking to protect public health, safety, or welfare, or the environment, or that their actions are intended to conserve energy or mitigate the effects of emergencies resulting from fuel shortages. While Virginia and Kentucky may argue that their actions are seeking to protect "public welfare," an examination of the legislative history of PURPA shows that economic regulation is not the type of "protection of public welfare" that Congress was considering when it enacted Section 205 of PURPA.

125. As can be seen from the Conference Committee Report on PURPA, in its "public health, safety and welfare" exception to Section 205, Congress wished to prohibit FERC primarily from overriding state laws and regulations in the environmental and land use planning areas.<sup>142</sup> The Conference Committee cited, as examples of the types of state

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<sup>142</sup> H.R. Conf. Rep. No. 95-1750, at 95 (1978), reprinted in 1978 U.S.C.C.A.N. 7797, 7829.

regulations that FERC could not preempt, "[s]tate siting laws, regulations under the Clean Air Act, and zoning laws, among others."<sup>143</sup>

126. Thus, the Commission preliminarily finds that these exceptions to its authority are not present here.

**E. The Commission Hereby Sets for Public Hearing Questions Relating to Whether the Commission Should Exempt AEP from Provisions of Kentucky and Virginia Law or Rule or Regulation that Would Prevent AEP from Voluntarily Joining PJM.**

127. On the bases provided above, the Commission preliminarily finds that, both on its own motion and on the application of Exelon, which has requested that the Commission take action under Section 205(a) of PURPA,<sup>144</sup> it should exempt AEP from the Virginia and Kentucky provisions discussed here.

128. We hereby set for public hearing the question of (a) whether 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; (b) 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; and (c) the aforementioned provisions of Kentucky and Virginia law or rule or regulation (1) are required by any authority of Federal law, or (2) are designed to protect public health, safety, or welfare, or the environment or

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<sup>143</sup> Id. at 95. Immediately thereafter, in discussing Section 206 of PURPA, the Conference Committee also addressed the meaning of the phrase "public health, safety or welfare" in the context of energy shortages. It noted that utilities were required to submit contingency plans for how they would handle such shortages, and that Section 206 was intended "to help insure the continuity of service to customers of public utilities" when such shortages occurred. The Conference Committee stated that it was requiring utilities give due consideration to the public health, safety and welfare "to convey the idea that contingency plans" for such shortages should have a minimum adverse effect on public health, safety or welfare. Id. at 95-96. This similarly suggests that Congress was primarily concerned with issues of public health and safety, rather than with issues of economic regulation, in enacting PURPA.

1. <sup>144</sup> Motion of Exelon Corporation and Commonwealth Edison Company for Expedited Decision on Pending Applications to Join PJM at 19-20, filed on March 17, 2003. Section 205(a) of PURPA provides that the Commission "shall" take action under Section 205(a) "on application of any person or governmental entity."

conserve energy or are designed to mitigate the effects of emergencies resulting from fuel shortages.

129. We therefore return this matter to Judge William J. Cowan, who conducted the September 29-30 Inquiry and is thus familiar with this case, to conduct a hearing on the above questions.<sup>145</sup> We direct Judge Cowan to issue his Initial Decision by March 15, 2004. After Judge Cowan issues his Initial Decision, if any party wishes to take exceptions to that decision, it must file its brief on exceptions within 15 days, and any briefs opposing exceptions must be filed 15 days after that.

130. Additionally, the Commission here provides notice to the public and the Governors of the states within the Eastern Interconnection that it may take action under Section 205(a) of PURPA. We therefore order the Secretary to provide this order to the Governor of each state within the Eastern Interconnection.<sup>146</sup>

## V. FUTURE STEPS

131. The Commission recognizes that this order does not resolve all the controversies involved in AEP's integration into PJM. However, the preliminary findings here identify and address outstanding issues which impede AEP's voluntary commitment to join an RTO.

132. Ameren in its Supplemental Comments states at 4 that "[t]here are several linchpin conditions from the July 31 Order which nearly all parties testifying at the Inquiry labeled critical conditions precedent to the Commission's accepting the proposed configurations of PJM and the Midwest Independent Transmission System Operator," including 1) the formation of a Joint Common Market between Midwest ISO and PJM, 2) NERC approval of reliability plans reflecting the various RTO elections, 3) the development of a JOA for Midwest ISO and PJM, 4) resolution of the rates for

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<sup>145</sup> The Inquiry Order was initially docketed under Docket Nos. ER03-262-001, ER03-262-004 and ER03-262-005, among other docket numbers. Inclusion of these three subdockets was in error because they were either previously terminated or relate to other matters. Responsive pleadings to the Inquiry Order are contained in these subdockets. This proceeding is henceforth being redocketed as Docket No. ER03-262-009.

<sup>146</sup> If any Governor to whom this order is provided is not already a party in this proceeding, and wishes to become a party, that Governor must file a motion to intervene as required by Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2003).

through and out service, and 5) resolution of connectivity issues in Michigan and Wisconsin created by the RTO choices of AEP, ComEd, and Illinois Power.

133. Ameren recognizes that Midwest ISO and PJM testified at the Inquiry that they had been close to filing the JOA to address 1) the complexities of blending market-based congestion management with non-market based congestion management until the advent of a joint and common market in October 2004; 2) seams management; and 3) loop flows within Michigan and Wisconsin. However, the August 14 and 15, 2003 blackout has delayed the internal reviews and joint submission of the JOA.

134. It is our understanding that Midwest ISO and PJM are preparing and will jointly file a JOA that will address several issues and will review that proposed agreement and its ability to address many of these issues (NERC approval of reliability plans reflecting the companies' elections, laying the groundwork for the joint and common market, and the operational aspects of the loop flows and connectivity issues in Michigan and Wisconsin). We will review how these issues are addressed at the time that PJM and Midwest ISO file a JOA.<sup>147</sup>

The Commission orders:

(A) The Commission finds, pursuant to its authority under Section 203(b) of the FPA, that, to address the market power problems that would otherwise be created by its merger with CSW, AEP must fulfill its commitment to join PJM. We additionally find that, if, pending further proceedings, we may exercise our authority under PURPA to override the provisions of Kentucky and Virginia law that prevent AEP from joining PJM, AEP will be required to proceed with integrating its transmission facilities into PJM by October 1, 2004.

(B) The Commission preliminarily finds that AEP's application to join PJM is designed to obtain economical utilization of facilities and resources in the Midwest and Mid-Atlantic areas within the meaning of Section 205(a) of PURPA.

(C) The Commission preliminarily finds that laws, regulations, or rules of Virginia and Kentucky are preventing AEP both from fulfilling its merger commitment to join an RTO, and from complying with Order No. 2000.

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<sup>147</sup> Regarding the financial aspect of the loop flow/connectivity issue in Michigan and Wisconsin, we trust that resolution of AEP's election here will facilitate resolution of that issue. Regarding the resolution of the rates for through and out service, this is the subject of ongoing proceedings in Docket No. EL02-111-000, et al.

(D) The Commission preliminarily finds that the Kentucky and Virginia laws, rules or regulations discussed above 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 is designed to mitigate the effects of emergencies resulting from fuel shortages.

(E) The Commission hereby sets for public hearing the following three questions:

(1) whether AEP's voluntary commitment to join PJM is designed to obtain economical utilization of facilities and resources in the Midwest and Mid-Atlantic area;

(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; and

(3) the aforementioned provisions of Kentucky and Virginia law or rule or regulation (a) are required by any authority of Federal law, or (b) 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.

(F) The Commission hereby returns this matter to Judge Cowan, to conduct a public hearing on the above questions. We direct Judge Cowan to issue his Initial Decision by March 15, 2004.

(G) After Judge Cowan issues his Initial Decision, if any party wishes to take exceptions to that decision, it must file its brief on exceptions within 15 days, and any briefs opposing exceptions must be filed 15 days after that.

Docket No. ER03-262-001, et al.

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(H) All future filings made in response to this order must be filed in Docket No. ER03-262-009.

(I) The Office of the Secretary is directed to serve a copy of this order on the Governor of each state within the Eastern Interconnection.

By the Commission.

( S E A L )

Magalie R. Salas,  
Secretary.