RECEIVED

NOV 18 2011

PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

NOV 18 2011

PUBLIC SERVICE COMMISSION

In The Matter Of:

APPLICATION OF AEP KENTUCKY TRANSMISSION COMPANY, INC. FOR A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY TO OPERATE AS A TRANSMISSION ONLY PUBLIC UTILITY)))))) **Case No. 2011-00042**

*****

POST-HEARING BRIEF OF AEP KENTUCKY TRANSMISSION COMPANY, INC.

AEP Kentucky Transmission Company, Inc. ("KY Transco") states for its post-hearing brief:

INTRODUCTION[1]

KY Transco is a targeted initiative employed by American Electric Power Company, Inc. ("AEP"), the common parent of KY Transco and Kentucky Power Company ("Kentucky Power" or "KPCo"), to address a specific problem facing each of AEP's operating companies: increasing demands for capital that could imperil the debt rating of the operating companies and ultimately increase the cost of service for the customers of the operating companies, including Kentucky Power.[2] KY Transco will help relieve Kentucky Power's capital constraints for infrastructure projects by offering an alternative for the financial community to invest in Kentucky through a transmission-only entity, thus facilitating future transmission projects and benefitting Kentucky Power and its customers.

---

[1] A transcript of the video recording of the October 19, 2011 hearing was prepared for the convenience of the Commission and the parties, and for use in preparation of this post-hearing brief. The transcript is attached as **EXHIBIT 1**. Citations to the attached transcript are in the form "T. at __"

[2] T. at 81.

The fundamental points regarding KY Transco and its proposed operation as a utility in the Commonwealth are:

- Kentucky Transco is intended to stand in the shoes of Kentucky Power. It will construct only those transmission projects Kentucky Power would have constructed in the absence of KY Transco if it was not capitally constrained. KY Transco is not intended to act as a "merchant" transmission provider.[3]

- Because KY Transco was created as a vehicle to finance future transmission projects, it will not acquire any of Kentucky Power's existing transmission assets without specifically requesting the Commission to do so.[4]

- Other than improving Kentucky Power's ability to maintain its current credit rating, and increasing the opportunity for investment in generation, distribution, and transmission facilities, KY Transco will have only a *de minimis* effect on Kentucky Power and its retail customers.[5]

- Although no determination has been made as to whether KY Transco would operate absent the grant of the requested certificate of public convenience and necessity, granting the requested relief will give this Commission substantial regulatory authority with respect to the operation of KY Transco.[6]

- The formation and operation of KY Transco is supported by the management of Kentucky Power.[7]

STATEMENT OF THE CASE

A. The KY Transco Application Is Supported By Kentucky Power.

The Transco concept was developed by AEP on behalf of and in conjunction with each of its operating companies.[8] Kentucky Power supports KY Transco's application because of the

---

[3] Post-Hearing Brief at 7-12.

[4] Post-Hearing Brief at 7, 11, 16, 19.

[5] Post-Hearing Brief at 7-18.

[6] Post-Hearing Brief at 9-10.

[7] Post-Hearing Brief at 2.

[8] T. at 21.

financing challenges facing Kentucky Power, as well as the benefits to Kentucky Power and its customers flowing from the operation of KY Transco as a utility.[9]

B. The Need For And Purpose Of KY Transco

Kentucky Power, like the other AEP operating companies,[10] faces significantly increased capital spending demands to meet environmental and transmission requirements over at least the next decade.[11] Thus, in addition to the environmental investment to be made at the Company's Big Sandy facility,[12] KY Transco projects an additional $260 million will need to be invested in Kentucky Power's transmission system over the next ten years.[13] This heavy demand for increased investment in transmission and generation assets – the timing and requirement of which is beyond Kentucky Power's control[14] – comes on top of existing strains on Kentucky Power's ability to finance needed investment. "Since 2008, Kentucky Power's construction expenditures have been in excess of its cash flows from operations (net of the accounting change for receivables securitization in 2010) by approximately $55 million, requiring that shortfall to be financed externally."[15]

[9] Prefiled Testimony of Ranie K. Wohnhas ("Wohnhas") at 3; T at 21.

[10] T. 31.

[11] Prefiled Testimony of Lisa M. Barton ("Barton") at 5.

[12] Case No. 2001-00401. At the October 19, 2011 hearing, Mr. Boteler was asked if he was aware that Kentucky Power could recover through the environmental surcharge the cost of environmental facilities during their construction. T. 33. Mr. Boteler noted that such a recovery would not necessarily ameliorate the burden on Kentucky Power because "AFUDC would be very negative for cash flow in spite—it may earn a return, but it's a deferred return from a cash perspective." T. 34.

[13] Staff Second Data Request, Item 4(a) at 1. This projected $26 million average annual capital investment in transmission over the next ten years contrasts with the average annual transmission investment of $17.525 million over the past four years. Wohnhas at 4 ($70.1 million/4).

[14] T. at 67-68 ("We are recognizing the fact that whether it be transmission or generation, we're under a lot of pressure on cap ex and pressure quite frankly that's now beyond our control. There are NERC requirements on the transmission side. There are PJM mandatory transmission builds on the transmission side. The EPA, as everyone here well knows, has had a tremendous impact on the environmental mediation that's needed with respect to the plants.").

[15] Staff First Data Request, Item 16(a) at 1.

These pressures and the resulting challenge have not escaped the notice of the credit rating agencies:

> Kentucky Power's cumulative long-term capital investment program is large given its size. Although the company has temporarily delayed some of the investment programs in 2009, 2010, and likely 2011, we expect the program to resume to its full force in the next few years. KYPCo received approximately $30 million in equity contributions from its parent AEP in April, 2009. However, we expect increasing upstream dividends in the next few years and ***free cash flow to return to negative over the intermediate and long-term horizon***. While we generally view investments in rate base positively, ***we would be concerned if KYPCo's spending plans result in a persistent negative free cash flow position that will be primarily funded with internal or external debt. Should this situation materialize, KYPCo's financial profile could become stressed given its Baa2-rating category.***[16]

Moody's also noted in the same report that "KYPCo's key financial credit metrics are somewhat weak for its Baa2 senior unsecured rating category."[17] Not surprisingly, Kentucky Power is "facing significant pressure to maintain its credit ratings ...."[18]

A downgrade of Kentucky Power's credit rating would increase the cost of debt for Kentucky Power.[19] Not only would the cost of borrowing increase, but the increased cost would be *applicable to all Kentucky Power Company borrowings* and not just to transmission-related investment.[20] In addition, a downgrade of Kentucky Power's debt to non-investment status as a result of these pressures would limit Kentucky Power's access to investment capital for all aspects of its business (i.e., transmission, generation and distribution), thus making financing not only more costly, but also less available.[21]

---

[16] Prefiled Testimony of Jerald R. Boteler ("Boteler"), Exhibit JRB-1 at 2 (Moody's Investors Services Credit Opinion January 14, 2011) (emphasis supplied).

[17] *Id.*

[18] Boteler at 3; Barton at 5; Wohnhas at 4.

[19] T. at 101.

[20] T. at 65.

[21] Wohnhas at 5; T. at 65.

KY Transco is a targeted solution for this problem.[22] Indeed, because other AEP operating companies are facing these same demands,[23] applications by AEP Transcos to operate as public utilities have been approved by the Ohio[24] and Indiana[25] commissions and are pending elsewhere. In addition, AEP Transcos are providing service in Michigan and Oklahoma where approval was not required.[26]

Conversely, the formation of KY Transco is not intended as a means of "cherry-picking" Kentucky Power's assets, or providing transmission pathways for Midwestern wind energy to flow to the eastern seaboard,[27] or evading Commission regulation.[28] To the contrary, as discussed below, the Commission's approval of KY Transco's application will provide the Commission substantial regulatory oversight of KY Transco.

C. Advantages And Benefits Of KY Transco.

The financing of Kentucky-based future transmission projects by a separate transmission-only entity like KY Transco offers significant benefits to Kentucky Power and its customers.

First, by assuming legal and economic responsibility for much of the $260 million in required transmission-related investment projected for Kentucky Power over the next ten years

---

[22] T. at 45, 49, 67, 79.

[23] Barton at 4.

[24] *Id.*

[25] Order, *Verified Joint Petition of AEP Indiana Michigan Transmission Company, Inc. ("IM Transco") and Indiana Michigan Power Company ("I&M"), Both Indiana Corporations, For Indiana Utility Regulatory Commission Approval, to the Extent Necessary, Of IM Transco's Status As A Transmission Only Public Utility; For Authority to Maintain IM Transco's Books Outside the State of Indiana; and for the Commission's Consent to Boards of County Commissioners For IM Transco to Occupy the Public Rights-Of-Way Pursuant to IC 36-2-2-23*, Cause 44000 (Ind. Util. Reg. Comm. November 2, 2011) ("Indiana Order'). The Indiana Order was entered subsequent to the hearing in this matter and is attached to this brief for the convenience of the Commission and the parties as **EXHIBIT 2**.

[26] Barton at 4.

[27] T. at 45, 50

[28] T. at 109.

KY Transco not only relieves the "stress" such borrowings would place on Kentucky Power's credit metrics,[29] it frees up additional borrowing capacity for non-transmission projects.[30]

Second, KY Transco is expected over the long-term to be able to obtain debt financing at a lesser cost than Kentucky Power. Several factors support this projection. As a transmission-only entity, KY Transco should be easily-understood and evaluated,[31] thereby making it attractive to investors.[32] In addition, KY Transco will offer a separate pool for investment by entities that have filled their demand for integrated utility debt.[33] Likewise, from a potential investor perspective, there is a more limited supply of debt issued by transmission-only entities, and thus debt issued by a transmission-only issuer is subject to stronger demand from investors than debt issued by an integrated utility such as Kentucky Power.[34] Finally, KY Transco will not be burdened with Kentucky Power's "legacy" debt.[35] All of these factors are projected to yield lower financing costs over the long term for KY Transco vis-à-vis Kentucky Power.[36]

Third, when capital is constrained, transmission projects that are not of immediate necessity may be deferred.[37] Because of its anticipated access over the longer term to additional capital at lower cost, KY Transco will be able to undertake projects that might otherwise be deferred,[38] thereby providing increased transmission reliability. In addition, by freeing up

[29] T. at 33.
[30] Boteler at 5.
[31] T. at 25, 29; Boteler at 6.
[32] T. at 53.
[33] T. at 28-29
[34] T. at 26.
[35] T. at 53; Boteler at 5.
[36] T. at 49.
[37] Barton at 6.
[38] *Id.*

capital capacity for Kentucky Power, KY Transco "will have an indirect benefit on the reliability of the generation and distribution systems."[39]

Fourth, the operation of KY Transco is not expected to affect adversely "the credit quality or risk levels" of Kentucky Power or the other AEP operating companies.[40]

D. Operation Of KY Transco.

1. KY Transco Will Stand In The Shoes Of Kentucky Power

As a financing vehicle for transmission projects Kentucky Power otherwise would construct,[41] assuming it had the financial ability to do so, KY Transco will stand in the shoes of Kentucky Power.[42] More particularly:

KY Transco Will Provide The Same Wholesale Transmission Service As Kentucky Power

- KY Transco will provide "transmission service at wholesale to load service entities within PJM, including Kentucky Power Company and other wholesale customers in the Commonwealth of Kentucky."[43]

- KY Transco will not be a merchant provider of transmission service.[44]

---

[39] *Id.*

[40] Boteler Exhibit JRB-2 at 3 (Julie M. Cannell, *AEP Transco: The Investor Perspective*, March 2010). At the hearing mention was made of the "minority view" reported in Ms. Cannell's white paper, *id.* at 6, that under certain limited circumstances the risk to the operating companies "could slightly rise." T. at 48-49. As Mr. Boteler explained, it is important to recognize that this concern was held only by a minority of the investors and credit rating agencies interviewed; a majority opined to the contrary. *Id.* More fundamentally, the minority view seemingly was predicated upon the contingency of AEP and its operating companies spinning off all of their transmission assets. Boteler Exhibit JRB-2 at 6. Such a transaction is not part of this proceeding, nor is it contemplated. T. at 14; *see also* Application at ¶ 10 ("KY Transco will develop and own new transmission assets within the Commonwealth of Kentucky. KYTCo will not acquire any existing Kentucky Power transmission assets that are in service."). Most importantly, with respect to Kentucky Power (and Kentucky Transco if this application is granted), any such transaction will be subject to Commission review and approval under KRS 278.218, or KRS 278.020(5) and KRS 278.020(6).

[41] Prefiled Testimony of Gregory G. Pauley ("Pauley") at 8; T. at 20; Barton at 5.

[42] T. at 20, 78, 80, 81, 82.

[43] Staff First Data Requests, Item 2(a); Staff Second Data Requests, Item 3.

[44] T. at 41.

<u>The Scope Of KY Transco's Future Projects Will Be The Same As Those Of Kentucky Power</u>

- KY Transco will build "projects that are extensions of Kentucky Power's system, projects ordered by PJM, and limited upgrades and replacements to KPCo's existing transmission facilities."[45]

- KY Transco's facilities will "serve the needs not only of consumers within the Commonwealth of Kentucky, but also consumers of power throughout the PJM system."[46]

- KY Transco may construct transmission lines outside Kentucky Power's service territory, but would not do so in any situation where Kentucky Power would not.[47]

- KY Transco is not a party to the Memorandum of Understanding between Pioneer Transmission, LLC and the Tennessee Valley Authority ("TVA"), and KY Transco will not have an ownership interest in any transmission project developed under the memorandum connecting AEP's Rockport Station and TVA's Paradise Fossil Plant.[48]

- KY Transco is not a party to the Memorandum of Understanding between AEP and TVA under which the parties are studying transmission enhancements to the interface between the PJM and TVA transmission systems.[49]

- KY Transco will not have the exclusive right to build transmission facilities within the Commonwealth.[50]

---

[45] Pauley at 7.

[46] *Id.*

[47] T. at 20. Kentucky Power, for example, owns the Hanging Rock-Jefferson 765 kV Transmission line. *Id.*

[48] Prefiled Supplemental Testimony of Lisa M. Barton ("Barton Supplemental") at 4-5.

[49] *Id.* at 2.

[50] T. at 81. A question arose during the hearing concerning the applicability of the certified territory statutes, KRS 278.016 to KRS 278.018, to KY Transco and the transmission operations of Kentucky Power. The certified territory statutes are applicable to retail electric service only. *See* KRS 278.016 ("the state [shall] be divided into geographical areas, establishing the areas ***within which each retail electric supplier is to provide the retail electric service*** ....") (emphasis supplied); KRS 278.017 (multiple references to retail electric supplier and existing distribution lines); KRS 278.018 ("each retail electric supplier shall have ***the exclusive right to furnish retail electric service***....") (emphasis supplied). Similarly, KRS 278.010(7) defines "retail electric service" to exclude "wholesale electric energy furnished by a wholesale electric supplier to another electric supplier for resale." Indeed, KRS 278.010(6), which defines "existing distribution line[s]," which in turn are used under KRS 278.017 to delineate each retail electric supplier's certified territory, excludes "any transmission facilities used primarily energy in bulk." Transmission, by contrast, is a wholesale service, *see* T. at 71, 75, 85, and thus it is not subject to the certified territory statutes.

KY Transco Will Be Subject To FERC Regulation And Ratemaking In A Fashion Identical To Kentucky Power

- KY Transco's transmission assets are regulated exclusively by Federal Energy Regulatory Commission ("FERC") to the extent (but only to the extent) FERC has preempted state commission authority.[51]

- KY Transco's rates for transmission service are set out in a FERC Open Access Transmission Tariff ("OATT") and not tariffs filed with the Commission.[52]

- The return on equity used to establish KY Transco's OATT rate is 11.49%, like the 11.49% rate used to establish Kentucky Power's OATT rate, and not the return on equity rate established by the Commission in connection with Kentucky Power's retail rates.[53]

- KY Transco's return on equity at FERC includes 50 basis points for being a member of a Regional Transmission Organization.[54]

- KY Transco will be equally eligible for FERC incentives in connection with yet to be constructed transmission facilities. These incentives will be based on the nature of the project and not the identity – Kentucky Power or Kentucky Transco – of the entity constructing and owning the facility.[55] The availability of FERC incentives is not driving this application or the Transco concept.[56]

---

[51] T. at 63, 64 ("it's all FERC jurisdictional assets, and it's subject to the FERC OATT, regardless of who owns the assets.").

[52] *Id.*

[53] T. at 63, 90. *See also* Attorney General Data Request, Item 4.

[54] T. at 90.

[55] As Ms. Barton explained:

VICE CHAIRMAN GARDNER: And we can follow up with him on that, but let me—so then to make sure I'm clear about this, what you're saying is the FERC incentives are available whether they're in—it makes no difference whether it's in Transco or whether it's in Kentucky Power, the level of incentive.

So it is not accurate that you—your position is you're not creating this company as one additional reason to get the FERC incentive for transmission, is that correct?

MS. BARTON: Correct.

T. at 95.

[56] T. at 58. ("You're saying have I been involved in the discussion that if there were no incentive rates would there be a need for Transco? I have not been involved in any discussion on that topic.")

KY Transco Will Be Subject To Substantial Regulation By This Commission (If This Application Is Granted)[57]

- Any transfer of control of KY Transco will be subject to Commission review and approval (if this application is granted) pursuant to KRS 278.020(5) and KRS 278.020(6).[58]

- The construction and siting of KY Transco transmission lines will be subject (if this application is granted) to Commission approval and governed by KRS 278.020.[59]

- KY Transco's service will be subject (if this application is granted) to the Commission's jurisdiction.[60]

- Any transfer of assets by KY Transco will be subject (if this application is granted) to the Commission's jurisdiction under KRS 278.218.[61]

- All financings by KY Transco will be subject (if this application is granted) to the Commission's jurisdiction under KRS 278.300.[62]

- KY Transco's transactions with its affiliates (other than Kentucky Power, which already is subject to the requirements) will be subject (if this application is granted) to the Commission's jurisdiction and the requirements of KRS 278.2201 to KRS 278.2215.[63]

---

[57] At the hearing questions arose concerning the applicability of all provisions of Chapter 278 of the Kentucky Revised Statutes to KY Transco. *See e.g.* T. at 62, 70. Of course, Kentucky Power's transmission-only activities are no differently regulated by the Commission than those of KY Transco. *See e.g.* T. at 64 ("But it is—it's really—it's all FERC jurisdictional assets, and it's subject to the FERC OATT, regardless of who owns the assets."). In addition, KRS 278.010(3)(a) defines utility as any non-municipal entity that "owns, controls, operates or manages any facility used or to be used for or in connection with [t]he ... transmission ... of electricity to or for the public, for compensation, for lights, heat, power, or other uses." The statute does not limit the definition to entities that engage in retail activities, or that are subject to all otherwise applicable provisions of Chapter 278 of the Kentucky Revised Statutes. Thus, an entity that engages in one of the jurisdictional activities identified in KRS 278.010(3)(a), as will KY Transco, is a utility and hence subject to the Commission's jurisdiction under KRS 278.040 even if the entity provides only wholesale service.

[58] KRS 278.020(5) ("No person shall acquire or transfer ownership of, or control or the right to control, ***any utility under the jurisdiction of the commission***....") (emphasis supplied); KRS 278.020(6) ("no individual ... shall acquire control, whether directly or indirectly, ***of any utility furnishing utility service in this state***....") (emphasis supplied).

[59] T. at 103; KRS 278.020(1), (2) and (8); KRS 278.700(5); KRS 278.714.

[60] T. at 104-105; KRS 278.040(1); KRS 278.260.

[61] KRS 278.218(1) ("No person shall acquire or transfer ownership of or control, or the right to control, any assets that are owned by a utility as defined under KRS 278.010(3)(a) ....") Likewise, and although no such transfer is contemplated, T. at 14, any future transfer of assets from Kentucky Power to KY Transco would be subject to Commission approval under KRS 278.218. T. at 9.

[62] KRS 278.300(1) ("No utility shall issue any securities or evidence of indebtedness....")

[63] KRS 278.2207(1) ("The terms for a transaction between a utility and its affiliates....')

- KY Transco will be required to obtain a certificate of public convenience and necessity before bidding on any required franchises.[64]

- KY Transco's books and records will be subject to production to and review by the Commission.[65]

- A portion of KY Transco's transmission revenues will be allocated to Kentucky as intrastate revenue and hence subject to the assessment levied by KRS 278.130.[66]

- KY Transco will abide by all legal requirements imposed by the Commonwealth.[67]

2. Manner of Operation

KY Transco will have no employees of its own,[68]with services being provided by employees of Kentucky Power and American Electric Power Service Corporation.[69] Otherwise, it will operate in the same manner as Kentucky Power.[70] As is the case today with Kentucky Power and the other AEP operating companies, KY Transco's transmission facilities will be:

> planned and operated on an integrated basis through the coordinated efforts of the AEP Transmission Department (AEP Transmission), a business unit of AEPSC [American Electric Power Service Corporation]. To accomplish its responsibilities, AEP Transmission uses a combination of services provided by AEP operating company employees, AEPSC employees and contractors.... There will be no change in the planning, operation, and maintenance of the transmission system since the services provided to KY Transco will be through the same service providers and will be administered in the same manner that these services are being provided today.[71]

---

[64] KRS 278.020(4)

[65] KRS 278.230.

[66] Staff Hearing Data Request No. 2.

[67] T. at 70; Wohnhas at 3.

[68] *Id.*

[69] Barton at 12.

[70] Barton at 5.

[71] Barton at 7, 11-12. *See also* Wohnhas at 13; T. at 69, 81.

As a result, KY Transco will enjoy the same low-cost advantages as Kentucky Power in the planning, procurement, construction, operation, and maintenance of its transmission facilities.[72] Likewise, KY Transco's relationship to and interaction with PJM, through AEP Transmission, will remain open and transparent.[73]

3. KY Transco Projects

KY Transco will make the same types of investments in transmission assets Kentucky Power would have made if it was not capitally constrained.[74] KY Transco will use the same standards as Kentucky Power to analyze the need for and to construct projects.[75] Because it is a financing vehicle, KY Transco will not acquire any existing Kentucky Power transmission assets.[76] Although KY Transco in general will build the more significant (over $500,000) transmission projects,[77] the determination of which projects will be built by KY Transco, and which will remain the responsibility of Kentucky Power, will be made on a case-by-case basis[78] using the AEP Transmission LLC Project Selection Guidelines.[79]

---

[72] T. at 81 ("AEP is a very low-cost provider... We want to continue to provide that low cost of service with our existing employee base and do it in the same manner that we would have for Kentucky Power...."); T. at 83.

[73] Barton at 14.

[74] Barton at 5.

[75] Wohnhas at 3.

[76] T. at 14; Barton at 13; Application at ¶ 10. In any event, a transfer of transmission assets by Kentucky Power would be subject to approval under KRS 278.218. In addition, if this application is granted, any transfer of transmission assets by KY Transco, although none is contemplated, would be subject to review in accordance with the same statute. Mr. Pauley also agreed that KY Transco would accept as a condition of an order approving this application the requirement that any transfer of assets from Kentucky Power to KY Transco be subject to Commission review and approval. T. at 9.

[77] T. at 69. Conversely, Kentucky Power's transmission investments will be limited to "refurbishment or replacement of existing assets." Wohnhas at 5.

[78] Barton at 13-14.

[79] Barton at 13; Barton Exhibit LMB-1.

ARGUMENT

A. Applicable Standard

KRS 278.020(1) provides that "[n]o person, partnership, public or private corporation, or combination thereof shall commence providing utility service to or for the public … until that person has obtained from the Public Service Commission a certificate that the public convenience and necessity require the service…." Kentucky Transco, will provide utility[80] service in the form of the transmission of electricity to its wholesale customers.[81] These wholesale customers in turn "constitute a portion of the indefinite public[82] which has a legal right to demand and receive transmission service."[83] As such, and upon determination that the public convenience and necessity require the transmission service to be provided, KY Transco is entitled to the requested certificate.[84]

---

[80] KRS 278.010(3)(a) defines utility to include "the generation, ***transmission***, or distribution of electricity to or for the public, for compensation, for light, heat, power, or other uses," (emphasis supplied). Kentucky Transco will be compensated for its provision of transmission service. T. at 99.

[81] Staff First Data Request, Item 2(a).

[82] This definition of "the public" and "public utility" is fully consistent with the standard quoted with approval by the Commission in *In the Matter of: The Petition of Doe Valley Utilities, Inc. For Determination As To Jurisdictional Status Of Doe Valley Utilities, Inc. And Additional Or Alternative Determinations*, Case No. 2003-00360 at 5 (Ky. P.S.C. May 19, 2004). There, the Commission applied the test used by the West Virginia Supreme Court in *Wilhite v. Public Service Com'n*, 149 S.E.2d 273, 281 (W. Va. 1966):

> The test as to whether or not a person, firm or corporation is a public utility is that to be such there must be a dedication or holding out either express or implied that such person, firm corporation is engaged in the business of supplying his or its product or services to the public as a class or any thereof ***as distinguished from the serving of only particular individuals***….

(Emphasis supplied). *See also, In the Matter of: Application of Hardin County Water District No. 1 Requesting A Certificate Of Public Convenience and Necessity To Own And Operate A Sewer Utility And For Approval Of Initial Rates*, Case No. 2004-00422 at 11 (Ky. P.S.C. December 1, 2004) ("'The primary duty of a public utility is to serve on reasonable terms all those who desire the service it renders.'"). Far from serving only particular individuals, KY Transco will provide wholesale transmission service to those seeking it, including "load service entities within PJM, Kentucky Power and other wholesale customers." Staff First Data Request, Item 2(a).

[83] *Id.*

[84] KRS 278.020(1) was amended in 1998 to require a certificate of public convenience and necessity before providing utility service to the public. 1998 KY. ACTS ch. 388 § 1. The appellate courts have yet to address the applicable standard under the amendment, or the Commission's obligation to issue a certificate upon a demonstration of a need for the proposed service. Because a certificate to provide utility service is more akin to a certificate to bid on a franchise than a certificate to build new facilities, it appears the standard set out in *Public Service Com'n v. Blue Grass Natural Gas* Co., 197 S.W.2d 765, 768 (Ky. 1946) should apply. Under that decision, the Commission's "authority is limited to the determination of whether there is a need and demand for the public service in question, and if it determines that there is such need and demand it must issue a certificate…." *Id.* Indeed, the question of the absence of wasteful duplication can logically only be determined in connection with the

B. <u>There Is A Need For The Wholesale Transmission Service To Be Provided By KY Transco, And KY Transco's Operation As A Public Utility Will Further The Public Convenience And Necessity</u>.

1. KY Transco Will Provide A Needed Utility Service.

The transmission projects to be constructed and owned by KY Transco will be used to provide "transmission service at wholesale to load serving entities within PJM, including Kentucky Power Company and other wholesale customers in the Commonwealth of Kentucky."[85] Many of the transmission investments to be made by KY Transco are expected to be projects mandated by PJM, or required to meet NERC reliability standards.[86] Indeed, the contemplated investment by KY Transco is limited to transmission projects that would have been built by Kentucky Power but for constraints on its capital spending.[87]

It is undisputed that there is a need for the wholesale transmission service to be provided by KY Transco. Indeed, the Commission need look no further than the fact that the transmission service will be used by Kentucky Power and other load serving entities in the Commonwealth and PJM, and that much of the investment is expected to be mandated by PJM, or required to meet NERC reliability standards. Also underscoring the need for the service is that the facilities and service would have been provided by Kentucky Power but for the constraints on its capital spending capacity.

The need for the transmission service to be provided by KY Transco is further underscored by the fact that Kentucky Power faces significant capital constraints over at least the

---

examination of specific projects. In any event, KY Transco also will address the additional showing of an absence of wasteful duplication required in connection with a certificate to construct new facilities. *See Kentucky Utilities Co. v. Public Service Com'n.*, 252 S.W.2d 885, 890 (Ky. 1952).

[85] Staff First Data Requests, Item 2(a); Staff Second Data Requests, Item 3.

[86] Barton 6; Pauley at 7.

[87] Barton at 5.

next ten years as a result of required environmental and transmission investments.[88] These constraints, coupled with the fact that the required investments are beyond Kentucky Power's control,[89] may cause deferral of generation, distribution, and transmission projects that are not of immediate necessity.[90] Kentucky Power will continue to provide reliable service to its customers. But the unique advantages of KY Transco will permit Kentucky Power to do so in a more cost-effective manner, and help mitigate the need to defer projects.[91]

2. The Provision Of Wholesale Transmission Service By KY Transco Will Further The Public Convenience And Necessity.

KY Transco's proposed operation as a public utility will further, and is consistent with, the public convenience and necessity in at least four respects.

First, by providing "an alternative vehicle for financing certain transmission investments that KPCo otherwise would have made if it had unlimited options of the allocation of its constrained capital,"[92] KY Transco will relieve pressure on Kentucky Power's credit rating,[93] while better permitting the Company to manage its credit ratios.[94] As Ms. Barton noted in explaining the risk facing Kentucky Power in the absence of KY Transco:

---

[88] T. at 17 ("With regard to capital spend, as we look out into the future, we see a number of things that impact the operating companies. You have NERC. You have environmental spend and all of that, and that's going to significantly impact not only Kentucky Power's balance sheet, but it's going to impact the other operating companies as well."); T. at 30 ("it is anticipated that there will be heavy future capital spending at Kentucky Power."); T. at 78 ("huge capital constraints); Barton at 5; Boteler at 3 ("Vertically-integrated investor-owned utilities are facing a challenging and uncertain environment.... [I]ts projected capital spending needs are significant across all areas of its utility business, including transmission, and are projected to extend over the next decade."); Wohnhas at 4.

[89] T. at 67-68.

[90] Barton at 6.

[91] T. at 45 ("[T]his is a targeted solution designed to find a way to continue to spend money on transmission in spite of large cap ex requirements at a number of the operating companies."). *See also* Wohnhas at 4; Barton at 6.

[92] T. at 30 ("This is just a purpose-built financing solution to have some assets built in a different entity that will allow us to capitalize it separately and finance it separately in order to relieve Kentucky Power of that future spending pressure—or some of that future spending pressure."); Barton at 5; Boteler at 6.

[93] T. at 16, 30. *See also* Staff First Data Request, Item 22.

[94] Boteler at 6. Kentucky Power's credit rating is based upon its own financials and not those of AEP. T. at 19-20.

> You know, again, getting back to the fact that with these huge capital constraints, there needs to be some kind of relief in terms of can we have some assets that are built in essence by an AEP affiliate utilizing the same services, the same people that are in place today and preventing Kentucky Power from going down that slippery slope with respect to its bond rating and therefore the increased cost of debt and instability.[95]

KY Transco also is expected to improve Kentucky Power's access to capital.[96] All of this will assist in strengthening Kentucky Power's financial health.[97]

Second, KY Transco is expected to free up capital capacity for investment by Kentucky Power in its distribution and generation systems.[98] These investments are expected to improve the reliability of Kentucky Power's distribution and generation systems.[99]

Third, KY Transco over time is expected to obtain lower cost financing than might be available to Kentucky Power.[100] In addition, KY Transco anticipates that it will have greater access to capital markets and investors than Kentucky Power.[101] This more-readily-available and lower-cost capital, as Mr. Boteler explained, will benefit Kentucky Power's customers:

> By separating transmission spend for which we have a large amount of across the system into transmission-only entities, we believe we will get lower cost financing over the long run than what you will get at the operating companies. And if that happens, the ratepayers of Kentucky Power will benefit because all of our transmission costs are passed—allocated across the system. They will benefit because their costs will go down over time.

---

[95] T. at 78.

[96] Boteler at 6.

[97] Wohnhas at 13.

[98] T. at 17; Boteler at 5, 6; Barton at 6.

[99] *Id.*

[100] T. at 27 ("I think it is the clear asset model to look at from an investor standpoint, and that also leads to, I think, a relatively lower price, cost-to-capital for it.")

[101] T. at 29-30 ("Because investors seek fixed income investments with those attributes, it provides a wider access to capital and another source of external funding for those assets, this being transmission assets.") *See also* T. at 79 ("But when you're combining that with Ohio Power, when you're combining that with Indiana/Michigan, now you've got that opportunity to access those debt markets and to off-load that capital spend and to make it a healthier financial environment for all of the operating companies and to do that under AEP Hold Co.") This greater access and investor demand also is driven by the greater transparency and ease of understanding a transmission-only business, T. at 29, a stronger credit rating, Boteler at 6, and providing a different investment vehicle for investors who have reached their limit on investments in the debt of integrated utilities. T. at 28-29.

Fourth, by making transmission investments sooner than otherwise would be made by Kentucky Power,[102] and by making investments that could not otherwise be made without jeopardizing Kentucky Power's credit rating,[103] KY Transco is expected to improve the reliability of the transmission system used by Kentucky Power to provide service.[104]

In sum, and while solely intended as a financing vehicle,[105] KY Transco will bring important non-financial benefits to Kentucky Power and its customers. These benefits – financial and non-financial alike – will further the public convenience and necessity.

3. The Transmission Facilities To Be Constructed By KY Transco Will Not Result In Wasteful Duplication.

KY Transco will stand in the shoes of Kentucky Power.[106] It will not be a merchant transmission company.[107] To the contrary, it will build only those transmission projects that Kentucky Power would have undertaken but for constraints on its capital spending ability.[108] The projects undertaken by KY Transco will be planned and analyzed in the same fashion used by Kentucky Power.[109] Because KY Transco is intended to relieve Kentucky Power of its obligations, financial and otherwise, with respect to major transmission projects, Kentucky

---

[102] Barton at 6.

[103] T. at 99; Barton at 6. The fact Kentucky Power has not been expressly threatened with a downgrade by the credit rating agencies if this application is not approved, *see* T. at 98, is far from probative of the need for KY Transco, or the benefits its operation is likely to provide Kentucky Power and its customers. Credit ratings agencies typically are not in the business of prescribing a specific "fix" for the challenges threatening the entity whose debt they evaluate. Moreover, Moody's has made clear that it "would be concerned if KYPCo's spending plans result in a persistent negative free cash flow position that will be primarily funded with internal or external debt. Should this situation materialize, KYPCo's financial profile could become stressed given its Baa2-rating category." Boteler Exhibit JRB-1 at 2. Likewise, Moody's has indicated that "KYPCo's key financial credit metrics are somewhat weak for its Baa2 senior unsecured rating category." *Id.* As Messrs. Pauley and Wohnhas, who are responsible to this Commission and Kentucky Power's customers and shareholder for the Company's financial well-being, explained, these "somewhat weak" credit metrics are further jeopardized by the looming capital expenditures facing Kentucky Power. T. at 17, 16; Wohnhas at 4. *See also* Boteler at 3; Barton at 5.

[104] Staff Informal Conference Data Request No. 3 at 2. *See also* Barton at 8.

[105] T. at 109.

[106] T. at 20, 78, 80, 81, 82.

[107] T. at 41.

[108] Barton at 5.

[109] Barton at 5.

Power by definition will not be duplicating KY Transco's efforts. In short, the transmission facilities to be constructed by KY Transco will not result in wasteful duplication.[110]

Most fundamentally, if this application is granted, the Commission will enjoy substantial jurisdiction over KY Transco and its construction projects.

C. The Slightly Higher "Front-End" Costs Associated With KY Transco Are Far Out-Weighed By The Benefits Provided To Kentucky Power And Its Customers Through KY Transco's Operations.

As KY Transco candidly disclosed in its initial filing, "the annual [wholesale] transmission cost to retail customers would be slightly higher for the same capital investment if it was made by KY Transco than if it were made by KPCo."[111] But as Mr. Wohnhas also explained, "there are reasons to believe this rate difference will diminish and possibly reverse over time."[112] These reasons include a lower cost of debt, operation and maintenance savings as a result of more timely asset replacement, and the elimination of KY Transco formation costs.[113]

Because of the differences between FERC wholesale rates and Kentucky retail rates, KY Transco can not be demonstrated to yield direct cost savings to Kentucky Power's retail customers under current conditions.[114] But the "pro-forma" presented by Mr. Wohnhas represents only a snap shot in time,[115] so that even the difference between FERC wholesale rates and Kentucky retail rates could diminish or reverse over time.[116] In particular, the FERC return on equity (accorded to <u>both</u> KY Transco <u>and</u> Kentucky Power) could decrease over time, or

---

[110] Likewise, the absence of employees, and KY Transco's use of the services of Kentucky Power and AEP in carrying out its operations, ensures that the operation of KY Transco will not result in wasteful duplication. T. at 81; Barton at 12.

[111] Wohnhas at 11. *See also* Staff Informal Conference Data Request No. 3 at 1.

[112] Wohnhas at 11.

[113] Staff Informal Conference Data Request No. 3 at 1.

[114] *Id.* at 2.

[115] T. at 109.

[116] Staff Informal Conference Data Request No. 3 at 2.

Kentucky Power's Commission-established return on equity for retail ratemaking could increase (or could increase at a faster rate than the FERC return on equity).[117] In such a case, any cost-savings gleaned by KY Transco at the wholesale level will yield "direct cost savings to [Kentucky] retail customers."[118] Finally, and perhaps most significantly, this difference between FERC wholesale rates and Kentucky retail rates may exist regardless of whether this application is granted. Although no determination has been made whether KY Transco will operate if it is not accorded public utility status, a non-regulated electric transmission line owner, whether that company is an AEP affiliate or a third party, seemingly is subject to the much more limited state jurisdiction[119] of the Kentucky State Board on Electric Generation and Transmission Siting.

Without diminishing in any respect the Commission's legitimate concern in limiting all increased costs that might be borne by Kentucky Power's retail customers, however small, it is important to recognize KY Transco is likely to have only a *de minimis* effect on the retail rates paid by Kentucky Power's customers even in the unlikely event all things remain equal.[120] First, the difference between the FERC wholesale rate and Kentucky retail rates is not large.[121] Second, KY Transco will not acquire Kentucky Power's existing transmission facilities,[122] and thus Kentucky Power's retail customers will continue to pay the same rates for Kentucky

---

[117] *See id.*

[118] *Id.*

[119] As its name suggests, the Kentucky State Board on Electric and Transmission Siting ("Board") has jurisdiction only over the siting of non-regulated electric transmission lines. KRS 278.714. It has no jurisdiction over the service provided by non-regulated electric transmission providers. Nor does FERC. T. at 71. Nor does the Board enforce the provisions of KRS 278.020(4), KRS 278.020(5), KRS 278.020(6), KRS 278.218, KRS 278.2201 to KRS 278.2215, and KRS 278.300.

[120] *Id.* ("These factors add up a negligible difference in the overall amount retail customers pay for their electric service.")

[121] Wohnhas at 11-12. Staff Informal Conference Data Request No. 3 at 2.

[122] Application at ¶ 10; T. at 14; Barton at 13.

Power's existing transmission assets.[123] Finally, Kentucky retail customers will pay only a small portion (approximately 5.9%) of the cost of the new transmission to be owned by KY Transco.[124]

But in the absence of KY Transco, it is far from clear that all things will remain "equal." KY Transco provides an alternative for transmission projects that will aid Kentucky Power in maintaining its investment-level credit rating, and thereby avoid the resultant increase in cost for all Kentucky Power borrowings (not just those required for transmission investment) and diminished access to credit markets.[125]

Although a transmission-only utility appears to be without precedent in Kentucky, the risks facing Kentucky Power and its customers, and the very real benefits to be received by Kentucky Power and its customers from the operation of KY Transco, make the grant of KY Transco's application not only reasonable, but in the public convenience and necessity. In this regard, the Commission may want to consider the proceedings before the Indiana Utility Regulatory Commission ("Indiana Commission") in connection with its recent approval of the settlement agreement under which AEP Indiana Michigan Transmission Company, Inc. ("I&M Transco") was granted public utility status in Indiana. At the hearing on the Indiana settlement agreement, the witness for the Indiana Office of Utility Consumer Counselor ("OUCC") echoed the points made by the witnesses testifying before the Commission in support of KY Transco's application:

> Mr. Keen [the OUCC witness] testified the OUCC believes IM Transco can achieve some type of cost benefit that could not be otherwise achieved by leaving all transmission assets under the control of I&M ["Indiana Michigan Power Company"]. He explained that I&M has outlined in testimony it will need to undertake a very substantial capital expenditure program to insure service reliability, as well as to comply with emerging environmental and nuclear

[123] Staff Informal Conference Data Request No. 3 at 2.

[124] Staff Informal Conference Data Request No. 3 at 2.

[125] T. at 65, 101; Wohnhas at 5, 13.

> regulations. He explained a transmission only entity may appeal to certain investors as a simpler type of investment with a more narrowly defined range of risks than other utility entities, which has potential to enhance AEP's overall investment opportunities. He stated it is the OUCC's expectation that the formation of IM Transco would therefore reduce somewhat the overall capital investment pressure on one hand, and the greater business visibility on the other, should reduce overall costs in the long run.[126]

Based on this testimony, and the other evidence before it, the Indiana Commission approved I&M Transco's application to be granted public utility status in Indiana, and it further recognized the challenges facing I&M and the benefits provided by a stand-alone transmission-only public utility:

> The creation of IM Transco does not solve the challenges I&M must face in financing a significant capital program across its generation, transmission, and distribution systems, but we consider it to be a constructive action that may improve I&M's financial flexibility. While an independent transmission company is a significant departure from the traditional regulatory construct in Indiana, the Commission finds it to be acceptable in this instance, in which the formation of I&M Transco may prevent or diminish the financing challenges I&M must face, providing sufficient potential benefits in the public interest to warrant this departure from a vertically integrated utility.[127]

KY Transco likewise is a constructive response to the challenges facing Kentucky Power that has the potential to aid in the delivery of reliable electric service to Kentucky Power's customers.

D. Conditions For Approval Of Application.

The Indiana Commission in part premised its approval of the settlement on certain further agreements by I&M Transco. These agreements were designed to ensure I&M Transco's operations remained transparent and accountable.[128] KY Transco agrees that approval of its application may be premised upon the following similar[129] requirements[130]:

---

[126] Indiana Order at 10.

[127] *Id.*

[128] *Id.* at 7.

[129] These conditions are intended to be identical to those agreed to in Indiana, as modified to include the Office of the Attorney General and Kentucky Industrial Utility Customers, Inc. in place of the Indiana OUCC, which was the sole counter-party to the Indiana Agreement. In addition, Mr. Pauley agreed at the hearing in response to a question

- Beginning July 1, 2013, and each July 1st for four years thereafter, KY Transco will file with the Commission, and serve on the Office of the Attorney General, Commonwealth of Kentucky ("AG"), and counsel for Kentucky Industrial Utility Customers, Inc. ("KIUC"), a comprehensive written report detailing KY Transco's transmission projects, practices taken by KY Transco to provide for the lowest reasonable cost, and a copy of the most recently available independent auditor's report for KY Transco.

- At six month intervals following a final order granting the application in this matter, KY Transco and Kentucky Power will meet with Commission Staff and representatives of KIUC and the AG to address KY Transco's operations. The meetings will continue for 18 months following the final order granting the application in this matter.

- KY Transco will file a petition to intervene in Kentucky Power's next general rate case, and any other general rate cases filed by Kentucky Power during the three year period following a final order granting the application in this matter. In any such proceeding, KY Transco will file testimony concerning its operations.

- KY Transco will produce at the offices of the Commission,[131] KIUC, and the AG duplicate copies of those portions of its books and records necessary to permit the AG and the Commission to perform their statutory duties.

- KY Transco will reimburse the Commonwealth of Kentucky, on behalf of the Commission, the AG, and KIUC, $25,000 in the aggregate for travel expenses incurred by KIUC, the AG and the Commission to participate in KY Transco proceedings before FERC for five years following the entry of a final order granting the application in this proceeding. The $25,000 in aggregate reimbursements will be allocated as agreed to by the AG, the Commission, and KIUC.

- Kentucky Power and KY Transco agree to waive the right to seek recovery of post-June 30, 2010 formation costs associated with obtaining necessary state or local approvals from the Commission.

---

from Vice-Chairman Gardner that KY Transco would accept, as a condition of an order approving this application, Commission review and approval of any transfer of assets from Kentucky Power to KY Transco. T. at 9. KY Transco remains willing to abide by that additional commitment in the event its application is approved.

[130] These are a summary of the conditions KY Transco would accept in connection with the Commission's approval of its application in this proceeding. The full conditions are set out in **EXHIBIT 3** to this post-hearing brief.

[131] This would supplement, to the extent applicable, KY Transco's obligation as a utility to produce its books and records to the Commission pursuant to KRS 278.230.

CONCLUSION

AEP Kentucky Transmission Company, Inc. respectfully requests that the Commission approve its application in this proceeding, and that it be granted a certificate of public convenience and necessity to provide transmission services in the Commonwealth as a public utility.

Respectfully submitted,

Mark R. Overstreet
STITES & HARBISON PLLC
421 West Main Street
P. O. Box 634
Frankfort, Kentucky 40602-0634
Telephone: (502) 223-3477

COUNSEL FOR AEP KENTUCKY
TRANSMISSION COMPANY, INC.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Post-Hearing Brief was served by first class mail, postage prepaid, upon the following:

David F. Boehm
Michael L. Kurtz
Kurt J. Boehm
Boehm, Kurtz & Lowry
36 East Seventh Street, Suite 1510
Cincinnati, OH 45202

Lawrence W. Cook
Assistant Attorney General
Office for Rate Intervention
1024 Capital Center Drive, Suite 200
P. O. Box 2000
Frankfort, KY 40602-2000

this 18th day of November, 2011.

Mark R. Overstreet

EXHIBIT 1

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AEP KENTUCKY TRANSMISSION COMPANY, INC. FOR A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY PURSUANT TO KRS 278.020 TO PROVIDE WHOLESALE TRANSMISSION SERVICE IN THE COMMONWEALTH	))))))	CASE NO. 2011-00042

TRANSCRIPT OF RECORD OF EVIDENTIARY HEARING

Mark R. Overstreet
STITES & HARBISON
421 West Main Street
P.O. Box 634
Frankfort, KY 40602-0634

FOR AMERICAN ELECTRIC POWER AND KENTUCKY POWER COMPANY

Lawrence W. Cook
Assistant Attorney General
1024 Capital Center Drive
Suite 200
Frankfort, KY 40601

FOR THE KY ATTORNEY GENERAL, OFFICE OF RATE INTERVENTION

Kurt J. Boehm
BOEHM, KURTZ AND LOWRY
36 East Seventh Street
Suite 1510
Cincinnati, OH 45202

FOR KENTUCKY INDUSTRIAL UTILITY CUSTOMERS, INC.

OCTOBER 19, 2011

TABLE OF CONTENTS

MR. ARMSTRONG: We're on the record. My name is David Armstrong. I'm the Chairman of the Public Service Commission. With me is the Vice Chairman Jim Gardner and our Commissioner, Charles Borders.

As counsel, we have Mark Overstreet. Nice to see you.

MR. OVERSTREET: Good morning.

MR. ARMSTRONG: And Mr. Cook.

MR. COOK: Good morning, Mr. Chairman. On behalf of the Attorney General, Lawrence Cook.

MR.ARMSTRONG: Mr. Boehm?

MR. BOEHM: Good morning. Kurt Boehm on behalf of Kentucky Industrial Utility Customers.

MR. ARMSTRONG: For the Staff:

MR. RAFF: For the Commission and the Staff, Richard Raff, Your Honor.

MR. ARMSTRONG: Has public notice been given, Mr. Raff?

MR. OVERSTREET: Your Honor, it has been given, and it was filed of record on October 13th.

MR. COOK: We've reviewed it, Your Honor, and we have no objection to it.

MR. BOEHM: No objection, Your Honor.

MR. ARMSTRONG: Are there any outstanding motions, Mr. Raff?

MR. RAFF: I don't believe so, Your Honor.

MR. OVERSTREET: No, Your Honor.

CHAIRMAN ARMSTRONG: Call your first witness.

MR. OVERSTREET: Thank you, Mr. Chairman. We'd like to call Greg Pauley to the stand please.

GREGORY J. PAULEY

BEING FIRST DULY SWORN, TESTIFIES AS FOLLOWS:

CHAIRMAN ARMSTRONG: Your name and why you're here?

MR. PAULEY: Gregory J. Pauley, President and CEO of Kentucky Power Company in the matter regarding the Transco filing before the Commission.

MR. OVERSTREET: Thank you, Mr. Chairman.

DIRECT EXAMINATION

by Mr. Overstreet

Q Mr. Pauley, would you just state for the record your business address?

A 101A Enterprise Drive, Frankfort, Kentucky.

Q And Mr. Pauley, did you cause to be filed in this proceeding testimony and certain answers to data requests?

A Yes, sir.

Q And do you have any corrections or modifications to those—

A No.

Q —to that testimony or those responses?

A No, I do not.

Q And if you were asked those questions here today, would your answers be the same?

A Yes, they would.

MR. OVERSTREET: The witness is available for cross examination, Your Honor.

CHAIRMAN ARMSTRONG: Mr. Cook?

MR. COOK: We have no questions, Your Honor.

CHAIRMAN ARMSTRONG: Mr. Boehm?

MR. BOEHM: No questions, Your Honor.

CHAIRMAN ARMSTRONG: Mr. Raff?

CROSS EXAMINATION

by Mr. Raff

Q Thank you. Good morning, Mr. Pauley.

A Good morning.

Q You are President of Kentucky Power Company?

A Yes, sir.

Q The proposal that is here today to create the Kentucky Transco, is that a result of you or your predecessor as President of Kentucky Power calling up to AEP and saying we, Kentucky Power, have a problem and we are unable to—we think we are going to be unable to construct transmission facilities here in Kentucky? Or is it a result of people at the AEP corporate level deciding that there should be another entity in Kentucky that would own and construct some of the high-voltage transmission facilities?

A The purpose of our filing in terms of your direct question is we believe this is another tool available through AEP that will be of benefit to the customers of

Kentucky Power with regard to future transmission build in Kentucky. And it is for that reason that we want to seek its approval in order to benefit our customers with regard to transmission spend that is needed here in Kentucky.

Q What I guess I'm trying to get at is did you tell someone at corporate headquarters that you thought that Kentucky Power would be unable to construct these facilities itself?

A No, I did not.

Q Okay, thank you.

MR. RAFF: Give me a minute please, Your Honor.

CHAIRMAN ARMSTRONG: Uh-huh.

Q I believe at some point this summer there had been a press release that resulted in some supplemental data requests related to an article from the—I guess maybe it's the new president of the parent company, talking about the potential sale of assets and having mentioned Kentucky Power as part of that conversation? Do you recall that?

A Yes, I do.

Q All right.

Since that time, to your knowledge, has there been any further discussion of the sale of assets, including or limited to Kentucky Power?

A Not to my knowledge has there been any other further discussion regarding that.

Q Okay.

Could you explain what would potentially happen in the future if this Commission were to approve the creation of the Kentucky Transco and then there was a separation of ownership between Kentucky Transco and Kentucky Power either by a sale of Kentucky Power or sale of the Kentucky Transco?

A Would you repeat the question again please?

Q Sure.

If the Commission were to create—authorize the creation of the Kentucky Transco and it is created and does own and construct some transmission facilities in the future and then at some point either Kentucky Power is sold from the AEP system or if Kentucky Power remains in the AEP system but the Kentucky Transco is sold from the AEP system such that there is no longer the same common ownership between the Transco and Kentucky Power, what impact would that have on Kentucky Power and its receipt of transmission service if that were to happen?

A The relationship between the Transco and Kentucky Power Company, if Transco is approved here in Kentucky, would be two separate entities, and of course, their responsibility or their involvement would be the building and constructing of transmission.

With regard to, let's say, the separation of Kentucky Power Company if Kentucky Power Company were sold, obviously that would be a matter that would come before the Commission with regard to that, and Kentucky Transco would still remain an entity within the Commonwealth with regard to what its purpose is intended to be with regard to the building of transmission.

Obviously, the dispensation or, if you will, the determination as to what happens to that Transco, I'm sure, would be a matter of conversation with regard to the Commission on the sale of Kentucky Power. And my observation would be it would be part of that conversation and could continue to exist as Kentucky Transco in the event that Kentucky Power would be sold.

Q Well, do you know if there's any provision that exists today that would allow Kentucky Power to purchase the transmission facilities that would be constructed by Kentucky Transco in the event that Kentucky Transco and Kentucky Power no longer are under common ownership?

A You're asking if Kentucky Power Company would purchase Kentucky Transco—have the right to purchase the—

Q If they have the right—if today—if under this proposal with the creation of the Transco, if there is a right that would exist for Kentucky Power to purchase the facilities that would be in the future owned by Kentucky Transco in the event that Kentucky Power and Kentucky Transco are no longer under common ownership?

A Okay.

I do not know the answer to that question.

Q Okay.

MR. RAFF: All right. Thank you, Mr. Pauley. No further questions.

CHAIRMAN ARMSTRONG: Questions?

MR. GARDNER: Thank you.

Mr. Pauley, let me follow up on Mr. Raff's last question first of all. Is there anyone here who would know the answer to that question?

MR. PAULEY: I think there would be.

MR. GARDNER: Okay.

And who would that be?

MR. PAULEY: Well, I think we have other—I think Lisa Barton might be able to address that.

MR. GARDNER: All right.

Do you agree that the—in the future that the sale of any transmission assets from Kentucky Power to Kentucky Transco would have to get approval by the Kentucky Public Service Commission?

MR. PAULEY: Yes, I do.

MR. GARDNER: Okay.

And do you have any objection, just for clarification purposes, for that being if the Commission approves the creation of Kentucky Transco that that be a condition of the approval?

MR. PAULEY: I have no problems.

MR. GARDNER: Okay.

In your testimony on page 9, you talk about—you give certain statutes that Kentucky Transco—the advantage of Kentucky Transco being a utility as opposed to a non-utility. That's basically the purpose of this hearing today because otherwise, you all can still—you could be merchant and then not be a utility in Kentucky. So I'm going to focus on these that manage—

MR. PAULEY: Okay.

MR. GARDNER: —a utility—in other words, why you all are here. And I understand the first two are advantages that you give to the Commission. In other words, we'd have to approve sale of assets and the company, and I understand that for change in control, that sort of thing.

But one question I have is, do—what would be this certified—I understand that a utility has to have a certified territory. What would be the certified territory for Kentucky Transco?

MR. PAULEY: Well, we have a distribution—a certified territory that we use for our retail business and all of that. The transmission build would provide a source of electricity to that, but I think the understanding would be that whatever area that the transmission company needed to get to our facilities would come under the jurisdiction and approval of the Public Service Commission because we currently have transmission facilities outside our distribution footprint in the state now.

MR. GARDNER: And all that makes sense. But, for example, there's been testimony about—and maybe this doesn't—do you believe that the certified territory would be the entire State of Kentucky so that every—that you all would then, subject to approval by the PSC, you all would then have the right to construct transmission anywhere in Kentucky? Or is the certified territory limited to your distribution system—the territory of your distribution system? That's really my question.

A Sure. My understanding is the transmission company is basically designed to help the distribution company with its transmission build in order to continue to serve its customers here, as well as the—as well as the connection that we have with the PJM. I do not know of any reason why we would be building transmission outside that area as a Transco for the distribution company, and if that would be, that would probably be under an independent endeavor or with regard to other joint ventures or whatever we may pursue otherwise.

MR. GARDNER: Such as Pioneer?

MR. PAULEY: Such as Pioneer.

MR. GARDNER: Okay. So—all right.

And then you mentioned that being a Kentucky utility—in other words, the purpose of this hearing would allow you likely to be able to exercise in that domain. Is there any other reason that you can think of as to why you want to be a Kentucky utility?

MR. PAULEY: Sure.

MR. GARDNER: I mean, again I understand—so it's not do you want to have—my question is not do—what's the advantage of having an entity—a separate entity for transmission that's of the finance issues. And I understand that.

MR. PAULEY: Okay.

MR. GARDNER: But why do you want—other than eminent domain, what advantage is there to AEP—for Kentucky Transco to be a Kentucky utility?

MR. PAULEY: I really think—if you have the understanding of the financial aspects because I really think that's important for our customers with regard to the future spend that's going to be needed there. But the ability to operate as a utility company within the state provides us the jurisdiction of the Public Service Commission to be over what it is we do.

And I think there's a better and more efficient way of handling these matters through the Public Service Commission. Now, there is other ways in which to do it, but with regard to the jurisdiction of the PSC, we just believe that it's more efficient and more appropriate for the operation that we have.

MR. GARDNER: Okay. That's all I have. Thank you.

MR. PAULEY: Thank you.

CHAIRMAN ARMSTRONG: Mr. Pauley?

MR. PAULEY: Good morning.

CHAIRMAN ARMSTRONG: This isn't the first Transco company that AEP has engaged, is it?

MR. PAULEY: That is correct.

CHAIRMAN ARMSTRONG: And in how many other states?

MR. PAULEY: We are in Indiana, Michigan, Ohio, and we have cases pending in West Virginia. We'll be re-filing in Virginia, so we're quite active on the east side.

CHAIRMAN ARMSTRONG: And the purpose of those Transco's would be what?

MR. PAULEY: The same as it would be for the Commonwealth with regard to utilizing the financing that would be available for the benefit of the consumers and building transmission, which we think is a more cost effective way in terms of impacting the—not only the ability to transmit electricity but from a cost benefit to our customers.

CHAIRMAN ARMSTRONG: You have an agreement now, do you not, with PJM?

MR. PAULEY: That is correct.

CHAIRMAN ARMSTRONG: And is that to sell all generation to PJM?

MR. PAULEY: I believe that's the current way in which we are operating today with regard to—it goes into PJM and then dispatched by PJM.

CHAIRMAN ARMSTRONG: And will that change?

MR. PAULEY: That does not change to my knowledge.

CHAIRMAN ARMSTRONG: But will that change?

MR. PAULEY: I do not believe that it will.

CHAIRMAN ARMSTRONG: Are you familiar with FERC's recent Order 1000?

MR. PAULEY: Not enough to testify regarding it.

CHAIRMAN ARMSTRONG: I know it's about 600 pages, so it's hard to comprehend all of it.

This action has nothing to do with that, does it?

MR. PAULEY: I'm not so sure—it probably plays with that, but I think Lisa Barton would be able to address that because she's more active in that order.

CHAIRMAN ARMSTRONG: And what is her position?

MR. PAULEY: She is Executive Vice President of Transmission.

CHAIRMAN ARMSTRONG: That's all I have.

MR. PAULEY: Thank you, sir.

CHAIRMAN ARMSTRONG: Questions?

MR. BORDERS: Yes, sir. Good morning, Greg.

MR. PAULEY: Good morning, sir. How are you?

MR. BORDERS: Doing well. How are you doing?

MR. PAULEY: Great, thank you.

MR. BORDERS: Just a couple of questions.

By reading your testimony, I sense that your testimony was for clarification to a large degree about whether Kentucky Power might be sold and these type things and getting into the weeds more or less than the other testimony as far as going into some aspects that I don't think that your testimony is necessarily intended to cover.

So my two questions I think I would have for you would be on page 9, you just mentioned the fact that Transco will own assets that otherwise would be built by Kentucky Power. My question would be if there is an advantage for the customers of Kentucky for that to transpire, will it be advantageous for Transco to just go ahead and take the transmission assets, all the transmission assets, those already constructed and those to be constructed in the future.

Why deviate—future construction would go to this entity? Why not just let that transmission entity do all the past and current and future?

MR. PAULEY: Our effort with regard to the Transco has to do with new builds and all of that that we are required to have through PJM and any other need in which we have. For example, the line that we're looking at building between Bonnyman and Soft Shell, which is a separate filing.

It is not intended to come in and take over the existing transmission that would remain under the purview of the operation that I am responsible for. We see no reason or benefit for them to merge with us or us to merge with them. Let us keep this in terms of what we're doing now, and anything new would fall under their purview, keep a separation of activities.

MR. BORDERS: And from a general perspective, because here again, I realize that the other folks get really in depth on talking about the financing and so forth, imply that it will be easier to get financing and better rates for financing and these type things.

Would the mother company, AEP, not be equally responsible for the obligations that fall under the Transco if they [inaudible] Kentucky Power transmission? Would they not be liable in both those cases for any debt and so forth that—

MR. PAULEY: The AEP system includes a number of operating companies, and it's my job to do the best that I can with the people I have to keep Kentucky Power Company as a stand-alone operation within the AEP family.

MR. BORDERS: But if you needed funding and you just took—to carry out the mission of Kentucky Power, it would be AEP you would make your sale to them that you need additional funding for vegetation management or whatever? It really ultimately falls back to them to cover any shortfalls in either situation?

MR. PAULEY: Well, that—and I'm sorry, Commissioner. That responsibility falls on me with regard to taking care of Kentucky Power, and we have to—we have to stand alone with regard to our relationship with AEP.

Now, if there are other opportunities in which the AEP corporate comes in and offers advice to us with regard to what it is we're doing, that advice is open to me, but I have to make the decision to make Kentucky as best as it can to stand on its own feet without the—without, if you will, the subsidy of AEP corporate.

MR. BORDERS: And that's getting to my point and what I'm really trying to get at at that end is why that this financing would be cheaper if the parent company were ultimately responsible for all debt and potential creditor would be looking at that, I'm trying to get in my mind—and maybe some of the testimony of the others will go into this in more depth.

But where would the advantage come from if AEP is responsible for $50 million to build a transmission line under Transco or $50 million under Kentucky Power's current situation, they're still responsible for the obligation of $50 million. So I'm just trying to establish early on where the benefits to the Kentucky customer would come, why—if you're blowing the same amount of dollars, if in the end of today the parent company would be responsible for all the debt, regardless of what entity it fell under, Transco or whatever, maybe they wouldn't be responsible for it under either condition.

I guess that's what I'm really asking?

MR. PAULEY: Well, let me see if I can go at it this way with you, and if I miss the mark, please stop me.

It's important for me with regard to how Kentucky Power Company operates to keep its credit rating in the best condition that it can be and to—and the impact on the customer to be in a way in which is what's best for the customer. The Transco provides me an opportunity to separate the transmission build from generation and distribution.

And as a result of that, the financing is looked at in a more favorable way with regard to the debt/equity ratio. That is not currently burdened by the attachment of distribution and generation. And so as a result of that, it provides me a better way of financing that process that's better for me and better for the customer than it would be under the conditions that exist today. And so I am responsible for making sure that debt is handled properly.

MR. BORDERS: And though I don't mean to really be going this far at this point in time based on your testimony and so forth, but it almost seems like a parent company—we hear more of the concept of securitization, which has been around for several decades. It seems like we're hearing more about people talking about—it's almost like that—at some point in time you secure better rates because your transmission would stand good for itself. Therefore, you're almost going off and selling that as an entity when you're going out to the creditors, securing financing.

And I'm wondering why Kentucky Power wouldn't want to keep that aspect if it has that benefit. But if I hear you—in some fashion that apparently since Kentucky Power in your borrowing to get that obligation off your books, even though the parent company would still be liable, I'm trying to see where—why at the end of the day that AEP, of which Kentucky Power is a part of, benefits—why it is they're given a more attractable rate.

And I'm not sure I understand that, but maybe the other testimony may bring that out.

MR. PAULEY: Well, I can address that. With regard to capital spend, as we look out into the future, we see a number of things that impact the operating companies. You have NERC. You have environmental spend and all of that, and that's going to significantly impact not only Kentucky Power's balance sheet, but it's going to impact the other operating companies as well.

And each of us as operating companies have to look at ways in which we can utilize another tool, if you will, with regard to Transco to help us through this incredible capital spend that we're going to have that's really going to impact the generation and the distribution side.

By having a Transco involved, you get to separate that from an investment standpoint, and the impact on the customer through financing would be less than it would be if you are burdened with the distribution and the generation tied to that. And that's why we feel that moving into a Transco operation is really healthy not only for Kentucky Power Company but it's healthy for the customer.

MR. BORDERS: And I guess that's—and there again, not to belabor but this will be my last point here on this. But I guess my thinking was if indeed Transco is going to go out and borrow money and the creditor says okay, the only asset you're putting up are those new transmission lines, I can see how that would benefit Kentucky Power and AEP.

But still, I assume that for that debt obligation under Transco, that if all else fails, that they would go back to the parent company, and the parent company would be obligated to pay unless there's some caveat where in the loan agreement that the borrowing for the Transco—transmission lines would indeed stand good for themselves and they couldn't go back and ask—attach anything else as an asset?

MR. PAULEY: It's my understanding that when we utilize Kentucky Transco, it stands alone on its own, and they—we, in terms of the Transco, are responsible in and of itself.

MR. BORDERS: Now, if that's the case, then that helps me—

MR. PAULEY: Yeah.

MR. BORDERS: Thank you very much. I appreciate it.

MR. PAULEY: It's a stand-alone operation.

CHAIRMAN ARMSTRONG: I have one other question.

MR. PAULEY: Yes, sir?

CHAIRMAN ARMSTRONG: Are you familiar with MISO?

MR. PAULEY: Yes, sir.

CHAIRMAN ARMSTRONG: And their attempts to build [inaudible] interconnect?

MR. PAULEY: Not to the extent to provide you expert testimony on, sir.

CHAIRMAN ARMSTRONG: No, not that. But in general?

MR. PAULEY: Yes.

CHAIRMAN ARMSTRONG: Do you think that's possible?

MR. PAULEY: I think it has a number of hurdles to go through in order to accomplish that. I don't know whether it's possible or not.

CHAIRMAN ARMSTRONG: The fact of its questionable success leads you into making the decision to become a Transco?

MR. PAULEY: I think what leads us in the decision regarding Transco for us is the fact that we think it's a better way in which to provide the service we need to from a transmission perspective to Kentucky Power Company.

CHAIRMAN ARMSTRONG: Redirect?

MR. OVERSTREET: Thank you, Your Honor.

REDIRECT EXAMINATION

by Mr. Overstreet

Q Mr. Pauley, I want to touch briefly on the series of questions that Commissioner Borders was asking. Is it your understanding that Kentucky Power has—issues debt in its own name?

A Yes.

Q And that Kentucky Power's debt is not guaranteed by its parent company?

A That is correct.

Q And is Kentucky Power's debt rating based upon Kentucky Power's own financials?

A That is correct.

Q And not the financials of AEP?

A That is correct.

Q Okay.

Vice Chairman Gardner was asking you about Kentucky Power's certified territory. Do you remember that questioning?

A Yes, yes.

Q Is it your understanding, Mr. Pauley, that Kentucky Power has transmission assets outside its certified territory?

A Yes, sir.

Q And would the Hanging Rock/Jefferson Line be an example?

A An example. Yes, it would be.

Q Okay.

And is it also your understanding that the intent of Transco is to stand in the shoes of Kentucky Power vis-a-vis transmission?

A Yes.

Q So that Kentucky Transco would not build any project that Kentucky Power otherwise would not build?

A That is my understanding.

Q Okay.

And Mr. Raff inquired in his questioning about whether the idea for Transco originated in a phone call made by you or your predecessor, Mr. Mosher. Do you remember those questions?

A Yes, sir.

Q And does Kentucky Power do its financial planning in conjunction with and using the resources of its parent, American Electric Power?

A Yes, we do.

Q And whether the idea originated with Kentucky Power or with the persons in Columbus with whom it does its planning, do you think it's a good idea?

A Yes, I do.

Q Mr. Raff also asked you questions about the effect on Kentucky Power's access to Transco facilities if the common ownership of Kentucky Power and Transco somehow ended and that they in the future were not owned by the same parent. Do your remember that question?

A Yes.

Q Could Ms. Barton address that in more detail?

A I believe she could, yes.

Q Okay.

MR. OVERSTREET: That's all the questions I have.

CHAIRMAN ARMSTRONG: Verification—is Hanging Rock/Jefferson in Madison, Indiana, if you know?

MR. RAFF: I believe it connects—the western end connects there, yes.

CHAIRMAN ARMSTRONG: The [inaudible] power plant.

MR. OVERSTREET: It actually ends at Rockport if I'm—

MR. PAULEY: At the Rockport facility.

MR. RAFF: Well, the Hanging Rock goes to Madison, Indiana.

MR. OVERSTREET: Right.

MR. RAFF: I believe there's another line that connects—

MR. OVERSTREET: I'm sorry, you're right. Yes.

MR. RAFF: —Madison down to Rockport.

CHAIRMAN ARMSTRONG: So it's still out of the jurisdiction. Thank you.

MR. COOK: No questions, Your Honor.

MR. BOEHM: : No questions, Your Honor.

CHAIRMAN ARMSTRONG: Thank you, Mr. Pauley.

MR. OVERSTREET: Your Honor, Mr. Pauley has to travel to Paintsville for a meeting. Would it be okay if he were excused?

CHAIRMAN ARMSTRONG: And leave the lovely surroundings in Frankfort? I can't imagine it. Sure.

MR. PAULEY: Thank you, sir.

CHAIRMAN ARMSTRONG: Thanks for being here.

MR. OVERSTREET: Our next witness, Your Honor, is Jerald R. Boteler.

JERALD R. BOTELER, JR.

BEING FIRST DULY SWORN, TESTIFIES AS FOLLOWS:

CHAIRMAN ARMSTRONG: Speak up loud and clear, your name and what do you do?

MR. BOTELER: My name is Jerald R. Boteler, Junior. I work for American Electric Power Service Corporation in the Corporate Finance Group, where I am responsible for—title of Managing Director there in the Corporate Finance Group. I'm responsible for parent company financings, all transmission-related financings and non-regulated operating—or non-regulated asset financing activities.

MR. OVERSTREET: Your Honor, if I might, I just have a couple of questions for Mr. Boteler.

CHAIRMAN ARMSTRONG: Yes.

DIRECT EXAMINATION

by Mr. Overstreet

Q Mr. Boteler—and I apologize. Do you have any changes to your testimony?

A Yes. There's a change—there's been a change in my title since my testimony was filed. My current title is Managing Director of Corporate Finance.

Q Okay.

And with that exception, would your answers to your—set forth in your testimony and in the data responses to which you respond—data requests to which you responded, would they be the same today?

A Yes, they would.

Q Okay.

MR. OVERSTREET: That's all I have, Your Honor.

CHAIRMAN ARMSTRONG: For this witness?

MR. OVERSTREET: Yes.

CHAIRMAN ARMSTRONG: Mr. Cook?

MR. COOK: I have no questions, Your Honor.

MR. BOEHM: No questions, Your Honor.

CHAIRMAN ARMSTRONG: Mr. Raff?

MR. RAFF: Thank you.

CROSS EXAMINATION

by Mr. Raff

Q Good morning, Mr. Boteler.

A Good morning.

Q Is the transmission-only business viewed by investors as being less risky than the generation, transmission and distribution business on a combined basis is viewed by those investors?

A I'm not sure if it's viewed as less risky as—more accurately as just being a different pool of assets, and so when they look at it, it's a different type of asset from their view. Integrated assets first is just transmission-only. The same way they would look at generation-only assets as a different type of investment than an integrated asset.

Q Okay.

So you're saying—would you say then that investors would view generation-only assets as being—as having the same risk as generation, transmission and distribution assets have?

A Probably not. The answer—the reason for that answer is due to the characteristics around the asset. Generation regulation sometimes can be variable from jurisdiction to jurisdiction. There are various market forces that act on generation in a way that may make it more risky, fuel volatility, things like that, market conditions.

I think that—so generation is probably viewed as more risky. Transmission, on the other hand, as I said, is viewed as a regulated asset the same way an integrated asset would be viewed as a regulated asset. So it's going to come under a jurisdiction of a commission, whether state or federal.

And a transmission asset from an investor viewpoint is going to be looked at as there's a stable set of cash flows. I understand the business. It's one line of business as opposed to three lines of business. So from that viewpoint, they're going to look at it and say it's easier to understand, not necessarily less risky. It's just easier to understand than, say, what's going on on the D side, what's going on on the G side, what's going on on the T side. Now, let's put all that together and figure out what their—you know, what this looks like.

Q Okay.

So if—but you did acknowledge that generation is more risky than transmission and distribution?

A If it is out on its own, it's certainly more risky. If it's under a jurisdiction of a commission that's going to look at all of the aspects there and you're assured of fuel recovery and so forth, then the risk profile, you know, is going to be more in line with an integrated asset.

Q Okay.

But isn't there—even with the distribution business, haven't we seen a lot of utilities in the last couple of years because of the downturn in the economy then suffering through revenue shortfalls as a result of lost sales due to, you know, customers that have been cutting back in usage and, you know, commercial industrial customers that have actually been closing?

A I have to say it's not exactly an area of my expertise. Those facts that you mentioned or general assertions sound correct, but it's really not an area that I'm very qualified to speak to.

Q Well, are you qualified to speak to the risk that a utility faces?

A Yes, from a financial perspective.

Q Well, do you deal with Wall Street investors or investors in general?

A Yes, sir.

Q Okay.

If there's no lower risk for a pure transmission company versus an integrated utility such as Kentucky Power, then I assume there is no financial advantage by having transmission facilities owned and constructed by a pure transmission company rather than by Kentucky Power. Is that correct?

A I don't believe so, and I'll explain a little further.

Q Please do?

A One, there is a very small amount of transmission-only assets available for investors to invest in the debt of those entities, and I can't even list them all but it's literally kind of on the handful size. So it's an underserved asset class, and that certainly, if you look at supply and demand, is going to lead investors to have a strong demand for a relatively scarce asset at this point in time. And that's going to be a factor in lower rates for that type of debt investment over time.

But I think the key point is that transmission—a transmission-only business is looked at as a relatively simple business model. You look at it. It's a single asset as opposed to three. You don't have to figure out the synergies or lack of synergies between businesses. It's a fairly transparent regulatory framework. You've got FERC. You've got state regulation. It's fairly clear, you know, how that works. They don't have to understand, you know, the dynamics between increases or decreases in customer demand by a class and so forth to figure out what's going on as you do for, say, distribution.

So I think it is the clear asset model to look at from an investor standpoint, and that also leads to, I think, a relatively lower price, cost-to-capital for it.

Q I guess I always thought that lower price was a result of lower risk. Is that not true, or is that true?

A I think there are multiple factors that come into pricing of debt assets, one of which—and it's very important—is supply and demand of that particular asset. So supply and demand of an asset can drive pricing on an asset quite aside from the risk profile of that asset.

Q Okay.

Will the Transco be issuing its own equity?

A No, the equity will all be provided by the AEP parent company.

Q Okay.

A Or from the earnings of its own operations.

Q So there's no financial advantage on the equity side by having transmission facilities constructed and owned through a Transco versus Kentucky Power, is that true?

A Not as currently envisioned, no.

Q Okay.

And have you made an estimate of the advantage that a Transco will have on the debt side?

A We provided some testimony to that effect in my testimony, and if the Commissioners will indulge me, I'll kind of page to that part here so we can refer to it. It's not certain, absolute, but it's, we think, a reasonable estimate. Bear with me a moment while I find where we put this. I don't know whether we put it in testimony or whether we put it into a data request.

In general, what we did was we contrasted the cost of debt between a single A-rated utility and a triple B-rated utility. And by examining the cost of debt as reflected in a Moody's single A utility index with a Moody's investor service triple B-rated utility, we found that there was a distinct cost of debt advantage for the higher rated utility. I want to say on the order of somewhere around 32 basis points, is the number that comes to mind, and I apologize for not being able to find the exact point.

Q All right.

To the extent that there is a limited pool of pure transmission companies for investors to invest in, if they want to get into investing and transmission, they otherwise would have to invest in vertically integrated utilities, is that correct?

A If they want to invest in transmission-only assets, then they have to invest in transmission-only debt securities. Investing in integrated utilities security is not going to get them that same exposure. And in point of fact, I believe we submitted as part of my testimony a white paper that discusses relative advantages to investors of investing in transmission-related debt securities.

The point they make is that that transmission asset is easy to understand. It's relatively transparent from a regulatory standpoint. The method of operation is fairly straightforward. The other thing that is also true is that most debt investors already have large portfolios of integrated utility debt already. They have their capital allocations to that pool of securities.

What they don't have a very large allocation to is transmission-only securities because of the relative lack of them in the market. So providing them a new opportunity to invest in a transmission-only security should attract them to that asset class.

Q And is an advantage of the transmission-only asset the steady return that is provided by those assets, predictable and steady?

A I think it's a predictable business, and that is attractive to them. We did put something in my testimony—and this one I may actually be able to find—to that effect. And if you'll—you know, I beg your pardon for—basically an excerpt from the testimony here.

Transmission-only business will be a straightforward, transparent business, meaning that the investor should be able to easily understand and assess it for investment purposes. And that's key in the assessment of any investment opportunity, of course. Transparency comes from managing one type of asset as opposed to a portfolio of three different types, all with conflicting needs and business operations as opposed also to having multiple state or federal agencies oversee the integrated utility.

Because investors seek fixed income investments with those attributes, it provides a wider access to capital and another source of external funding for those assets, this being transmission assets.

Q Do you agree that those investors are looking for—I think what you said was the predictability of the earnings?

A I believe predictability of cash flows.

Q Cash flows?

A Yes.

Q And so then by having the transmission facilities owned and operated and constructed by the Transco rather than Kentucky Power, you are taking from Kentucky Power assets that would otherwise produce these predictable cash flows? You're taking them from Kentucky Power, putting them into another entity, correct?

A Well, not quite. Those investments have not been made by Kentucky Power. In order for Kentucky Power to build those transmission assets, Kentucky Power would have to come up to the capital—with the capital to make those investments, and that comes back to the real crux of why we're doing this. We're doing this to relieve cap expend pressure—our anticipated future cap expend pressure on Kentucky Power.

I know that—and I'm not an expert on what's going on at Kentucky Power from a future spend perspective, but I do know that it is anticipated that there will be heavy future capital spending at Kentucky Power. This is just a purpose-built financing solution to have some assets built in a different entity that will allow us to capitalize it separately and finance it separately in order to relieve Kentucky Power of that future spending pressure—or some of that future spending pressure.

Q Are these issues facing Kentucky Power any different than other vertically integrated utilities that rely almost exclusively on coal-fire generation?

A I think that certainly not being an expert on companies outside the AEP system, there are some companies out there who may not be coal-fired—primarily coal-fire generators that have large capital spending programs. Maybe they're building large gas plants, or maybe they've got to build lines for large wind facilities, say, in the middle of the country.

However, when it comes to AEP, this is—it is true that we face pressure from future environmental spend at a number of our subsidiaries—operating company subsidiaries. And in each of our states—and I believe Mr. Pauley mentioned states in the east. We are also having this same initiative to put Transco's in the states in the western part of our system.

So we already have an operating Transco in Oklahoma, where we're spending money. We are seeking to get a company in Arkansas and Louisiana for the same purpose for the exact same reasons that we have in the east, too much spend for the cash flow profile at those operating companies. And so trying to get that capital out of those companies, transmission is very readily identifiable and reasonably separable, assuming you have commission approval for that purpose.

And so we're able to identify those projects and have that spend occur in a Transco instead of the operating company and relieve the operating company of that future cap expend. But it also relieves them of the capital—the need to raise the capital to support the spend. It doesn't relieve AEP of that, but it does relieve the operating company of coming up with all the cash flow support for that spend.

Q Mr. Boteler, could you refer at page 5 of your direct testimony at line 9, I believe.

A Yes, sir. I have that.

Q Well, actually, it starts at 9 but line 16 through 19.

A Yes, sir. I have that.

Q And there is a similar statement in the application at paragraph number 20 on page 9 and similar in the sense that it refers to the limited funding available within Kentucky Power.

Can you explain how and why the funding level within Kentucky Power is limited?

A Yes, sir. Kentucky Power has a smaller asset base than some of the operating companies, and depending on—each operating company has its own spending profile based on the types of assets it has and the age of those assets and whether or not they've already done environmental spend, et cetera.

Kentucky Power over time—and I think, you know, we have a recent rate case that I think both sides are reasonably satisfied with the results—and it's able to earn its return in the latest calendar year that's been completed. But in past/previous years to that, it's been hard for Kentucky Power to earn its allowed return. If you don't earn your allowed return, you end up having lower cash flows available to support your business.

Since we do believe that Kentucky Power will have a heavy future cap expend, we feel it's better—it's best to be proactive in preparing a solution that will help us mitigate some of that exposure as much as possible. And so as a result, when we look at that—if you have a heavy capital spend, you go into negative free cash flow. Negative free cash flow is an undesirable situation when you look at rating agencies and their evaluations of the company.

And I believe that in my testimony I've submitted was some concern or indicated from Moody's investors in particular about what would happen to the future cash flow at Kentucky Power if they were to, you know, experience prolonged periods of higher spending and, as a result, negative free cash flow.

So again, the solution that we've come up—and we are applying this to operating companies across the AEP system, is to come up with a separate, wholly owned Transco or transmission company—we call them Transco's—in each of the states in order to lay off some of the future capital spend into those companies.

And then in the case of Kentucky Power, they would not be burdened with that future spend.

Q Well, to the extent that future spending is needed for environmental facilities, there is an environmental surcharge statute here in Kentucky, is that not true? Are you aware of that?

A I believe that is true, but I actually don't know much about that aspect of Kentucky Power, the ratemaking.

Q Are you not aware that Kentucky Power is entitled to—if the Commission approves the environmental facilities, that Kentucky Power is entitled to on a monthly basis charge its customers for the cost of the facilities during construction, as well as to recover a return on its capital investment?

A Again, I'm really not very familiar with the environmental rider. I know that there is one. I'm not—I'm really not familiar at all with its mechanics. I apologize for that, but I'm just not. I would ask, though, whether—I guess, from our perspective—you know, we charge the cost of capital whatever monthly and recover that on that environmental rider depending on whether it's AFUDC or a cash CWIP recovery, and I don't know which it is, of course.

But AFUDC would be very negative for cash flow in spite—it may earn a return, but it's a deferred return from a cash perspective.

Q Do you know whether Kentucky Power has ever requested a cash return on CWIP?

A I do not. I would maybe defer that question to Mr. Wohnhas.

Q Okay.

With regards to your statement that prior to the most recent rate case Kentucky Power was under earning on its return, would it be fair to say that that existed for a number of years prior to the most recent rate case?

A Yes, sir, I believe that's so. And I believe that we've got an exhibit in one of the supplemental data requests that shows the ROEs across time, and those for Kentucky Power are well down in the single-digit percentage ROE range, which I'm pretty sure is below the allowed return.

Q And would that be a result of Kentucky Power not timely filing for rate relief?

A I really don't know.

Q Do you know who would know?

A I would say perhaps Mr. Wohnhas, but I honestly do not know. I would guess that maybe you should ask Mr. Wohnhas that question. I'm not sure if he's been in the position across that whole time.

Q Okay.

Well, do you know the history of Kentucky Power's filing of rate applications?

A I'm not familiar with it, no.

Q Okay.

Would it not be necessary for you to know why there was this under earning if you know that there was an under earning?

A Would it be necessary—let me make sure I understand your question. Are you saying would it not be necessary for me to know it for—

Q Well, I'm trying to understand why you know that there was an under earning but you don't know why there was an under earning?

A Oh. Let me address the first point. We submit—

Q And excuse me. Let me just say—it's partly because, you know, I don't know exactly what you do and what you're responsible for. So that's the purpose of, you know, the question.

A I'm not responsible for analyzing the regulatory recovery and the rate structure for any of the operating companies. So I don't have that expertise.

Q Okay.

A My expertise is in the financing of the capital structure for companies.

Q So you just take the numbers as they're given to you as to earnings?

A For what—I'm sorry. For what purpose? I'm not—I don't mean to be particularly [inaudible] here, but I don't quite understand your question.

Q Well, I guess—you know, if you looked at Kentucky Power's earnings and you said geez, these are below what they should be, you would not be expected to say to somebody, something needs to be done about those earnings, it appears that they need to file a rate case? Would that be within the scope of your job duties?

A No, it would not be.

Q Okay.

If the Commission turns down the request to create the Kentucky Transco and Kentucky Power is then responsible for constructing future transmission facilities, will AEP, the parent company, provide the necessary equity that is needed to fund those facilities?

MR. OVERSTREET: Your Honor, I probably need to object here. I don't know that the predicate to Mr. Raff's question is accurate. If the Commission were to deny the application of Transco to become a public utility, I believe as one of the Commissioners indicated—it might have been Vice Chair Gardner—that wouldn't prevent a Transco, which is an existing legal entity from undertaking the projects as a non-utility. And I just want to make sure that—

MR. RAFF: Okay. Thank you. I'll revise the question.

Q Mr. Boteler, let's assume that the Commission does not approve the creation of the Transco as a utility and further assume that all future transmission facilities needed by Kentucky Power are constructed by Kentucky Power, in that situation would the parent company, AEP, provide the equity necessary for Kentucky Power to maintain a proper capital structure in order to finance those transmission facilities?

A I believe that AEP would be—if they decided to provide that equity, they would be the one providing it. I think the question is whether or not AEP would feel like Kentucky Power could afford to build all of these facilities. The question would be one of looking at it and saying, you know, does the company provide enough cash flow to support all of this capital spend.

And again, we're not just talking about transmission spend because it's obvious that—it is anticipated that Kentucky Power will have very large future cap expends, and the solution—the Transco solution is designed to be proactive in facing that and helping to mitigate some of that spend.

But at the end of the day, all of our operating companies are evaluated on—are given allocations of capital to spend based on how well they perform in terms of cash flow and income produced from those operating companies. And so if a company were to, let's say, relatively underperform for whatever reason, the corporation would look at that as a factor in deciding how much capital to allocate to them.

So yes, AEP would be responsible for providing that equity capital. The question would be would they provide it at the same level, or would they just say look, the company is—no matter whether we provide it at the same capital structure it currently has or at a lower level and allow their capital structure to deteriorate slightly because of the returns from the business, that that is a decision that, you know, we'd have to make at that point in time.

And I think that's a decision that any business, utility or otherwise, will make in assessing when they make capital expenditures. They will look at how the business is performing, how it's anticipated to perform and what the profile looks like now and what it will look like in the future as they allocate capital to that business.

MR. RAFF: Could we have just one minute please?

Thank you, Mr. Boteler. We have no further questions.

CHAIRMAN ARMSTRONG: Questions?

MR. GARDNER: I have a couple of questions, sir. Just so I have a complete understanding, there is no equity issued by any company in the AEP system, other than the AEP corporation, is that right?

MR. BOTELER: That's correct. Now, there are certain preferred equity securities that were issued in the past at various operating companies, but there are no additional equity securities issued at any of the operating companies in the AEP system, other than [inaudible].

MR. GARDNER: So when you were talking about investors and what investors are looking for where they want to make direct investments in transmission, we're really talking about debt and not equity, is that correct?

MR. BOTELER: Yes, sir.

MR. GARDNER: Okay.

And is the entity that is going—well, are the individual Transco's going to be issuing debt, or is it going to be AEP Transmission or AEP Transmission Holding that will be issuing the debt?

MR. BOTELER: Initially, it will probably be AEP Transmission Company, which is their immediate parent, and then, I think, we anticipate that they'll probably file intercompany notes from that entity down to the various Transco's. And the reason—the rationale for that is just the size of the debt needed, the long-term debt needed, is kind of below the threshold of what you'd want to go out to the public market for.

MR. GARDNER: On an individual—

MR. BOTELER: On an individual basis. So that as those companies invest in transmission assets and grow their business, eventually they'll grow to a size where it makes sense to have a separate debt issuance at that transmission operating company level, that Transco operating company level. Likely that probably the larger entities will be the first ones to do that.

MR. GARDNER: Such as?

MR. BOTELER: Probably Ohio would be the first state that there would be enough spend. We're already spending quite a bit of money there, and then there's the others.

MR. GARDNER: So when you say large, you're talking about the amount of transmission that might be required within the territory of the operating Transco?

MR. BOTELER: Right.

MR. GARDNER: Not anything related to the number of customers in the Kentucky Power or its affiliates?

MR. BOTELER: No, sir. It's solely based on the amount of capital spend in each particular Transco.

MR. GARDNER: Okay.

Just so I understand, there are seven different entities that are—seven or six. One second, I'm sorry. There are seven different Transco operating entities, is that right?

MR. BOTELER: I believe that's correct.

MR. GARDNER: Okay.

What states does Southwestern—AEP Southwestern cover?

MR. BOTELER: Southwestern Transco, I believe, is Arkansas and Louisiana. I'm not sure if it's also anticipated being Texas or not, but we can—I think Ms. Barton can probably answer that a little better.

MR. GARDNER: Okay.

Well, let me ask it this way, and I can follow up with her. Do all the states that have subsidiary operating companies where [inaudible] they have also a Transco, or is there some state that is not going to have a Transco? Or do you know?

MR. BOTELER: In general, yes. Well, there's Indiana, Michigan. Transco covers both of those states. Ohio is Ohio only. Appalachian—West Virginia Transco for Virginia. Appalachian Transco for Virginia, and West Virginia Transco for West Virginia. Kentucky Transco for Kentucky, Southwest Transco for Arkansas and Louisiana.

MR. GARDNER: So it's really Texas?

MR. BOTELER: Texas is a little bit of a different animal. It has two RTOs. It's two RTOs on it, so there is a joint venture between AEP and MidAmerican Energy in Texas called Electric Transmission Texas or ETT for short, which had a substantial—huge maybe is a better word—transmission build-out program, close to $3 billion for that entity alone.

And that entity is separately capitalized as a joint venture between us and MidAm, separately capitalizing, has already made two debt issuances in its own name over the last couple of years—earlier this year and last year.

MR. GARDNER: Okay.

If the Commission turns down—let me ask it this way. Has there been discussion about what AEP would do if the Kentucky Commission turns down this application? In other words, has there been discussion that you all will go ahead and do merchant generation—excuse me, merchant transmission company without that? Or would you leave it in—a transmission within the Kentucky Power Company?

MR. BOTELER: Well, I don't believe there—I haven't been party to any discussion that discussed merchant transmission in Kentucky.

MR. GARDNER: Okay.

MR. BOTELER: Or actually anywhere else. I believe that we had referred to—when Mr. Pauley was on the stand that, you know, might have a non-utility transmission company, but I believe they would still have to come to you for approval of transmission lines.

MR. GARDNER: Okay.

So the answer is you haven't been involved in any discussion as to what approach AEP would take if this Commission or another commission turned down request to form Transco as a utility?

MR. BOTELER: No, I have not.

MR. GARDNER: Okay.

Were you involved in the retention—and I don't know if this is her right name—of Julie Cannell?

MR. BOTELER: No, not directly in the retention of her for the White Paper Study, I believe is what you're referring to.

MR. GARDNER: Okay.

Do you know her?

MR. BOTELER: I know her by reputation.

MR. GARDNER: Did you have discussions with her about her paper?

MR. BOTELER: No, I did not.

MR. GARDNER: Okay.

So your testimony, which incorporates what she said—you're just relying on her paper itself as opposed to conversations you had with her about her paper?

MR. BOTELER: Not exactly.

MR. GARDNER: Okay.

MR. BOTELER: I am relying on her paper and, of course, her background and reputation as a Wall Street utility equity analyst.

MR. GARDNER: Sure.

MR. BOTELER: But I've also had one-on-one discussions with a number of debt investors out there, companies such as Prudential Insurance, a number of banks because that falls under my job duties.

MR. GARDNER: I'm sorry. I didn't make my question clear, and I understand what you're saying, that she wasn't the only person that you relied on to make your decision.

I guess—let me ask it this way. Were you involved with the decision as to why she didn't present testimony or not in this case?

MR. BOTELER: No, I was not.

MR. GARDNER: Okay.

I was just curious because she ends up, in her [inaudible], she talks about how—what investors would do. And so you're relying on a report that she gives, and then she's relying on what investors give, say, in—you know, it's at least double hearsay. I realize we allow hearsay, and we don't adhere strictly to the rules of evidence.

But you know, she goes through a detail that there is a minority opinion, saying that the risk could increase—in her talking with investors, the risk could increase to Transco. And it's unfortunate that—excuse me, the risk could increase to Kentucky Power. There's a minority opinion, and it's a shame that we don't have the ability to ask her directly those questions. So that's all I have. Thank you.

MR. BORDERS: Good morning, Mr. Boteler.

MR. BOTELER: Good morning.

MR. BORDERS: Looking back at your testimony and just the fact that you were asked the purpose of your direct testimony, you said specifically you were testifying to the primary financial reasons behind the formation of Kentucky Transco. And so hopefully, my questions will lend themselves to that. Even though it may feel like they are not going that direction, that's my intent.

Are you familiar with the application filed in this case?

MR. BOTELER: Yes, sir.

MR. BORDERS: On page 2 of that application, it actually refers to the fact that Transco will not provide retail transmission service directly to citizens within Kentucky. Now, so going back some to Mr. Raff's questions, talking about risk commensurate with generation and transmission and so forth, and you're looking at it from a financial standpoint of what the aspects of financing would be, I guess, for AEP as much as Kentucky Power?

MR. BOTELER: Yes, sir.

MR. BORDERS: And my reason for asking that is the testimony that Mr. Pauley was referencing was talking—going back and referencing some of the statements that have been made where there was some talk about Kentucky Power maybe being sold off and those type things.

Would it be advantageous, I guess my question is, for AEP, going through the Kentucky Transco aspect because if you did get yourself—did get to the point where you wanted to sell off Kentucky Power, that transmission aspect might be one that you would want to keep while selling off the other, especially going back to the application where it says that retail transmission service will not directly impact any consumer within Kentucky.

Would it make sense that—from a financial standpoint that AEP—one reason for doing these might not be so much—our gut role here is to look out for the consumer and make sure that it's fair, just and reasonable while the company can—obviously could reduce internal investment.

But could the benefit actually be more in this particular case for AEP than it would be for Kentucky Power and consumers of Kentucky Power?

MR. BOTELER: I don't believe so, Commissioner. As we said before, one of—this is a targeted solution designed to find a way to continue to spend money on transmission in spite of large cap ex requirements at a number of the operating companies.

So it's not just solely purposed designed for Kentucky obviously.

MR. BORDERS: Hold on. And the reason I ask that is because I can see if you ever had a desire to—or it would seem to me that if you ever had a desire to sell any of the entities, that having this transmission service that will not provide retail transmission service to consumers in Kentucky, that just the fact that it goes through Kentucky, would it not be possible that perhaps—let's say wind, for example—that this might enable wind to go from the west out to West Virginia, crossing through Kentucky.

And I guess my concern is is there a benefit to AEP for which there would not be a direct benefit to Kentucky Power, which would fall upon the Kentucky consumer because if the ultimate generation doesn't end up to Kentucky consumers but the transmission line [inaudible] Kentucky.

And so I'm looking from that—from a financial standpoint, is there financial potential gain for AEP here that may not be commensurate with Kentucky Power and the consumers of Kentucky?

MR. BOTELER: I'm not aware of any discussion along those lines at AEP. That is not the reason to my knowledge that we have pursued the Transco issue. I believe that Ms. Barton can probably address some of these issues, particularly your leading to wind going across Kentucky to West Virginia.

MR. BORDERS: Well, I'm just using that as a good example.

MR. BOTELER: Okay.

I think she can probably address a number of these issues better than I, but I can say without a doubt that I have been part of no discussion—and I haven't heard anybody talk about or characterize it in the way that you were proposing might have been discussed. That is not the reason for the formation of Transco, to be able to separate the transmission assets away and then sell the remainder at some point in the future. That is not at all what this is about.

MR. BORDERS: And a little earlier in your testimony, you alluded to some financing aspects, there'd maybe be a 32-point differential and so forth. And I don't know that we've ever seen a number on what the potential or hoped savings would be by having Transco. Do you save a half percent in financing? A percent? Or 20 points?

MR. BOTELER: Well, let me give a couple of examples. We really only have one pure play transmission entity that is issued debt. I alluded to it or mentioned it earlier with Commissioner Gardner. That is the ETT entity in Texas. They issued debt early last year in 2010. And the market was still a little unsettled, but this was the first new transmission-only debt in quite a while.

We were issuing, I think, $225 million of debt was the amount we issued. We got—we went out into the market and asked for quotes in an indicative range of 225-250 basis points over the 10-year Treasury. We got over $800 million worth of interest at levels below that.

I have to say in my career, I've never had people come back and say no, I don't want to borrow money at this high—I don't want to loan you money at this higher rate. I want to loan it to you at a lower rate. We actually had $800 million worth of interest at levels from 250 basis points over Treasuries down to 200 basis points over Treasuries.

And in fact, we ended up selling $225 million worth of debt across three different maturities, all flat at 200 basis points over Treasuries. That was even beyond our expectations. It was a better result than we expected. I will note that I believe last year—maybe it's in 2009—that Kentucky Power did a similar private placement of debt, and they issued debt. And the market was even more unsettled in '09 than it was in early 2010—at 360 basis points over Treasuries.

Not that there's a direct tie between those two issuances, but that's some indication that in times of market turmoil and whatever, they're going to look around and say where do I want to put my money? They like transmission. They are underinvested in transmission debt securities. So they obviously wanted to put a lot of money there.

This year in 2011, we issued again at ETT, and this time, we issued $350 million of private placement notes to the market. We didn't get quite as much interest this year as we got last year, but we did get pricing around 10-year Treasuries, plus 145 basis points.

So while spreads may have tightened in since last year to this year, it's clear that people are more comfortable with the transmission asset and were willing to invest at even better rates this year than last year. Now, next year, the rates may be higher. That's just the way—that's the way market trends go, good times and bad times.

But there's definitely very large interest in transmission-only debt. We are not the only entity. American Transmission Company issues regularly. They're an A-rated company with a capital structure somewhat similar to what we're proposing here. They issue debt on a—not a frequent basis but every year or so, and they get very good results.

International Transmission Company, ITC, has done a number of debt offerings at various levels in their capital structure, and they get attractive Treasury-based financing, long-term with rates that are quite attractive. So I think there is plenty of anecdotal evidence in the market, direct evidence, that investors like transmission-only debt securities and that they are very eager to invest in transmission-only—excuse me, transmission-only debt securities.

MR. BORDERS: And let me make sure I understand that. Transco, which currently exists but the application, [inaudible] today, is not affiliated with Kentucky Power per se. It's really an AEP entity?

MR. BOTELER: Yes, sir.

MR. BORDERS: And therefore, going back to Mr. Raff's line of questioning, if indeed there were less risks and if having transmission is an asset for a utility company, would it not be fair to say that this could do harm to Kentucky Power from a financial—from a borrowing standpoint that if transmission is seen as being more of an asset than the other aspects of the utility business, could this—while maybe opening up some opportunities in the short run, perhaps getting—saving those 32 points or what have you, that down the road it could be detrimental to Kentucky Power [inaudible]?

MR. BOTELER: Well, you know, obviously as Ms. Cannell said in her study, there was a minority opinion on that, that that could be the case. I think it's also important to note that the majority of opinions were on the other side in her study, direct—and as I believe—as I said, I wasn't involved in the hiring or the scoping of her study.

But I believe that, you know, the majority of opinions were that it was not a detriment to the incumbent utility. But I think our focus is more on literally—while that's support for the investor view, our focus has been on the targeted solution for the problems at the operating companies of large capital spend.

I mean, we have an unbelievably large, many billion dollars' worth of cap expend through the end of this decade that we are looking for ways to finance as efficiently as we can and efficiently being as low cost as possible.

By separating transmission spend for which we have a large amount of across the system into transmission-only entities, we believe we will get lower cost financing over the long run than what you will get at the operating companies. And if that happens, the ratepayers of Kentucky Power will benefit because all of our transmission costs are passed—allocated across the system. They will benefit because their costs will go down over time.

Now, again, I'm not an expert on the rate design, but if you finance your debt cheaper than an operating company, there will be savings to the customers.

MR. BORDERS: But when we look at all of these potential expenditures late—in the [inaudible] years, and as Mr. Raff again alluded to with the environmental surcharge and so forth, in a sense could it be argued that AEP's cherry picking?

In other words, they're taking the most advantageous part of the expenditures for them and maybe what could be most advantageous for Kentucky Power by not being able to pick and choose another $50 or 60 million expenditure by Kentucky Power [inaudible] transmission.

Is that being believed over and above—

MR. BOTELER: We are—yes, I'm sorry. We are talking about future expenditures, not current. We're not saying transfer large blocks of transmission assets from Kentucky Power to Kentucky Transco. So we're not asking for that. We're just asking for the ability to spend future transmission dollars in this Kentucky Transco entity.

As to the question of cherry picking, I don't believe we're cherry picking. If we could figure out a way to separate generation spending from Kentucky Power, for instance, and finance it more cheaply outside of Kentucky Power, we'd probably be talking to you about that. That's not what we're doing, and I think it would be hard pressed to get cheaper financing for it.

It's really about trying to look for ways—and this is the way we thought would be most effective—to relieve Kentucky Power of some of its future cap expend. And that's really all there is to it.

MR. BORDERS: Okay.

And this will be my last question, I believe. So you don't anticipate that AEP may be wanting to build these lines because here again, we didn't—no one here brought up the point of potential sales. That was articles of the past months and so forth. But you can envision where AEP may be wanting to put in place lines that would never, ever service anyone in Kentucky but for the ongoing future of AEP that they may want to take on these—that that might be the sole purpose of taking over the future transmission expenditures?

MR. BOTELER: Well, I don't believe that's the case, but I believe the question is probably better directed to Ms. Barton.

MR. BORDERS: Thank you very much. Appreciate it.

MR. BOTELER: She's responsible for the—you're welcome.

CHAIRMAN ARMSTRONG: You may ask on re-direct, but I have a couple of questions.

MR. OVERSTREET: Oh, surely.

CHAIRMAN ARMSTRONG: This business model intrigues me. You may not have this information at hand, but I would like to understand how this money pool operates among the various distribution companies that are within AEP's [inaudible].

MR. BOTELER: Commissioner, maybe you could explain—I want to make sure I understand the question and would be happy to come back and provide an answer. But when you say money pool, we have a money pool.

CHAIRMAN ARMSTRONG: I'll ask the question. You may not want to answer. Is Nick Akins the CEO of this company?

MR. BOTELER: [inaudible] the President of AEP Transco is? I think Ms. Barton probably has the answer for that. I'm not sure that Mr. Akins is or not.

CHAIRMAN ARMSTRONG: I'm trying to understand the organizational flow.

MR. BOTELER: I understand.

CHAIRMAN ARMSTRONG: Unfortunately, Mr. Pauley had to leave, or I'd have him back on the stand. But if he's going to be the President of this company, the buck's going to stop with him?

MR. BOTELER: Yes, sir. Well, the buck stops at the top, at the CEO and the Chairman of the Board of AEP.

CHAIRMAN ARMSTRONG: Let me try this again. Is Mr. Pauley the manager of the Transco?

MR. BOTELER: I do not believe so.

CHAIRMAN ARMSTRONG: Okay.

And who is?

MR. BOTELER: Well, the President of AEP Transco. And again, I think Ms. Barton can answer this exactly, and I apologize for not having that direct information. I'm not trying to avoid the question. I just—it's not an area that I've focused on.

CHAIRMAN ARMSTRONG: That's fine.

Redirect?

MR. OVERSTREET: Thank you, Mr. Chairman.

REDIRECT EXAMINATION

by Mr. Overstreet

Q Mr. Boteler, you were discussing with Mr. Raff the perceived financial advantages that a Transco would have—let me try that again. You were discussing with Mr. Raff the perceived financial advantages that a Transco would enjoy in issuing debt versus the issuance of that same debt by Kentucky Power Company.

Do you remember that discussion?

A Yes, sir.

Q Okay.

And you went through them. What I want to ask you is would the absence of Kentucky Power's legacy debt be one of those advantages that Transco would have?

A Yes, it would because Kentucky Power's capital structure is—the overall cost of capital is based on the cost of—the return on equity that's allowed by the Commission, as well as its existing debt portfolio.

Q And you and Mr. Raff and Commissioner Borders were discussing this notion of pulling transmission assets out of Kentucky Power, and I think the Commissioner even used the term cherry picking.

Do you remember that?

A Yes, I do.

Q Okay.

Is it true that the advantage that's perceived by the financial community of a stand-alone transmission company is driven at least in part by the fact that it's a single line of business?

A Yes, it is.

Q So that when those same transmission assets are mixed with distribution and generating as you have in the case of Kentucky Power, that advantage is not there?

A It's not readily apparent. I think you see debt securities of Kentucky Power and its mix of businesses, not Kentucky Transco and just transmission.

Q Thank you.

MR. OVERSTREET: That's all I have.

CHAIRMAN ARMSTRONG: I'll come back to the question that I had then. I know you don't know this. It's not in your field, but in your model, who decides where these lines will go?

MR. BOTELER: I believe Ms. Barton—that is part of her testimony, but where they go—of course, it's approved by the Commission at the end of the day. And I imagine they would propose those lines as part of the same process that they go through at Kentucky Power. But again, I believe Ms. Barton can probably address that when she's up here.

CHAIRMAN ARMSTRONG: Well, I think they would be regulated by FERC, wouldn't they?

MR. BOTELER: I believe it would be regulated by the FERC, yes, sir.

CHAIRMAN ARMSTRONG: So [inaudible] have any authority over that?

MR. BOTELER: I don't think it's any different now at Kentucky Power than it would be at Kentucky Transco [inaudible].

CHAIRMAN ARMSTRONG: Other questions, Mr. Raff?

MR. RAFF: Yes.

<u>RECROSS EXAMINATION</u>

by Mr. Raff

Q Mr. Boteler, can you tell me what consideration was given to establishing a Transco in Kentucky, but rather than having that Transco a subsidiary of an AEP at the parent level, having the Transco a subsidiary of Kentucky Power with that subsidiary then issuing its own debt and the equity would be invested by Kentucky Power through and from AEP as AEP will do for the Kentucky Transco as it is actually being proposed?

A I believe we looked at a number of alternatives for investing money in transmission on a stand-alone basis. I think that when we thought about it, dropping it down as a subsidiary of an existing operating company doesn't get you away from the problems at that operating company.

So whatever problems we anticipate or difficulties that we may anticipate Kentucky Power having in the future would still be there and would still affect the drop-down entity in the same way. So it doesn't really solve the problem of having too much capital spend at Kentucky Power.

Q I guess I'm not sure why that would be if the Transco is issuing its own debt. Wouldn't that debt be rated based upon the operations of the Transco and not its parent company?

A I believe you would have to clearly rainfence___ those assets in some fashion, and I can't say we didn't go any further with it because again, whatever issues are affecting Kentucky Power would still affect that entity below it because even though AEP might put the equity into Kentucky Power, Kentucky Power still is responsible on a legal basis for putting the equity down into a drop-down entity.

So whatever is going on at Kentucky Power is going to affect it. If Kentucky Power has a large capital spend in the future and comes under ratings pressure, the rating agencies will look at the entity above the drop-down and assess credit on that basis. And they're going to be tinted with whatever view they have of the parent company on that drop-down entity. That's just a way to look at it.

Q But that's then the same as it is now for the structure that is proposed here. To the extent that Kentucky Power has a large capital spending program due to meeting environmental requirements or similarly to the extent that Appalachian Power has those requirements, Indiana and Michigan has those requirements, to the extent that the generation in Ohio is unregulated and the market prices may not be what were envisioned some years ago, all of those problems flow up to AEP and the market would then look at AEP in determining how to rate the Transco's finances or its debt, is that correct?

A They would—yeah. And I would agree to some extent. The market will look at the entity above. That's definitely true, but when you look at AEP parent, you're looking at a portfolio of companies in different jurisdictions with different asset mixes at varying stages of where they are in their environmental compliance.

So while Indiana/Michigan has some large capital expenditures on the generation side coming and Ohio Power may have some, Appalachian Power doesn't have as many because their program for environmental is largely complete. There will be some more over there.

But that's the beauty and the strength of the system as a whole, is it is a blend across all of the operating companies. You have the Texas companies that don't have generation at all, so they're not going to be impacted by environmental rules coming out of the EPA to any significant extent at all. So there's some strength there to offset weakness in other places.

So the portfolio of companies that affect in determining AEP parent's credit rating is a strength, and I believe that that's stated in every rating agency report we get probably from all three rating agencies, although those are not attached as an exhibit here. So you do get some mitigation there. Whereas when you look at Kentucky Power on its own, you have one company and its set of problems—or its set of circumstances, excuse me. And that dominates and determines their view of that company.

I believe that there was some questioning by the Commissioner—Commissioners early about a parent company being liable for operating company debt, and I think this is a good point to kind of clarify this. I believe we got it clarified in cross, but AEP parent does not—is not liable for any of the debt of any of its operating companies.

And so issues at Kentucky Power—if things were to get bad enough there that we felt like it was not an investment in the best interest of AEP shareholders, then we would look at it that way and say, you know, Kentucky Power needs to stand on its own. And all of our operating companies are required to stand on their own two feet from a financial perspective.

So whatever is going on at Kentucky Power would be segregated from what would happen at Kentucky Transco but only if they were separate entities, not in the exact chain of ownership.

Q And isn't one of the advantages of being a regulated entity versus a non-regulated that if your financials start to drop, you can come into the regulatory agency and seek timely rate relief?

A Yes, that's true.

Q Okay.

MR. RAFF: Thank you. I have no other questions.

MR. GARDNER: One more question, and it has to do with the FERC incentive rate. What you've testified to shows that investors really want transmission and really to invest in it in the right—if it's set up properly. There's—I've read articles that are questioning the need for the FERC incentive rate on transmission at this point in time because of that, because there are people who are willing to invest in transmission assets.

How important is that incentive rate that FERC offers? And I guess second is would you all still be interested in doing this if there were no FERC incentive rate for transmission because I think it's a possibility?

MR. BOTELER: Well, my testimony doesn't address FERC incentive rates in any way. I think there's mention in the Cannell study that they like FERC regulation. I don't know that it necessarily references FERC incentive rates. Ms. Barton is an expert on this and I believe is our witness on this particular matter, and she'd be better placed to answer this.

MR. GARDNER: Okay.

Let me just ask you this one question then. Had you been involved in any discussion as to the—if the incentive rate is eliminated as to whether there's a need for Transco or not?

MR. BOTELER: Let me make sure I understand your question. You're saying have I been involved in the discussion that if there were no incentive rates would there be a need for Transco? I have not been involved in any discussion on that topic.

MR. GARDNER: Okay. Thank you.

MR. OVERSTREET: In complete candor, I should have asked this question the last time. I can delay it or I can ask it now.

CHAIRMAN ARMSTRONG: Go ahead.

MR. OVERSTREET: Okay.

REDIRECT EXAMINATION

by Mr. Overstreet

Q Mr. Boteler, Commissioner Borders was asking you about the purpose of Transco, and there was the discussion about perhaps it was a step along the way of spinning off Kentucky Power or spinning off the transmission assets or something like that.

And my question is twofold. First, is that a purpose of Transco?

A Not at all.

Q Secondly, does Kentucky Transco intend to build any project that Kentucky Power would not have built but for the existence of Transco, assuming financing were available?

A I do not believe so, but that's actually a question for Ms. Barton.

Q Okay.

MR. OVERSTREET: Thank you.

CHAIRMAN ARMSTRONG: Is this witness going to stay?

MR. OVERSTREET: This witness will be here.

CHAIRMAN ARMSTRONG: Okay.

You're excused.

MR. OVERSTREET: I'm sorry, Your Honor.

CHAIRMAN ARMSTRONG: Who is your next witness?

MR. OVERSTREET: We were just talking about that. Our next witness will be Lisa Barton.

CHAIRMAN ARMSTRONG: I think she will probably be a while. So if you'd like, we can break for lunch, to come back at 1 o'clock.

MR. OVERSTREET: That would be fine with us, but it's the Commission and the parties' and staff's convenience.

CHAIRMAN ARMSTRONG: This would be an appropriate time.

MR. OVERSTREET: All right. Thank you.

CHAIRMAN ARMSTRONG: We'll adjourn until 1 o'clock.

* * *

[OFF THE RECORD]

* * *

CHAIRMAN ARMSTRONG: We're back on the record.

LISA BARTON

BEING FIRST DULY SWORN, TESTIFIES AS FOLLOWS:

CHAIRMAN ARMSTRONG: Speak up loud and clear. Your name and what do you do?

MS. BARTON: My name is Lisa Barton, and I'm Executive Vice President of Transmission for American Electric Power.

MR. OVERSTREET: Thank you, Mr. Chairman.

DIRECT EXAMINATION

by Mr. Overstreet

Q Ms. Barton, would you give your business address for the record please?

A 700 Morrison Boulevard, Gahanna.

Q Is that Gahanna, Ohio?

A Ohio.

Q Okay.

And did you file testimony and responses to data requests in this proceeding?

A Yes, I did.

Q And do you have any corrections or modifications to that testimony or those responses?

A Yes, I do. The first is my title, which is now Executive Vice President, and the second are my roles and responsibilities. So in my new role, I basically oversee all of transmission operations for the 11-state AEP region.

MR. OVERSTREET: Mr. Chairman, we had intended to call Ms. Barton last, but given the questions that the Commission has been asking and Mr. Raff has been asking, we thought it might be useful to have her on now. Mr. Wohnhas will follow her. In the event that you would have a follow-up question that Mr. Wohnhas couldn't answer, then we would be pleased to put Ms. Barton back on once you've finished with Mr. Wohnhas. She will be here for the duration is all I'm trying to say.

CHAIRMAN ARMSTRONG: Okay, fine.

Do you pass the witness?

MR. OVERSTREET: Pass the witness.

MR. COOK: We have no questions, Mr. Chairman.

MR. BOEHM: No questions.

CHAIRMAN ARMSTRONG: Mr. Raff?

MR. RAFF: Thank you.

CROSS EXAMINATION

by Mr. Raff

Q Good afternoon, Ms. Barton.

A Good afternoon.

Q Let me hand you an exhibit that—six pages, and it has some of the Kentucky statutes on it. As I understand it, you are an engineer, and you also have a law degree?

A Yes.

Q And in your work up at—was it Northeast Utilities prior to coming to AEP—one of your areas of responsibility, rates/regulatory affairs?

A On the transmission side.

Q Okay.

A So that dealt mostly with RTOs and FERC.

Q Okay. Well, I got some questions. If you feel uncomfortable answering them, just speak up.

MR. RAFF: If we'd have this identified please, Staff Exhibit 1.

Q The first statute on page 278.042, paragraph number 2, jurisdiction of the Commission shall extend to all utilities in this state. Commission shall have exclusive jurisdiction over the regulation of rates and service of utilities. And I'll omit the rest because I don't think it's really relevant to our discussion here today.

And then I've also included below that from the Kentucky statutes the definition of rate and the definition of service, the two subjects that the prior statute says the Commission has exclusive jurisdiction over. Am I correct in my understanding that the rates and the service that will be provided by the Kentucky Transco will be under the exclusive jurisdiction of the Federal Energy Regulatory Commission?

A The rates of the Transco, much like the rates of Kentucky Power with respect to transmission assets, is under the jurisdiction of the Federal Energy Regulatory Commission.

Q Well, Kentucky Power currently has transmission assets in its rate base, does it not?

A It has—all of Kentucky Power's, just like all of AEP's, transmission assets are regulated by FERC. And it has an OATT, an Open Access Transmission Tariff that pertains to those facilities, as does the Transco. And in our recent settlement of the Transco rate, we made sure that that rate was the same. So for the east companies, that is 11.4 percent return.

Q But that's not the same return that the Kentucky Commission grants—or granted Kentucky Power in its last rate case on its investment, correct?

A Mr. Wohnhas can talk about how the interaction is between the FERC rate and the state retail rate, but for example, every industrial customer—and it was very important during that FERC proceeding because we had interveners from the industrial customers in the AEP East and AEP West system. They wanted to make sure—it was very important to them that those two rates are the same.

So in essence, the wholesale rate that is charged is the 11.4 percent rate from FERC, and it is exactly the same for the Transco, as it is for Kentucky Power. There is no difference.

Q But that rate and any terms or conditions of service are not under the jurisdiction—or will not be under the jurisdiction of the Kentucky Commission for the Kentucky Transco, is that correct?

A For the Kentucky Transco and for Kentucky Power. There's no difference. They're both under in essence the same rate, in essence the same. There are minor differences in the structure.

Q Well, isn't there a major difference in the rate because if this Kentucky Commission sets a different rate of return, then what the retail ratepayers of Kentucky Power actually pay is the return as set by the Kentucky Commission, not the return as set by FERC?

A Well, Mr. Wohnhas is going to talk about the specifics of exactly how that works in terms of revenue requirements and so forth. But it is—it's really—it's all FERC jurisdictional assets, and it's subject to the FERC OATT, regardless of who owns the assets.

Q So you're saying you don't know whether the retail ratepayers have to pay the rate of return as set by the FERC on transmission assets?

A The way that it works is—and again, Mr. Wohnhas will talk about the details of this, and he's more of an expert as to how it impacts at the retail level in

Kentucky. But from the federal wholesale—the rate that's under the tariff is exactly the same for the two companies.

And how it works is in essence, you have your revenue requirements associated with the facilities, and those are in essence running through the FERC formula rate and getting charged back through PJM. And we have—in Mr. Wohnhas' testimony, he goes through all of that.

What I—you characterized it is there a big difference between the two, and the Delta, which was explained and explained in a very conservative manner, as was stated in the testimony, is fairly small. And the most critical point here to mention is the fact that if Kentucky Power's—if their cost of debt changes, if their bond rating changes, that bond rating ends up impacting the—implies to everything that Kentucky Power is borrowing.

And so that results in millions of dollars a year in terms of additional costs, and that's what the whole Transco initiative was intended to solve.

Q What I'm trying to determine—and I realize Mr. Wohnhas can explain it.

A Uh-huh?

Q I'm trying to determine whether you know how the FERC transmission rate is passed through at a retail level?

A Mr. Wohnhas can give a much better and more accurate answer to your question.

Q So are you saying you do not know how that rate is passed through at the retail level?

A No, I did not. I said that Mr. Wohnhas can give a much more accurate description, and I really would prefer not to confuse the record.

Q Well, but you say that the transmission rate as currently set for Kentucky Power is the same as it would be—or I thought this is what you were saying—that it's the same as it would be if those facilities were owned by Kentucky Transco?

A All FERC assets, all FERC jurisdictional assets, so transmission assets that are owned by a utility, are subject to FERC's jurisdiction and therefore their ratemaking authority. It does not matter if it's the Transco, if it's the operating company. FERC has the jurisdiction with respect to the establishment of rates and how that passes through the PJM tariff.

Q But is there not a difference—

A It is going through the exact same way. It is going through the exact same way.

Q But is there not a difference in the ultimate revenue impact to Kentucky Power as to whether those assets are in its retail rate base or not in its retail rate base?

A There is a difference, and it was explained by Mr. Wohnhas in his testimony of applying one asset built by the Transco and one asset built by Kentucky Power. And he ran through exactly what that impact is, and so I will defer to Mr. Wohnhas with respect to explaining the differences in that calculation.

But I will say first and foremost what this entire initiative was about was to make sure that we were being very proactive when it came to the very large capital expenditures that Kentucky Power and its sister companies would be experiencing over the next 5 to 10 years.

And so that's what this entire initiative was designed to focus on that and to create in essence a vehicle to minimize that effect. So while there is a difference in that retail for a small portion, that is quite frankly miniscule compared to the harm that would be caused if Kentucky Power's bond rating was adversely impacted and then the cost of debt for Kentucky Power, not applied just to the Transco assets or even these incremental Transco assets but everything that Kentucky Power owns.

That's the ledge that this is trying to prevent from happening.

Q Was any consideration given by AEP in proposing this Transco structure to the fact that the returns on equity granted by FERC are typically higher than at least what has been traditionally granted here in Kentucky, as well as the fact that FERC grants incentives—I believe it's 50 basis points for being a member of an RTO? There's a potential for another 50 basis points if you're using an advance transmission construction methodology?

A Technology.

Q Technology, yeah. And I believe up to 150 basis points for what is called risks and challenges with investing for new transmission?

A The Kentucky Transco, just like all of the Transco's in AEP's footprint, was intended to be a very targeted solution. And what was done in essence is we took a look at what is the investment community looking for, and one of the things that we heard repeatedly is that they're looking for a greater level of transparency with respect to the utility industry.

AEP is a very large utility company. It is somewhat confusing from an investor's standpoint. What we looked at is what are the assets that AEP has? We are recognizing the fact that whether it be transmission or generation, we're under a lot of pressure on cap ex and pressure quite frankly that's now beyond our control. There are NERC requirements on the transmission side. There are PJM mandatory transmission builds on the transmission side. The EPA, as everyone here well knows, has had a tremendous impact on the environmental remediation that's needed with respect to the plants.

So in terms of why this was formed, it was formed simply to create a relief valve for these companies, and a relief valve—by looking at all of the companies and what is it that we can do in essence to—I guess I use the word aggregated. So we did consider, as was asked by one of the Commissioners earlier, to look at transferring all of the transmission in the various jurisdictions.

But when we were talking about that internally, we felt that that was something that probably would not be well received. And so we said okay, what's our real concern? Well, our real concern is the future spend. Our real concern is what's going to happen over the next couple of years, in that capital over the next couple of years.

So does that really mean we need to separate all the transmission, or is it that we're just going to create again that level or a vehicle to transfer—I shouldn't say transfer but basically to build these same assets, the same assets that Kentucky Power would have been building and all of the other affiliates would have been building in a new entity.

You asked the question with respect to, is it the returns? The returns are the same. So there's—and we were very concerned in that FERC filing, as were the industrial customers. And we were very pleased that we were able to get it so it was the same rate so that there would not be in essence talks or accusations of arbitrage.

What we did, as put forth in the testimony, we have a project selection guideline, and through that project selection guideline, our planners determined what's the need. It goes to a group that basically is looking at who should build. It doesn't meet the guidelines that are articulated in the testimony.

So in essence, if it's physically discernible and it's over half a million dollars in terms of assets, then it qualifies because we want to make sure that we're capitalizing and using everything that we've got today so that it's the same employees basically doing the exact same work. And so that the service company, Kentucky Power employees, the Ohio Power employees are basically doing all of this work that would have been done by the other entity if it had access to the capital that quite frankly it will not have access to on a going forward basis.

Would you like me to talk about the incentives a little bit?

Q No, I'd like to get back to this exhibit.

Kentucky Power provides bundled retail service to its customers, is that correct?

A Yes, it does, but the transmission—

Q I'm sorry.

A It provides bundled transmission service to its customers, and in that is the FERC OATT rate.

Q Okay.

It provides generation, transmission and distribution all at a bundled rate, correct?

A Mr. Wohnhas can talk exactly again, but I feel that you're getting to the exact same question. And I apologize if I'm not meeting your expectations, but the way the FERC rate works through that bundled rate is an expertise that Mr. Wohnhas has with respect to Kentucky. I can talk about it at the FERC level and at the wholesale level.

Q Well, let's go to the second page?

A Okay.

Q 278.160, paragraph 1. Under rules prescribed by the Commission, each utility shall file with the Commission, within such time and in such form as the Commission delegates [sic], schedules showing all rates and conditions for service established by it and collected or enforced.

Will the Kentucky Transco have any tariffs on file here at the Commission?

A The Kentucky Transco will abide by all the requirements that—the legal requirements associated with the State of Kentucky. The rate would be the FERC OATT rate, which would be charged to Kentucky Power. And to the extent that Kentucky Power passes those charges through, that goes to the retail level. To the extent that it does not, it doesn't.

MR. RAFF: Just a second please, Your Honor, if I may.

Q We'll come back to that.

So it's your testimony that you believe that there will be tariffs on file here, and they will be the FERC rate?

A If that is what the statute requires.

Q Okay.

Let's go to page 3, 278.260, the Commission shall have original jurisdiction over complaints as to rates or service of any utility. Will this Commission have any jurisdiction over complaints as to the rates and service of Kentucky Transco?

A Jurisdiction with respect to the rates of any transmission asset, whether it's owned by Kentucky Power or Transco, is subject to FERC jurisdiction and subject to what's called a 206 complaint at FERC. And it's exactly the same for Kentucky Power assets.

If there was a concern with respect to the rate that is charged by any PJM company, it has to go to FERC.

Q What about by any retail Kentucky Power customer?

A The Transco is not providing service at retail. It's providing service at wholesale. And Kentucky Power is providing both service at wholesale and service at retail.

Q Now, if a retail customer has a problem with the power being transmitted to that customer, they would file a complaint at this Commission regarding that transmission service. If the transmission line is owned by Kentucky Transco and they have a complaint with that transmission, they would file the complaint at FERC?

A No, FERC is just for rates. So—

Q So FERC doesn't have—

A The rate authority is at FERC. If there was a—if there was a transmission service complaint, that would be filed at the state level just as it would for Kentucky Power today. FERC does not have jurisdiction with respect to transmission—it's rates. Their primary authority is with respect to rates.

Q So the quality of service is still under the state commission jurisdiction for transmission?

A I believe it would be, but that's probably interpretation necessary by a Kentucky attorney.

MR. GARDNER: Can I follow up, Richard?

MR. RAFF: Sure.

MR. GARDNER: Just for a second.

So say I own a piece of property, and there is a—right now your all's 765 kv line goes over the property, and something happens to the—you know, the pole. I know it's not a pole but whatever you call it.

MS. BARTON: A pole.

MR. GARDNER: Okay.

And so that it's, you know, damaging my property, hits a barn or something that I own. Right now, who do I complain to? Who do I file a complaint with? Would it be Kentucky Power?

MS. BARTON: Kentucky Power owns that asset, yes, the existing 765 system.

MR. GARDNER: Okay.

MS. BARTON: If it was a new—

MR. GARDNER: New 765 that's built by Transco and I'm not a customer but I've got a complaint—

MS. BARTON: Right.

MR. GARDNER: Who do I file the complaint with?

MS. BARTON: It would be the Transco, whoever owns the asset.

MR. GARDNER: But do I file it with FERC, or do I file it with the Commission, my complaint?

MS. BARTON: I would—subject to check, I believe it's this Commission.

MR. GARDNER: I think that's—

MS. BARTON: Because if we're a public utility in this state, then we're subject to all of the requirements that Kentucky Power would be for the same asset.

MS. GARDNER: Okay.

I think that's what he's trying—

Q Yeah, that's what we're trying to determine here, of what—the extent to which a Transco would in fact be subject to this Commission's jurisdiction?

A To the extent that it's a public utility in the State of Kentucky, it would be subject to all of the rules and requirements associated with that status. It is with respect to the setting of rates, which is preempted under federal law. So that would be different from, say, maybe a merchant transmission facility.

So if Lisa, Inc. or if, you know, AEP was going a merchant facility, then those complaints would not, I would image, come to the Commission if it wasn't a public utility.

Q Okay.

Let's turn to page 4 please. Starts out with a couple of more definitions from the Kentucky statute, 278.010(23) defines regulated activity as a service provided by a utility or other person, the rates and charges of which are regulated by the Commission.

Now, the next one, subsection 22, nonregulated means that which is not subject to regulated [sic] by the Commission. And 21, nonregulated activities means provision of competitive retail gas or electric service or other products or services over which the Commission exerts no regulatory authority.

Now, would I be correct in assuming that Kentucky Transco's provision of transmission service would not come within the definition of regulated activity since the rates and charges are not regulated by this Commission?

A I would defer to Kentucky counsel on this. The service provided by a utility would lend one to think that it is a regulated activity. The rates and charges of which are regulated by the Commission is what I'm not sure about in terms of how this would actually be interpreted from a statutory standpoint.

Q Turn to the next page please, page 5. Statute 278.225 says all service supplied by a utility shall be billed within two years of the service.

Would this apply to the Kentucky Transco?

A To me, this looks like a retail provision, and the Kentucky Transco will sell—basically, that's part of the wholesale rate. So like right now—

Q So it would not apply—

A Even today with Kentucky Power, there are charges that are coming from other parts of the system that are basically being—that are billed to Kentucky Power. So even if it's a project—like a very large project like the trail project that Allegheny built, a part of that project is actually billed to Kentucky. That's how the PJM rate works.

Q But I guess the question is if Kentucky—would Kentucky Transco be bound by the terms of this statute to the extent that if it did not bill a customer within two years for service, that it could not then bill that customer for that service?

A I would again defer that to Kentucky counsel or FERC counsel.

Q Okay.

If you turn to the last page, page 6 please.

A Just a reminder that there would be no retail customers. So it's only wholesale customers. It's only utilities and the like who are being charged by the Kentucky Transco.

Q But have there not been instances where there's been areas of billing by a transmission company to its wholesale customers?

A That is typically governed by PJM's rules and regulations with respect to billing charges, is my understanding, at the wholesale level. PJM maintains all of that.

Q So to the extent that the Kentucky Transco is providing only wholesale service, it would be under the jurisdiction of the PJM tariffs, not the Kentucky statutes?

A I believe that's correct, subject to check by counsel.

Q Okay.

The last page 6, 278.130 says paragraph 1—subparagraph 1, for the purpose of maintaining the Commission, including the payment of salaries and all other expenses, the cost of regulation of the utilities subject to its jurisdiction, the Department of Revenue shall each year assess the utilities in proportion to their earnings or receipts derived from intrastate business in Kentucky for the preceding calendar year.

Will the Kentucky Transco have any intrastate business in Kentucky?

A Will have any intrastate business in Kentucky?

Q Intrastate business?

A I guess I'm not sure what you mean by that. Would it be subject to this provision, is that you're—

Q	Well, I'm assuming that it will be, but the provision says that the assessment is based upon each utility's intrastate business in Kentucky. So I'm trying to determine will Kentucky Transco have any intrastate business within Kentucky?

A	To the extent that there is anything that applies to rates for the Transco or Kentucky Power transmission facilities, it's under the jurisdiction of FERC and not under state jurisdiction. And that's just federal—but it's the same for Kentucky Power. So I think we're confusing things a little bit in the sense that if Kentucky Power's 765 system, 138 system, that is all regulated today under FERC and under that OATT.

And a very substantially similar OATT is also what the Transco is operating under, and all of that is FERC.

Q	All right.

Does Kentucky—

A	This probably applies to distribution, generation and so forth.

Q	Okay.

So Kentucky Power has distribution and generation so that it has intrastate business in Kentucky, correct?

A	I would have Mr. Wohnhas answer that question specific to Kentucky Power.

Q	Okay.

A	I don't want to speculate outside of transmission, which is my area of expertise.

Q	But would it be your understanding from your knowledge of the FERC tariffs and FERC's jurisdiction, as well as this statute, that the Kentucky Transco will not be paying any assessment to the Kentucky Commission for any business that it conducts as a result of its transmission facilities because none of those facilities result in intrastate business?

A I believe that to be correct. I cannot give a legal opinion with respect to this statute. That is taking—you know, I don't want to say out of context by me, but I'm just—having this one paragraph in front of me isn't going to give me enough information to draw the necessary legal conclusions to give you a more definitive answer.

Q Thank you.

There are in existence today at least a few companies who focus exclusively on owning and constructing transmission facilities, is that correct?

A Yes, there are.

Q And there are some vertically integrated utilities and utility holding companies that are also engaged in owning and building transmission facilities on a merchant basis, typically in locations outside of their traditional service territories, is that correct?

A There are companies that are engaged in merchant transmission.

Q Okay.

If the Commission finds sufficient justification for future transmission facilities that would have been owned by Kentucky Power to be owned by someone other than Kentucky Power, can you tell us why Kentucky Transco should have the exclusive right to own and operate those facilities rather than allowing non-affiliated companies to also either bid on those projects?

A We're not saying that Kentucky Transco would have the exclusive right to build transmission facilities in the State of Kentucky. We are asking that the Commission allow Kentucky Transco to sit in the shoes of Kentucky Power. You know, again, getting back to the fact that with these huge capital constraints, there needs to be some kind of relief in terms of can we have some assets that are built in essence by an AEP affiliate utilizing the same services, the same people that are in place today and preventing Kentucky Power from going down that slippery slope with respect to its bond rating and therefore the increased cost of debt and instability.

So with respect to—if Kentucky Transco exists here tomorrow by virtue of the Commission's desire, then it's not in—it's not necessarily exclusive. FERC Order 1000 and how that is ultimately implemented by PJM will probably result in changing the game there to some extent. It's a little premature to tell.

When we had capital constraints—we had significant capital constraints with respect to Texas. Texas is somewhat unique in that there wasn't the generation spend, but it was unprecedented transmission spend as Mr. Boteler had indicated. And so what was done in that case was to say, you know, what are our options because this is financially detrimental to the Texas operating companies.

And what was sought as a solution there was the development of a joint venture, in that case with MidAmerican Energies Holding Company. What we saw for the remaining operating companies was this huge environmental spend, and as Mr. Boteler indicated, it is a little difficult and tricky to separate out the generation. What is a little easier to do is to separate out the transmission.

And so what we looked for is what is that targeted solution to meet a targeted need. And that's why it's as limited as it is, as opposed to let's move all of the transmission, which is what First Energy had done. It is what some of the companies in Michigan had done, which is to basically transfer it to ITC.

Some companies have done some extreme measures like that. Again, we are trying to get a targeted solution and to sit there and take advantage of Kentucky Power with respect to transmission is fairly small. So it would be very difficult for it to access the debt markets and so forth.

But when you're combining that with Ohio Power, when you're combining that with Indiana/Michigan, now you've got that opportunity to access those debt markets and to off-load that capital spend and to make it a healthier financial environment for all of the operating companies and to do that under AEP Hold Co.

Q So are you saying then that if the Commission approves the establishment of the Kentucky Transco, that at some point in the future if a transmission line is needed to be built and it would fall within the scope of Kentucky Transco, the Commission can require that there be some kind of, I guess, a bidding process to determine whether it should be built by Kentucky Transco or should be built by some merchant—other merchant entity?

A Well, FERC Order 1000—and I know the question was asked earlier in terms of its implications. It has three areas that it touches on, and it's how is the system going to be planned? And what they said is that—and how it impacts PJM is—it probably impacts PJM a little more so than the other RTOs quite frankly.

So it basically says that you've got to plan the system a bit more holistically than you've been doing in the past. So you have to look at not only reliability, but you have to look at the economics. Are there customer savings and so forth associated with building this particular transmission project or group of projects and public policy initiatives.

What they have required is that each of the RTOs make a filing—that filing will take place next year around this time—as to how they're going to do that. How are they going to change their planning process to accommodate that. They also talked about the fact that—from a cost allocation standpoint. Who pays for it is also going to have to be addressed as part of that filing. Today, for example, 500 kv and above is regionalized across PJM. That may change as a result of that filing.

The last notion was with respect to competition and the right of first refusal. So utilities in essence have a—what FERC had indicated is that for any projects that are rebuilds in existing right-of-ways, you know, tearing down an existing station, all of those kinds of normal—that type of normal work is going to continue to be the obligation of the company. So in this case, say Kentucky Power, and we are asking for Kentucky Transco to sit in those shoes.

Now, it will be up to the RTOs to determine how in the states—how and if new facilities that are supported from a cost standpoint on a more regional basis. So for example, if you were to take that snapshot today, that would be a 500 kv line or a 765 kv line. And if it's something that's regionally supported, then PJM will need to develop a means by which transmission companies would be qualified.

It is then up to the Kentucky Commission, or any commission located within PJM, to determine what those requirements might be. They would have to do the same thing in terms of filing to get public utility status. So if the Commission moves forward with the Transco tomorrow, if three years from now they want to—or two years from now they want to change it so that anybody can come in, then the Commission can certainly do that.

But it will be all subject to how the PJM is filing, which we won't know what that says until some time next year. But what we're asking for is quite simply the Transco to stand in the shoes of Kentucky Power for all of its rights and its obligations with respect to transmission service.

Q And I guess my question is what consideration was given to having a non-affiliate stand in the shoes of Kentucky Power rather than the affiliated Kentucky Transco?

A So is your question did we consider just giving the projects away to others because that's, I think, what you're asking?

Q In essence, yes.

A We feel that—AEP is a very low-cost provider. We have benchmarked ourselves against pretty much the top 20 in the industry with respect to how much we spend per average on-line mile. We're the largest transmission company in the country. That means we can procure very competitive deals from our various vendors and so forth.

We want to continue to provide that low cost of service with our existing employee base and do it in the same manner that we would have for Kentucky Power but quite frankly to do it through a mechanism that's going to allow us to be able to make those investments. It's more of a financial—it's more of a financial mechanism than it is anything else.

Every single person—there are 1,600 people in the transmission organization within AEP. They will all be doing work the exact same way that they've done it in the past. For example, we have lots of equipment today that has—you can be a transmission substation with a distribution substation. We have to have records and inventory that says, you know, this is distribution and this is transmission for FERC Form 1 filing requirements.

We also have situations where we have—we've got different assets of, say, Duke or Allegheny, a transformer that's in our existing stations, and we treat all that separately. So when our folks are there working on a job, they know exactly what they're working on, and everything is going to the right financial bucket.

So we're utilizing all of those systems, and that's what those transmission project guidelines are really targeting to address. They're making sure that it's an asset that is, you know, from a financial standpoint we're having in the Transco, bigger than [inaudible] kind of thing. And it is physically discernible so that our folks 20 years form now can understand what it is that they're working on.

And I could give examples of what those are if that's helpful.

Q Well, I guess what you're saying is you did not consider having a non-affiliate stand in the shoes of Kentucky Power?

A Our preference is for Kentucky Power through the AEP system to be able to provide for Kentucky Power's needs and the needs of Kentucky Power's customers because we feel that we can do the best job at that. If this does not go through, then I don't know what options are on the table.

But at some point in time, you get to the point where you can't afford to do everything. And so then difficult decisions would therefore need to be made, and maybe at that point in time, it would be well—I mean, ITC builds at 12½ percent returns. And I know exactly our carrying costs compared to them because we have a very detailed analysis of that, particularly in SPP.

And we are extraordinarily competitive when you look at our carrying costs. You look at our carrying costs. You look at our procurement abilities, and you look at our technical abilities because we do much of this in-house instead of farming it out to more expensive consultants and so forth. So we can certainly provide the historic view over the past five years of what our cost-per-line-mile has been, our investment-per-line-mile has been as compared to other FERC Form 1 reporting companies. We can do it on O&M as well if that's of assistance.

Q Do you have the responses to the Commission Staff's first set of data requests there? Item number 2, paragraph A in the response?

A You said paragraph A in the response?

Q Paragraph A in the response, the last sentence.

A Okay. I must not be looking at the right one. The first set of data requests, item number 2, page 1 of 1?

Q Yes?

A Okay.

But it says—

Q Could you read that last sentence aloud please?

A If I'm reading from the correct one, it says no, please refer to response to AG's first set number 3.

Q No.

A So I'm thinking that we're looking at two—

Q Item 2, the first—

MR. GARDNER: It's dated March the 18^{th}?

MS. BARTON: Yes.

Q March 31—

A And it says item 2.

Q March 31?

MR. OVERSTREET: I apparently have the same one that Ms. Barton does.

Q It's got 25 items in total?

MR. OVERSTREET: Mr. Raff, may I come over and see what you're looking at?

MR. RAFF: Why sure. I'm sorry.

Q Filed on March 31, Kentucky Power's response to Commission Staff initial set of data requests? Hopefully, I'm in the right case. 2A?

MR. OVERSTREET: I'm sorry. I was looking at—I think we're both looking at the AG's—

MR. GARDNER: At the top of the page, Richard, does it state March 18^{th}?

MR. RAFF: In the upper right-hand corner, yes. Order dated March 18.

MR. OVERSTREET: Okay.

I'm sorry. We were looking at the AG's data requests.

A I'm just going to read the question.

Okay. You'd like me to read the last sentence?

Q The last sentence of A?

A Kentucky Transco—oh, I'm sorry. These wholesale customers constitute a portion of an indefinite public which has a legal right to demand and receive transmission service.

Q After all that, my question isn't really significant, but the question is, what's the basis of this legal right that you're referring to here to demand and receive transmission service?

A With respect to any, again, FERC jurisdictional transmission asset, FERC has rules with respect to the interconnection of new generators, the interconnection of new customers, the interconnection between one utility and another utility. Those are all interconnection agreements and all dictated again, just as they are today for Kentucky Power, by FERC. It's the same for the Transco. We have interconnection agreements, and we have to meet, for example—we have to provide timely response, all within the construct of the timetable that FERC has dictated for the entire country.

Q So it would be fair to say then this—the obligation to serve doesn't arise under any Kentucky requirement. It's the FERC requirement?

A The obligation to serve wholesale customers is exactly the same with respect to Kentucky Power today. It's all subject to FERC, just as it is with the Transco. There's no difference. I mean, wholesale customers are usually utility companies or extraordinarily large industrial customers, the Alcoa's, that kind of load.

MR. GARDNER: I think he's asking, does that legal right that you refer to in that last sentence arise from FERC rules?

MS. BARTON: Yes.

MR. GARDNER: Okay.

Q And if we could refer for a moment to the—Kentucky Power's response to what is labeled Commission Staff's September 13, 2011 informal conference data request, and it was filed here on September 23, and it has six items in it.

A I don't have it. [given document] Thank you.

I'm sorry. So where?

Q In item number 1, the question was does Kentucky Transco intend to file any tariffs with the PSC, and the answer because it will not be providing retail service in the Commonwealth, Kentucky Transco does not intend on filing any tariffs with the PSC. Do you believe that to be accurate?

A Yes.

Q Okay.

A All of the FERC rates are a matter of public record also.

MR. RAFF: Thank you, Ms. Barton. I have no further questions.

MS. BARTON: You're welcome.

CHAIRMAN ARMSTRONG: I asked the question of Mr. Pauley this morning. He said you were the expert on this. Does Kentucky Power sell all of its generation to PJM?

MS. BARTON: On the generation, I believe that to be the case. I'm the transmission expert. I apologize on the generation side. Transmission is functionally separated from generation.

CHAIRMAN ARMSTRONG: I thought he said.

MS. BARTON: I believe that to be the case, and that is what he said.

CHAIRMAN ARMSTRONG: So you don't know?

MS. BARTON: I don't know for—no.

CHAIRMAN ARMSTRONG: Okay.

MR. OVERSTREET: Mr. Chairman, would you like us to get—provide the Commission with a—

CHAIRMAN ARMSTRONG: Would you?

MR. OVERSTREET: —a definitive written response to that question? We'd be pleased to do that. I apologize that we couldn't do it in the hearing.

CHAIRMAN ARMSTRONG: Thank you, sir.

MR. GARDNER: Let me ask Mr. Raff a question. Are you going to ask Mr. Wohnhas the same questions off Commission Exhibit Number 1 that Ms. Barton—

MR. RAFF: Probably a couple of them.

MR. GARDNER: Okay.

Because if you don't, I'm going to want answers to that if they can't answer them today, and I'm just saying that I'm going to need answers to those questions. Okay.

Ms. Barton, how does FERC determine what is—what constitutes transmission that comes within their jurisdiction?

MS. BARTON: Basically, how it is in the eastern part of the system, it was a case held long ago through—they call it a seven-prong analysis in terms of are a majority of the facilities there to serve wholesale loads and so forth. And then it dictates it by voltage class.

So that answer basically changes sometimes with utilities. It is 34½ kv in the eastern part of PJM.

MR. GARDNER: Only 34½?

MS. BARTON: 34½ in op—sorry.

MR. GARDNER: Right, right. Okay.

So it's not necessarily a bright line, but it's almost like a presumption at 34½ [inaudible] jurisdiction of transmission and below 34½, it's considered distribution for FERC purposes, but there are certain—one can present factual evidence that would make that different?

MS. BARTON: It's pretty much a bright line.

MR. GARDNER: Okay.

MS. BARTON: Is how it's applied. And so the transformers between the two—between the 34½ and the lower voltage are distribution—they're classified as distribution.

MR. GARDNER: Okay.

So right now, if Kentucky Power ops or decides—well, in fact, let me be more specific. Kentucky Power is proposing to build 138 kv line between Soft Shell and Bonnyman. So that would be a FERC jurisdictional transmission line subject—and then the return—first, is that correct?

MS. BARTON: Yes.

MR. GARDNER: Okay.

So and then the rate of return that Kentucky Power will receive on that will be determined by FERC and not this Commission?

MS. BARTON: Correct.

MR. GARDNER: Okay.

So and FERC has—have you all been to FERC yet on this?

MS. BARTON: Yes, for the Transco and for the operating companies.

MR. GARDNER: On this particular line?

MS. BARTON: Oh, you don't go on a per-line basis. So the citing is up to state citing authority.

MR. GARDNER: Correct.

MS. BARTON: And the rate is just one rate until it changes.

MR. GARDNER: Okay.

MS. BARTON: So until there's—

MR. GARDNER: So you have a—so right now, is it Kentucky Power gets the same rate on every transmission that it builds? Or is it AEP gets the same rate on any transmission that any of its service companies build?

MS. BARTON: It's an AEP rate because it's filed on behalf of all of the companies.

MR. GARDNER: Okay.

MS. BARTON: So whether it's in Ohio—it's the east companies. So the PJM—

MR. GARDNER: Okay.

MS. BARTON: —utilities all get the same rate, and it's the same as the Transco.

MR. GARDNER: Okay.

And what did you say that rate was?

MS. BARTON: 11-4.

MR. GARDNER: Okay.

And the—and that will be the same rate for Kentucky Transco unless AEP applies for a different higher rate?

MS. BARTON: Correct, correct.

MR. GARDNER: Does AEP have any current intentions of applying for a higher rate?

MS. BARTON: No, it does not.

MR. GARDNER: Okay.

Does that 11.4 include any of the incentives, as I understood Mr. Raff, that accounted for about 300 basis points in that 11.4?

MS. BARTON: It has—and it's 11.49. I apologize. It is—it has a half—it has 50 basis points associated with RTO participation, and that applies to the Transco and it applies to Kentucky. And it applies to everybody who—every utility company that is part of PJM.

MR. GARDNER: And is that the only—

MS. BARTON: There are no other incentives.

MR. GARDNER: Okay.

MS. BARTON: We have not—we have not filed for any transmission incentives outside of, I would say, extraordinary projects, very large projects such as large, 100-, 200-mile 765 projects like that.

MR. GARDNER: Okay.

MS. BARTON: Those are the only ones.

MR. GARDNER: Okay.

So what you're saying is the only incentive—as we sit here today, unless for whatever reason Kentucky Transco wants to build another 765 line someplace else—I mean, an additional line for whatever reason that there is no additional incentive rate that Kentucky Transco would receive above what Kentucky Power currently receives?

MS. BARTON: That's absolutely correct.

MR. GARDNER: Okay.

That's helpful to understand that. I may have another question, so if you want to ask somebody else—

CHAIRMAN ARMSTRONG: Questions?

MR. BORDERS: Yes.

Talking about FERC 1000, we know that's kind of a [inaudible] and so forth, and I'm going to ask this question to kind of back up and see if it's the same today and so forth.

Is it your understanding that like with this—any proposed line, which ever, if we go through Kentucky Power or not, that in working through PJM and the decisions made that this line is needed and will be built that, I believe, FERC 1000 uses some language like that the benefits or costs would have to be roughly commensurate, one with the other?

MS. BARTON: The cost commensurate with the benefits for it to qualify for regional cost allocation or whatever type of cost allocation methodology that they end up using. Yes, that's the language.

MR. BORDERS: And I guess my question would be under our case that we have before us today, if you were to build a line, you think through FERC, through the Public

Service Commission of Kentucky or both, either/or, that criteria has to be met that any cost would have to be at least roughly commensurate with the benefit received by the consumer in Kentucky for the cost associated with Kentucky?

MS. BARTON: Oh, yes, that's for—it's the same—that was the language that was there with the Seventh Circuit remand. And I believe actually something is coming out of FERC tomorrow.

MR. BORDERS: So would that alleviate any concerns that one might have that indeed Kentuckians might bear a cost for a line for which they would maybe not receive any benefit or anything close to the cost? You don't think that's possible?

MS. BARTON: You know, it's hard to speculate as to exactly what PJM will do, but I don't think it is, given what FERC Order 1000 has said and what the Seventh Circuit has said in terms of that there needs to be some type of analysis that's showing the benefit and that it is roughly commensurate.

MR. BORDERS: And do you believe that based on how the way FERC 1000 is going that [inaudible] PJM [inaudible] those adjacent RTOs and everything as well and determine what line might benefit Kentucky? It could be that you'd have to work with other entities?

MS. BARTON: Yes. And so the same type of review would need to take place for those, even if—so if you're saying that two RTOs next to each other are looking at a line, that same test would apply. What that test is is what we don't know.

MR. BORDERS: Thank you.

MS. BARTON: That will be part of that submittal by PJM.

MR. BORDERS: Thank you very much. Thank you, Mr. Chairman.

CHAIRMAN ARMSTRONG: I have a question, one question.

Can you point us to some jurisdiction that you have worked in as a transmission expert where AEP has tried to do the same thing here or is doing the same thing in that state?

MS. BARTON: The Transco's?

CHAIRMAN ARMSTRONG: Yes?

MS. BARTON: Yes. So we have one in place in—

CHAIRMAN ARMSTRONG: I know where they are.

MS. BARTON: Okay, sorry.

CHAIRMAN ARMSTRONG: Can you tell me if there is a model similar to Kentucky that we could look at to see how that works?

MS. BARTON: A model similar to Kentucky? Oh.

CHAIRMAN ARMSTRONG: Is West Virginia similar to this?

MS. BARTON: Yes. Oh, they're all the same. All of the AEP—

CHAIRMAN ARMSTRONG: Same laws?

MS. BARTON: Same laws? Each—what we've done—what we've done with respect to the Transco's is we took a look at—you know, we had the—I'll call it the high level solution in terms of what we're trying to do with the Transco, and then what we did is we looked at what does each jurisdiction require with respect to a filing.

And some do, some don't. Oklahoma, Michigan [inaudible]. Ohio did. Indiana did. I would say of the state statutes that I recall, probably Indiana was maybe the—you know, the closest.

CHAIRMAN ARMSTRONG: Thank you.

Redirect?

MR. OVERSTREET: No redirect, Your Honor.

RECROSS EXAMINATION

by Mr. Raff

Q Ms. Barton, I'm sort of confused. Does the FERC rate of return, 11.49, is that with the 50 basis points for the RTO membership?

A Yes, that includes it. So it would be 10.99 without it.

Q 10.99 plus?

A Uh-huh.

Q Okay. Thank you.

MR. GARDNER: Okay.

So what we—what Mr. Raff was earlier asking questions about was comparing what I as a Commissioner thought that I was giving a rate of return on the particular transmission assets as part of all the assets that Kentucky Power owned. What I heard you to say in response to his question is first, he needs to check with Mr. Wohnhas to make sure that that's correct.

But you thought that—or you stated that 11.49 is going to be the rate of return on that particular—on transmission assets currently within Kentucky Power's rate base?

A It is. And what happens—if you have, for example, a tracker, then 100 percent of the tracker or pass-through at the state level. Then 100 percent of that gets passed down to the retail level. Without that, whether it's built by Kentucky Power or whether it's built by Kentucky Transco, there is a portion of that to some extent that gets tracked.

MR. GARDNER: Okay.

And we can follow up with him on that, but let me—so then to make sure I'm clear about this, what you're saying is the FERC incentives are available whether they're in—it makes no difference whether it's in Transco or whether it's in Kentucky Power, the level of incentive.

So it is not accurate that you—your position is you're not creating this company as one additional reason to get the FERC incentive for transmission, is that correct?

MS. BARTON: Correct.

MR. GARDNER: Okay.

So when I was going to ask questions about would you be willing to forego FERC incentives in order to do this, that question doesn't make any sense in light of what you've just said about—that currently, Kentucky Power is getting some FERC incentives for its transmission assets?

MS. BARTON: Correct.

MR. GARDNER: Okay.

MS. BARTON: And how incentives work again in terms of—what FERC will do is they will look at a project's specific basis. So you know, FERC is—in my opinion, FERC is not very likely to give somebody, particularly like AEP and the size of AEP, incentives for, you know, rebuilding a 345 kv line or building a new 345. It would be for those exceptional projects, the ones that are coming with a higher risk. They're a higher—commitment path is a good example of that going through multiple states.

And a lot of those incentives include things like construction work in progress and things like that that are associated with the nature of a big, big, major project. This Transco is really intended to service Kentucky Power. It was not intended for it to be a major developer of 765 in the State of Kentucky. There probably won't be a lot of that in Kentucky.

MR. GARDNER: Okay. Thank you, ma'am.

MR. OVERSTREET: Nothing else.

CHAIRMAN ARMSTRONG: Thank you, ma'am. You're excused subject to recall.

Next witness:

MR. OVERSTREET: Your Honor, we'd call Ranie Wohnhas.

RANIE WOHNHAS

BEING FIRST DULY SWORN, TESTIFIES AS FOLLOWS:

CHAIRMAN ARMSTRONG: Speak up loud and clear.

MR. OVERSTREET: May I proceed?

CHAIRMAN ARMSTRONG: You may.

DIRECT EXAMINATION

by Mr. Overstreet

Q Mr. Wohnhas, please state your name and position with Kentucky Power Company?

A My name is Ranie Wohnhas. I'm Managing Director of Regulatory and Finance for Kentucky Power.

Q And what's your business address?

A 101A Enterprise Drive, Frankfort, Kentucky.

Q And Mr. Wohnhas, did you file testimony in this proceeding?

A Yes, I did.

Q And did you file responses to data requests in this proceeding?

A Yes, I did.

Q Do you have any changes to your testimony or responses to data requests?

A No, I do not.

Q And if you were asked those same questions here today, would your answers be the same?

A They would.

Q Okay.

MR. OVERSTREET: Pass the witness.

MR. COOK: I have no questions, Your Honor.

MR. BOEHM: No questions, Your Honor.

CHAIRMAN ARMSTRONG: Mr. Raff?

MR. RAFF: Thank you, Your Honor.

CROSS EXAMINATION

by Mr. Raff

Q Good afternoon, Mr. Wohnhas.

A Good afternoon.

Q To your knowledge, have you seen anything from the investment community or rating agencies that have indicated that the credit rating for Kentucky Power would be downgraded if the Kentucky Transco is not approved as requested in this case?

A I have not seen anything that stated that specifically. Witness Boteler would know better if there was something like that out there, but I am not aware of anything that specific.

Q Okay.

If you could refer to page 5 of your direct testimony please?

A Yes, sir.

Q Regarding line 13. Can you tell us—when you refer to non-investment grade utilities being required to pay higher interest costs on debt, how much higher do they have to pay compared to investment-grade utilities?

A My understanding—again, Witness Boteler would know better about those. As we say there, as discussed within his, I'm not—know for sure exactly what that basis points is, but he could be re-asked.

Q All right. Thank you.

Let's talk about retail revenue requirements. To the extent that Kentucky Power currently owns transmission facilities, and those facilities are included in a FERC-approved rate, open access transmission tariff, and that rate includes an 11.49 percent return on equity, am I correct that to the extent that Kentucky Power uses its own transmission facilities to provide retail service to its retail customers, that it has to charge itself that OATT based upon the megawatts used on its own transmission lines?

A If I understand your question, I mean, we do the PJM and the revenues and expenses [inaudible], we record at the level of the FERC return on equity initially, yes.

Q Okay.

So you charge yourself the FERC wholesale rate, but then you get a credit back for that revenue?

A For revenues, that is correct.

Q Okay.

So to the extent that you charge yourself the 11.49—the portion of the rate that has the 11.49 return on equity, you know, you pay that and you get the revenues back. But from the retail customer's perspective, what they are actually paying in their retail rate is the return on equity that is established by the Kentucky Commission on your rate base, which includes transmission facilities.

Is that correct?

A That is correct. If you were to look at my testimony on page 9, table 1, you see where just as an example, we use a plant investment, and then you see that we have a state return on equity level there of 10½ percent in this example, again showing—coming up with the revenue requirement.

And then if you were to go to the next page, page 11, and look at table 2, you see that we started that revenue requirement level. We then—the PJM OATT revenue and the PJM OATT expense are what we talked about previously that has the 11.49 percent in there to make those calculations.

But then you net that to come down to the total cost to retail customers if you look at column 1 of 3,120,000 in this example. So that—the retail customer is getting the 10½ percent on the rate base charged to them.

Q Okay.

So if in the future there were transmission projects that were to be built by Kentucky Power and those projects were to be included in wholesale rate with the 11.49 plus some incentives—additional incentives on top of that, the effect on the retail customers would be the same as we just discussed, that there would be a higher wholesale rate. You would charge yourself the higher rate. You would get back the higher revenue credit, and retail customers would be indifferent, correct?

A That is correct.

Q But if those transmission facilities to be built in the future were not owned and constructed by Kentucky Power but they were owned and constructed by Kentucky Transco and assuming an 11.49 return on equity and then assuming there were additional incentives, the retail ratepayers would not be indifferent because while you would be charged the FERC rate for the usage of the transmission facilities owned by Kentucky Transco, the revenue would not come back to Kentucky Power. It would go back to Kentucky Transco. Is that correct?

A That is correct. And if you'll look at table 2, just as an example, it shows—it contrasts exactly what you just described, that there is a difference. And that is all predicated on the idea of looking at a point in time, the differences in rates of return, capital structure that are currently in effect today.

If we look in the future, we don't know what those rates of returns, you know, could diminish between the state-regulated—in this case, between the Kentucky PSC and what is in with FERC. And those numbers could become much smaller as far as a difference between the two.

But in this case, yes, there is going to be more at a higher—to the retail customers on the front end using these calculations. But on the back end, as been expressed by my three predecessors of witnesses, is that even though up front the cost will be higher, all right, on the back end—and that back end is the idea that if we don't keep our credit rating at investment grade, if we're not able—and I'm talking about Kentucky Power Company. You know, the Transco is over there by itself now.

With the investment that we have to—will be required to make over the next 5 to 10 years EPA-wise and whatever you want to consider, if we're not able to keep our credit ratings at investment grade and they reduce and we start losing basis points, that is going to be much, much more expensive to our in-use customers than what we have here on the front end.

We're all very aware of what we just went through in the last rate case and this last past winter and the pressures that are on our retail customers, the very cold winter and the complaints that we got and with they're not able to pay and in the forums that the Commissioners yourselves sat and listened to the customers before we came up to a decision in that rate case.

We're very aware that on the front end that this is an increased cost. What we are really looking at, trying to look farther than just the short-term. We're looking to the long-term, a longer term and trying to come up with some type of mechanism that will assist us, assist the customers to try to decrease the total, overall cost that's going to be coming in the future. And this Transco is just a tool to hopefully proactively work towards doing that.

MR. RAFF: Could I have one minute please, Your Honor?

CHAIRMAN ARMSTRONG: Sure.

Q If you could refer for a moment to the response to the Staff's request at the informal conference of September 13, item number 3, page 2 of 2?

Part of the request—the second sentence of the request was why does Kentucky Transco believe a Transco option would become more advantageous for ratepayers. And in the last paragraph of page 2, you have a sentence that says finally, the investments made by Kentucky Transco will create jobs and tax base in the State of Kentucky with the great majority of the cost of those projects paid by others in PJM.

Would this statement be true for any investment that is made by Kentucky Power if there is not a Kentucky Transco?

A Yes, I believe it would.

Q Okay.

Do you have the exhibit that I was—

A No, I do not.

Q Let me give you a—

A I have one now.

Q Okay.

I've got some extras.

A I got it.

Q Okay.

And I believe it was your data response that indicated that you believe the Kentucky Transco would not be filing any tariffs at the Kentucky Commission, is that correct?

A That's correct.

Q Okay

And I guess that's your—is it your belief that this Commission will not have jurisdiction over the rates or the service of Kentucky Transco?

A Over the rates. They will have responsibility over the service. If we were to look at this current Bonnyman/Soft Shell line as an example, we currently have it filed under Kentucky Power transmission. And so it—or Kentucky Power. And so we are going through the process of the idea of whether it's the prudent thing by the Commission for us to continue on with this project.

If we had Kentucky Transco today and we were to have filed under Kentucky Transco for the Bonnyman/Soft Shell, we would be in the same position today, asking the Commission to approve building that 20-mile line. That goes—so the idea is that whether it's for the—to build the line or the service, the reliability of our transmission line, it would still be under the—in our opinion, under the edict of the Public Service Commission of Kentucky.

Q Okay.

Let's assume there is a merchant plant that is located or wants to locate in Pikeville and it wants to get transmission service from Kentucky Transco and it is unable to negotiate what it believes to be the appropriate terms for that service, would that merchant plant come to this Commission to file a complaint regarding that service?

A I believe all of that would be at the FERC level. A merchant plant, number one, would have to get its—through the PJM all of the approvals and authorities to be that. And if they could not connect, that would be a FERC jurisdiction.

Q Okay.

So I guess I'm struggling with understanding the extent to which this Commission would have jurisdiction over the service of Kentucky Transco? I mean, you know now if one of your retail customers has a complaint about service, they file that complaint—if they choose to, they could file it here with this Commission?

A That is correct.

Q But if your—if a wholesale customer of the Kentucky Transco has a complaint about transmission service, that complaint would be filed at PJM?

A Well, in your previous question, you talked about just interconnecting with them, not about, you know, service. So you know, I was addressing—and again—

Q Okay.

A Witness Boteler can look at that more—could respond to that closely as to what happened in trying to make that interconnection. But now if you're asking after there is a connection, you know, that we are providing wholesale transmission service to a plant or to a wholesale customer, then it's my opinion that if there was an issue around the service, the reliability of that service, that it would come to the Public Service Commission here in Kentucky.

I apologize if I mis—

Q That's okay. I assumed that interconnection was part of service and that they would be treated the same, but maybe they're not. I don't know.

So then if Kentucky Transco were to build a transmission line within Kentucky Power's territory—let's just say, for example, from Pikeville to the West Virginia border and that line were then to connect to a line owned by Appalachian Power and there was a wholesale customer who was buying power in Virginia and that wholesale customer had a complaint that the customer felt that there was some problem with the service being provided on the portion of the Kentucky Transco's line that went between Pikeville and the West Virginia/Kentucky border, that wholesale customer would file a complaint here at the Kentucky Commission regarding that service?

A That's a good question. I don't have the—I'd have to think about that answer and respond after giving it more thought. When you were talking about intrastate—

Q Okay.

A I don't know.

Q And let me ask you about—do you believe that the Kentucky Transco would have intrastate business in Kentucky for the purpose of the application of KRS 278.130, which assesses utilities—and I'm looking at page 6 of that.

A Okay, thank you.

Q For the purpose of assessing utilities for the upkeep of the Commission.

A Okay.

Let me read this a moment.

Q Sure.

A If the Kentucky Transco is granted utility status, yes, I believe—you know, again subject to check, you know, from a legal standpoint that they would be subject to assessments.

Q And what do you believe would be their intrastate business? And if all of their transmission is charged at a FERC rate, I'm assuming that that means that it is intrastate in nature—I'm sorry, interstate in nature?

A I guess I'm not sure what you mean by their business. I mean—and don't take—I mean, it's selling electricity—you know, transmitting power. So I guess I'm not sure what—when you say what their business is.

Q Well, you know, that's the word that's used in the statute, but if you look at the paragraph below that, 278.140, it says to ascertain the amount of the assessment provided for in 278.130, each utility shall on or before March 31 of each year file with the Commission a report of its gross earnings or receipts derived from intrastate business for the preceding calendar year.

A I guess I would suggest at this time that, you know, that we respond to this—looking at this from a standpoint of looking at these two particular sections and what we feel that that would be if that would be appropriate.

Q Sure, that's fair.

MR. RAFF: Thank you, Mr. Wohnhas. I don't believe we have any more questions at this time.

MR. WOHNHAS: Thank you, sir.

CHAIRMAN ARMSTRONG: Questions?

MR. GARDNER: Yes, thank you.

MR. WOHNHAS: Do you need this back, sir?

MR. GARDNER: No, that's okay.

I think I now understand your table 1 and table 2. So let me try to repeat that to you because I didn't understand it when I read it. One of the things that—is that in table 2, you've got OATT revenue and OATT expense, and that benefits Kentucky Power customers because we have a small number of customers using power but—using transmission, but we've got those who are—you know, Kentucky Power has the large 765 kv?

Or if that's not accurate, then tell me why is there a big discrepancy there?

MR. WOHNHAS: Again, you've got to look at a couple of examples maybe that will help, you know. In what we talked about here—and we're talking about—

MR. GARDNER: I'm just—before you—I'm just right now looking at the difference between—for the way Kentucky Power is now in your table 2 between the PJM OATT revenue and the PJM OATT expense. I'm just looking at that, which ends up being a credit to Kentucky Power customers off their otherwise revenue requirement?

MR. WOHNHAS: And that's what I was going to say.

MR. GARDNER: I'm sorry.

MR. WOHNHAS: That's okay.

To the point that this illustrates a case where we are putting in a large investment, all right, and using 40 million as an example. You know, during the normal course of a year in our last rate case, it was actually reverse. The expenses were more than the revenues because we had not made any—in that test year, had not made any large transmission capital investments.

So it's a snapshot. You have to look at what point in time. And the illustration, just trying to show—when you look at 40 million and compare it to the 330 million, which is what the AEP system was doing Transco, that's a high percentage. The reality is that that's not going to happen that often in Kentucky.

MR. GARDNER: I see.

MR. WOHNHAS: So you know, in our last rate case, if you look at the adjustment that we made in there, it was reversed because we had no large investments in that year.

MR. GARDNER: So therefore, the customers [inaudible] were greater and it increased [inaudible].

MR. WOHNHAS: That's it exactly, sir.

MR. GARDNER: Okay.

MR. WOHNHAS: Yes, sir.

MR. GARDNER: That makes sense.

So what you're saying then is in that hypothetical—then now back to your table 2 and table 1 and actually table 3, kind of looking at it, what you're saying is initially with comparing the $40 million investment by Kentucky Power and the $40 million investment by Transco constitutes about on an annual basis $300,000 difference in revenue that would be owed by Kentucky Power customers.

What you're saying then is over time, that diminishes, and what you're also saying with your table 3 is immediately that diminishes if the Commission puts in a rider so that that cost is recovered immediately and that—again, in your example, 300,000 is reduced to about 20-something thousand? Is that correct?

MR. WOHNHAS: Yes. And can you remember that as a snapshot—

MR. GARDNER: Sure.

MR. WOHNHAS: —in time, and the difference is—if you go back to table 2 is really about the capital structure—

MR. GARDNER: Uh-huh.

MR. WOHNHAS: —and the differences between FERC and the PSC. And then in table 3 is if those costs are flowed through through a tracker type of mechanism, then the difference becomes less because there's no revenue credits being applied.

MR. GARDNER: Okay.

MR. WOHNHAS: And I guess I just would like to emphasize—I know I said it before—is that, you know, this is higher on the front end, and it really is us looking—trying to look down the road further to say is this a—is a Transco a mechanism from a financial standpoint—and that is our full, only intention is from a financial standpoint—to give us another tool to try to in any way that we can shorten or lessen the impact to the customer over time because, you know, there are a lot of large charges coming, and we're just trying to use, you know, every way that we can.

There is no big solution to what's coming down the road. If there was, we'd have all jumped on it by now. So we're trying to take every small bite that we can.

MR. GARDNER: Let me just see if I've got any others.

So your—tell me in the data requests which were the—that were filed to the informal conference and it's data request number 6, page 1 of 1, which is would the company be willing as part of a settlement to address Kentucky Transco's eligibility for future FERC incentives.

Now, tell me what that means because in listening to Ms. Barton's testimony, the FERC incentives are going to be identical whether it's in Kentucky Power or whether it's in Kentucky Transco. So tell me what you meant by your answer here and what you thought—tell me—

MR. WOHNHAS: In that informal conference, it was asked—there was the incentives, as Ms. Barton was talking about, that those that we asked on top of the basis points, the 50 basis points that we could request. And that is where—and the only place that we would have considered that we would be willing to discuss—

MR. GARDNER: Would be above the PJM 50?

MR. WOHNHAS: Above the 50, that is correct, would we be willing to discuss the possibility.

MR. GARDNER: Okay.

And then what I heard Ms. Barton say in her testimony—and I'm sure you heard her say that—is for most transmission, you all wouldn't be eligible for any more than that anyway?

MR. WOHNHAS: That is correct.

MR. GARDNER: So you wouldn't be giving up much?

MR. WOHNHAS: That is correct.

MR. GARDNER: Okay.

That's all I have. Thank you.

MR. OVERSTREET: No redirect, Mr. Chairman.

CHAIRMAN ARMSTRONG: Mr. Wohnhas, you're excused.

MR. WOHNHAS: Thank you.

MR. OVERSTREET: Your Honor, that concludes our witnesses. I believe we have two outstanding data requests. If we may have 10 business days as per standard practice to respond?

And I have not discussed this with Mr. Raff, Mr. Boehm or Mr. Cook, but I'm wondering whether it would be of any benefit to the Commission for us to brief this matter?

MR. COOK: Well, I was just discussing with Mr. Boehm. I don't believe the Attorney General will be filing a brief. So—

MR. BOEHM: We won't be filing a brief either.

CHAIRMAN ARMSTRONG: Mr. Raff?

MR. OVERSTREET: No, Mr. Raff will not.

MR. RAFF: I will not be filing a brief.

CHAIRMAN ARMSTRONG: You won't be?

MR. RAFF: But it might be in the company's interest if they want to address some of the legal—

MR. OVERSTREET: We would certainly like an opportunity maybe to—because information has come in in kind of a disparate fashion, and we could maybe help the Commission and the parties by pulling it together?

CHAIRMAN ARMSTRONG: That would be fine.

MR. OVERSTREET: 30 days?

CHAIRMAN ARMSTRONG: 30 days is fine.

MR. OVERSTREET: I haven't asked my client, but I guess it's okay.

Thank you.

CHAIRMAN ARMSTRONG: All matters coming before this issue have been discussed, and this hearing is adjourned.

* * *

[OFF THE RECORD]

* * *

CERTIFICATE

I, Teresa G. Lewis, Notary Public, Kentucky State at Large, typed the foregoing transcript of the October 19, 2011 hearing before the Public Service Commission of Kentucky in *In the Matter of: Application of AEP Kentucky Transmission Company, Inc. For A Certificate Of Public Convenience And Necessity To Operate As A Transmission Only Public Utility*, Case No. 2011-00042 from a DVD provided me by Mark R. Overstreet, counsel for the Applicant. The attached transcript is to the best of knowledge and ability a true, accurate and complete transcription of the proceedings appearing on the DVD, except where otherwise noted because of inaudibility.

My Commission Expires: July 8, 2015
Notary ID # 444451

Teresa G. Lewis

Teresa G. Lewis

COMMONWEALTH OF KENTUCKY)
)
COUNTY OF FRANKLIN)

The foregoing instrument was subscribed and sworn to before me this 18th day of November, 2011, by Teresa G. Lewis.

My commission expires:

1/21/2015

NOTARY PUBLIC

[SEAL]

<u>EXHIBIT 2</u>

ORIGINAL

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

VERIFIED JOINT PETITION OF AEP INDIANA MICHIGAN TRANSMISSION COMPANY, INC. ("IM TRANSCO") AND INDIANA MICHIGAN POWER COMPANY ("I&M"), BOTH INDIANA CORPORATIONS, FOR INDIANA UTILITY REGULATORY COMMISSION APPROVAL, TO THE EXTENT NECESSARY, OF IM TRANSCO'S STATUS AS A TRANSMISSION ONLY PUBLIC UTILITY; FOR AUTHORITY TO MAINTAIN IM TRANSCOS BOOKS AND RECORDS OUTSIDE THE STATE OF INDIANA; AND FOR THE COMMISSION'S CONSENT TO BOARDS OF COUNTY COMMISSIONERS FOR IM TRANSCO TO OCCUPY THE PUBLIC RIGHTS-OF-WAY PURSUANT TO IC 36-2-2-23.	)	CAUSE NO. 44000 APPROVED: NOV 02 2011

ORDER OF THE COMMISSION

Presiding Officers:
Kari A.E. Bennett, Commissioner
Loraine L. Seyfried, Chief Administrative Law Judge

On March 1, 2011, Joint Petitioners, AEP Indiana Michigan Transmission Company, Inc. ("IM Transco") and Indiana Michigan Power Company ("I&M" or "Company") filed their Joint Petition with the Indiana Utility Regulatory Commission ("Commission") initiating this matter. On March 1, 2011, IM Transco and I&M also filed their prepared testimony and exhibits constituting Joint Petitioners' case-in-chief. On April 5, 2011, the Commission issued a Prehearing Conference Order which, among other things, established a procedural schedule for this Cause. On May 20, 2011, IM Transco and I&M filed their prepared supplemental testimony and exhibit. In accordance with docket entries dated June 16 and July 19, 2011, Joint Petitioners and the Indiana Office of Utility Consumer Counselor ("OUCC") filed a Settlement Agreement on July 18, 2011 and supporting testimony on July 22, 2011.

Pursuant to notice given and published as required by law, proof of which was incorporated into the record of this Cause by reference and placed in the official files of the Commission, a public hearing was held on August 16, 2011 at 9:30 a.m. in Room 224, 101 West Washington Street, Indianapolis, Indiana. At the hearing, IM Transco, I&M and the OUCC appeared by counsel. The parties' evidence was admitted into evidence without objection. No members of the general public appeared.

The Commission, based upon the applicable law and the evidence of record, now finds as follows:

1. **Notice and Jurisdiction.** Proper notice of the public hearing in this Cause was published as provided by law. IM Transco plans to engage in providing electric transmission service and facilities and to own, operate, manage and control plant and equipment within Indiana for the transmission of electricity at wholesale. These activities fall within the plain language of the term "public utility" under Ind. Code § 8-1-2-1. I&M is engaged in rendering electric service in the State of Indiana and owns, operates, manages and controls plant and equipment within the State of Indiana that are used for the generation, transmission, delivery and furnishing of such service to the public. I&M provides electric service to approximately 457,000 customers within the State of Indiana. I&M is also a "public utility" as defined in Ind. Code § 8-1-2-1. IM Transco and I&M are each subject to the jurisdiction of this Commission in the manner and to the extent provided by the Public Service Commission Act, as amended. The Commission has jurisdiction over Joint Petitioners and the subject matter of this proceeding in the manner and to the extent provided by the law of the State of Indiana.

2. **Joint Petitioners' Characteristics.** IM Transco is a wholly-owned subsidiary of the American Electric Power Transmission Holding Company, LLC. ("AEPHoldco"), which is a wholly-owned subsidiary of American Electric Power Company, Inc. ("AEP"). IM Transco is a corporation organized and existing under the laws of the State of Indiana, with its principal office at 1 Riverside Plaza, Columbus, Ohio. I&M is a wholly owned subsidiary of AEP and a corporation organized and existing under the laws of the State of Indiana, with its principal office at One Summit Square, Fort Wayne, Indiana. Unlike I&M, IM Transco will not provide retail services to customers within Indiana. IM Transco's transmission service is subject to regulatory oversight by the Federal Energy Regulatory Commission ("FERC"). Specifically, PJM Interconnection, LLC ("PJM") will bill Load Serving Entities ("LSEs") within PJM, including the AEP companies, municipalities, electric cooperatives and other LSEs for IM Transco's transmission service based on FERC-approved tariffs.

3. **Relief Sought.** Joint Petitioners request Commission approval, to the extent necessary, of IM Transco's status as a transmission only public utility; authority to maintain IM Transco's books and records outside the State of Indiana; and for the Commission's consent to Boards of County Commissioners of all Indiana counties to grant IM Transco such licenses, permits or franchises as may be necessary for IM Transco to use county roads, highways or other property and public right-of-way for the provision of its services and facilities pursuant to Ind. Code § 36-2-2-23. Three affiliate agreements filed with the Commission pursuant to Ind. Code § 8-1-2-49 have also been presented in this Cause.

4. ***Joint Petitioners' Case-In-Chief.*** Mr. Paul Chodak III, President and Chief Operating Officer for I&M, discussed the major challenges facing I&M, including a substantial capital expenditure program for generation necessary to meet the needs of I&M's customers for affordable, reliable service and for environmental controls to comply with regulatory requirements of governmental agencies such as the U.S. Environmental Protection Agency ("EPA") and the North American Electric Reliability Corporation ("NERC"). He discussed I&M's concern that the impact of these challenges could cause a downgrade in the Company's debt ratings and subsequently a greater cost of debt. Mr. Chodak explained that these concerns caused the Company to look at financial solutions outside of its traditional way of doing

business. He explained why the formation of IM Transco, particularly in light of the financial challenges I&M is managing, would benefit I&M and its customers.

Ms. Lisa M. Barton, Senior Vice President Transmission Strategy and Business Development for American Electric Power Service Corporation ("AEPSC") and officer of several AEP affiliates, provided an overview of the AEP Transmission Company, LLC ("AEPTCo") corporate structure, discussed the business rationale and benefits associated with the creation of IM Transco, described various services to be provided by AEP affiliates to IM Transco, discussed the selection process for transmission projects to be owned by IM Transco, and discussed IM Transco's membership in PJM. Ms. Barton also discussed IM Transco's request to maintain its books and records in Columbus, Ohio.

Ms. Barton echoed Mr. Chodak's view that I&M is facing significant pressure to maintain its credit ratings at a time when capital spending needs are significant across all areas of the utility business and are projected to persist over the next decade. She stated the Company's transmission system is expected to require a sustained level of investment to meet customers' needs and NERC requirements, as well as PJM requirements. She explained that in addition to new transmission projects that are mandated or required for compliance, the existing transmission grid is aging and various improvements to, and replacements of, existing facilities will be required. She stated I&M's inability to make all reasonable improvements to the system when capital is tightly constrained can result in projects which are not of immediate necessity being deferred. She testified the operation of IM Transco will alleviate some of these capital constraints. In her view, the operation of IM Transco will have an indirect benefit on the reliability of the generation and distribution systems because the capital demands of mandated transmission projects may limit the amount of available capital for other needed investments by I&M, including generation and distribution projects.

Ms. Barton testified that as a company focused only on making transmission investments, IM Transco will be able to pursue certain transmission only projects in Indiana without being limited by the funding levels available within I&M. She added that this will provide long-term benefits to Indiana customers by relieving I&M of the burden of incurring debt and equity financing for those projects, and preserving debt issuance capacity for other needs.

Ms. Barton explained the process by which the AEP transmission system is planned and operated today, and elaborated on the types of transmission investments that will upgrade and improve the transmission grid, specifically as it relates to Indiana. Ms. Barton explained that Indiana's transmission system is unique with respect to its location because in addition to serving major load centers, it is at the crossroads of two major energy markets (i.e., PJM and Midwest ISO). Consequently, the reliability of Indiana's transmission grid is critical to the entire region and is also influenced to a greater extent by the frequent changes and variations that occur on the system. Ms. Barton testified that while demand has slowed somewhat with the recent economic downturn, overall load continues to increase. She stated there have been a number of new industrial and commercial customer requests for electric service from AEP's transmission system, which require new and upgraded transmission facilities, including new lines, substations, and meters. Ms. Barton explained that the Indiana transmission system will require significant replacements of transmission facilities in the future and discussed the impact that new generation, especially in the more remote areas of the state with high wind potential, has on the Indiana transmission system.

Ms. Barton also described the effect that wholesale power markets have on the transmission system in Indiana and explained that to address reliability and congestion concerns, the AEP Transmission Department ("AEPTransmission"), a business unit of AEPSC, forecasts investments in the transmission system in I&M's service territory will range from $100 to $150 million per year over the next ten years. She added that of this amount, 65% or more of the contemplated projects would likely qualify for IM Transco to develop under the AEPTCo Project Selection Guidelines ("PSG"). Ms. Barton testified that the PSG, provided as Exhibit LMB-1 to Joint Petitioners' Exhibit 2, will be used to determine which facilities will be developed by the AEP transmission companies and which will be developed by the AEP operating companies. She stated the PSG will be used by AEPTransmission personnel to designate projects and provide a clear physical demarcation between potential assets of the AEP transmission companies and assets of the AEP operating companies.

Ms. Barton discussed how the creation of IM Transco will affect the ownership and operation of the AEP transmission system in Indiana. She explained that IM Transco will develop, construct, own and operate certain new transmission facilities interconnected to existing transmission facilities owned by I&M, other AEP electric utility operating companies, other AEPTCo subsidiaries and unaffiliated third parties within the PJM footprint. As a result, much of the new transmission investment in Indiana will be owned by IM Transco instead of by I&M. She said that I&M will retain ownership of all transmission assets currently in service. However, Ms. Barton explained that should I&M propose in the future to pursue transferring any of its transmission assets to IM Transco, prior approvals will be sought from the appropriate regulatory agencies including the Commission, the Michigan Public Service Commission, and the FERC. She further stated there will be no change in the planning, operation and maintenance of the transmission system because the services provided to IM Transco will be through the same service providers and will be administered in the same manner that these services are being provided today. She also discussed the financial viability of IM Transco and explained that IM Transco will be able to rely on the managerial, technical, engineering, financial and transmission system expertise of I&M, AEPTransmission and AEPSC to ensure seamless operation of transmission services across both I&M and IM Transco.

Ms. Barton explained that the AEP transmission system will continue to be planned by AEPTransmission and PJM in a manner that is consistent with the approved regional planning processes in place today. She stated that AEPTransmission will participate on behalf of IM Transco in PJM's open, transparent planning processes, just as AEPTransmission does today on behalf of I&M, thus ensuring that AEP has a consistent voice within the PJM processes. Ms. Barton further explained that IM Transco will not have any advantages over any participant in the PJM planning processes, which ensures transparency and coordination through existing stakeholder processes.

Through her supplemental testimony Ms. Barton presented a Joint License Agreement between I&M and IM Transco, which provides a joint license to I&M and IM Transco to attach to or occupy the other party's facilities, equipment and real property for the purpose of maintaining and removing their respective facilities and equipment.

Mr. Jerald R. Boteler, Jr., Director, Corporate Finance of AEPSC, discussed the primary financial reasons behind the formation of IM Transco as a vehicle to make incremental additions to the existing transmission system. He elaborated on the need for I&M to work proactively to prevent a downgrade in its credit rating due to its significant capital needs and the resultant increase in debt costs to customers. Mr. Boteler opined that adverse impacts on I&M's financial condition and credit rating metrics could be avoided or mitigated if certain transmission system additions were instead constructed and financed through IM Transco. He testified that IM Transco will rely on AEPSC and AEPTransmission for operational, technical, managerial and financial resources. Mr. Boteler noted IM Transco's management of a single type of electrical asset, as opposed to operating three types of major electrical assets, will attract certain investors seeking fixed-income investments with these attributes. As a result, Mr. Boteler said that IM Transco will have wider access to capital for utility projects. Mr. Boteler concluded that over a period of time, AEPTCo should be able to develop a strong credit profile as it builds new transmission assets and places them into service. He added that by freeing I&M of the equity and debt capital raising burden, IM Transco will provide I&M with greater control of its annual expenditures, which in turn will enable I&M to better manage its credit ratios. Mr. Boteler stated the characteristics of IM Transco should help I&M obtain improved and broader access to debt capital over time, with any long-term financing benefits ultimately benefiting customers.

Mr. Rhoderick C. Griffin, Manager, Regulated Accounting, of AEPSC, discussed the services to be provided by I&M and AEPSC to IM Transco pursuant to the corresponding service agreements filed with the Commission. He explained the service agreements are modeled after those in the existing service agreement in effect between AEPSC and I&M. He explained that because the various services provided by and through AEP-affiliated service providers to IM Transco will be provided at cost and because services will be allocated on a cost-responsibility basis, IM Transco will receive cost-effective services under these arrangements on a basis that is fair and reasonable to the respective AEP-affiliated service providers. He opined each service agreement includes reasonable terms and conditions, does not give either party an undue advantage over the other party and does not adversely affect the public in Indiana. Mr. Griffin described the controls and oversight employed by AEPSC to ensure the proper accounting and billing of costs to affiliates, including (1) accounting system controls, which ensure that the accounting systems are operating correctly and that the mechanical processing is accurate; (2) management oversight, including review of the monthly AEPSC bill; and (3) audit and reporting oversight, which includes both internal and external audits performed on AEPSC, as well as state and regulatory reporting requirements.

Mr. Joshua D. Burkholder, Manager, Transmission Strategy and Business Development for AEPSC presented an illustrative pro forma analysis comparing Indiana retail jurisdictional cost of service for a transmission investment of $300 million under a Transco Build scenario versus an Operating Company Build scenario. He explained that his pro forma analysis calculates the Indiana jurisdictional cost of service resulting from a $300 million AEP Zone transmission investment, $60 million of which is assumed to be made in I&M's territory. He illustrated how the costs of the transmission investment flow to I&M and ultimately to the Indiana jurisdiction. Mr. Burkholder also explained the Network Integration Transmission

Service costs and billing of charges under the two scenarios modeled. He stated the difference between the two scenarios of $0.23 million in the Indiana jurisdiction is expected to diminish, or possibly reverse, over time. He added that the lower cost of debt will lower IM Transco's revenue requirement, which will be reflected in I&M's cost of service. More importantly, he stated, IM Transco can assist in alleviating some of the approaching financial pressures on I&M.

Mr. Scott M. Krawec, Director of Regulatory Services for I&M, discussed the distinct roles of I&M's participation within PJM and how these roles will be affected by the formation of IM Transco. Mr. Krawec testified I&M will continue to own transmission assets and will continue to recover its transmission costs in PJM in the same manner as it does today, but that ownership in future transmission investments was expected to change. However, Mr. Krawec stated he did not expect the charges I&M incurs for the provision of transmission service to retail customers to change significantly due to the formation of IM Transco. He explained that because I&M and IM Transco have similar FERC approved formula rates in the PJM Open Access Transmission Tariff ("OATT"), the incremental LSE charges to I&M for wholesale transmission service received from PJM will not be significantly different for new transmission investments regardless of whether I&M or IM Transco makes the investment.

Mr. Krawec also explained that transmission owners in PJM recover their transmission investment costs by submitting an annual revenue requirement to PJM based on their transmission investment costs in accordance with the PJM-OATT. He stated PJM then charges transmission users under the OATT to collect the revenue requirement. He added that revenues collected from transmission users are distributed by PJM to the transmission owners based on their individual OATT revenue requirement. Mr. Krawec stated IM Transco will follow the same steps to recover its transmission costs as would any other transmission owner in PJM.

Mr. Krawec testified because I&M is an LSE within PJM, I&M is charged for regional or "system" transmission costs based on I&M's usage of the transmission system. He explained the revenue requirement I&M presented in its most recent Indiana basic rate case, Cause No. 43306, was developed from a cost of service that included an Indiana jurisdictional share of costs and credits from I&M's traditional embedded cost of transmission. Additionally, as a result of the order in Cause No. 43306, I&M has a PJM Cost Rider that tracks the portion of the PJM-OATT transmission costs that are regional in nature, but does not track the costs that are zonal in nature, i.e., AEP Zone OATT transmission costs. He said that I&M plans to include in its next Indiana basic rate filing revenue requirement, the recovery of I&M's share of the remaining PJM-OATT transmission costs that are zonal in nature and are charged to I&M by PJM to serve I&M's Indiana retail load.

Mr. Krawec explained witness Burkholder's pro forma analysis shows that, under current conditions, the annual transmission costs are only slightly higher for the same investments if made by the transmission company rather than the operating company. He explained the difference would equate to an increase of less than $0.02 to a retail customer using 1000 kWh compared to the increase per month if the investment was made by the operating companies. He reiterated witness Boteler's view that there are reasons to believe this difference will diminish over time and possibly reverse.

5. **Settlement Agreement and Supporting Testimony.** The Settlement Agreement was entered into by all parties to this proceeding. The Settlement Agreement provides that it resolves all matters pending before the Commission in this Cause and is supported by substantial evidence.

A. **IM Transco.** Mr. Burkholder summarized the terms of the Settlement Agreement. He explained the Settlement Agreement provides for Commission approval of IM Transco's status as a transmission only public utility in Indiana, which includes the right to exercise the power of eminent domain. The Settlement Agreement further provides for the Commission to give its consent to Boards of County Commissioners of all Indiana counties to grant IM Transco such licenses, permits or franchises as may be necessary for IM Transco to occupy and use county roads, highways and other public rights-of-way for the provision of its services and facilities pursuant to Ind. Code § 36-2-2-23. He explained that to ensure the operations of IM Transco are transparent and accountable, the Settlement Agreement establishes an annual reporting requirement regarding a number of aspects of IM Transco's investments, operations and benefits. He stated this report will help the Commission and the OUCC ensure IM Transco delivers on its commitment that, from a system planning and operational standpoint, there will be no change in how things work today.

Mr. Burkholder explained the annual report required by the Settlement Agreement will include detailed information about IM Transco's completed, in progress and future planned projects, including, but not limited to, the description, purpose, key target dates and cost of each project. For projects that are in progress, the report will include information about the cost and estimated completion percentage to date. He also stated the report will include qualitative information about each project, including: if the project was assigned by PJM or identified by AEP; what other alternatives were considered in planning the project; the inclusion of any Smart Grid technologies in the project; and a description of the application of the PSG for the various project components of the transmission project.[1]

Mr. Burkholder testified the annual report will also include information regarding long term debt issuances by AEP Transco or any of the AEP Transco subsidiary companies, including IM Transco, made in the last calendar year, including information comparing the cost of debt and underlying spread versus the comparable U.S. Treasury bond to those of any issuance, within 30 days before or after the date of the Transco's issuance, by other vertically integrated utility companies within one credit rating level up or down of I&M, as defined by Moody's and S&P. He said this information will help the Commission and OUCC evaluate if IM Transco delivers the financing benefits described by witness Boteler in his direct testimony.

Mr. Burkholder stated the annual report will include charts showing for each of the subsidiary companies of AEPTCo, including IM Transco, the annual capital investment and

---

[1] Mr. Burkholder pointed out that Smart Grid technologies are primarily associated with the electric distribution system and this reporting requirement should not be interpreted as an indication that I&M or IM Transco plans widespread deployment of any Smart Grid technologies to the transmission system.

miles of transmission lines owned, by voltage level, and an analysis that compares the entire AEP transmission system total capital cost and operations and maintenance expense per line mile of transmission to a peer group. He said the report will also provide any changes in IM Transco's corporate structure, updates to the PSG, a description of the practices taken to provide for the lowest reasonable cost consistent with industry practices and operational requirements, including any competitive bidding practices, and a copy of the most recently available Independent Auditors' Report for IM Transco. Mr. Burkholder explained the report will be submitted to the Commission annually by July 1 and for a period of five (5) years following the date of a Final Order approving the Settlement Agreement. He stated IM Transco will provide the OUCC an opportunity to review the report prior to submitting it to the Commission.

Mr. Burkholder explained that to ensure the Commission has a complete view of the operations of AEP's transmission system in Indiana, IM Transco agrees it will file a petition to intervene in I&M's next general rate case and any other future I&M general rate case filed during a period of three (3) years following the date of a Final Order approving the Settlement Agreement. He added that if granted leave to intervene by the Commission, IM Transco will file testimony updating the Commission on the status of IM Transco's operations. Mr. Burkholder explained the Settlement Agreement also provides that I&M and IM Transco will provide the OUCC a copy of all affiliate agreements filed with the Commission. Further, I&M will not sell, lease or otherwise transfer its used and useful utility plant in service to IM Transco without first obtaining Commission approval. The Settlement Agreement also provides that IM Transco will likewise seek Commission approval before it transfers functional control of its transmission facilities to a regional transmission organization other than PJM or to an independent transmission company.

The Settlement Agreement provides that IM Transco's request to maintain its books and records out of state should be approved. Mr. Burkholder explained that IM Transco agrees to produce in Indiana, upon reasonable notice, duplicate copies of those portions of its books and records necessary for the OUCC and the Commission to perform their statutory duties. However, the Settlement Agreement also provides that to the extent it presents an undue burden on IM Transco to produce the books and records in Indiana, IM Transco commits to fully reimburse the OUCC and Commission for all travel expenses, including travel fare, mileage, lodging and meals, incurred while inspecting IM Transco's books and records outside of Indiana. He indicated these requirements are the same as those applicable to I&M and are also consistent with Commission practice.

Mr. Burkholder explained that to ensure accountability, the Settlement Agreement provides that IM Transco will reimburse the State of Indiana up to a total amount of $25,000 for travel expenses incurred by the OUCC or the Commission to participate in IM Transco proceedings before the FERC during the five (5) years from the date of a Final Order approving the Settlement Agreement. He explained that in a settlement entered into in a FERC proceeding, IM Transco agreed, among other things, that costs related to the formation of the transmission company organizations incurred after June 30, 2010 would not be included in FERC-regulated rates. He stated the FERC settlement also provided that AEP reserved the right to seek recovery of post-June 30, 2010 state-related formation costs from the applicable state regulatory commission. Mr. Burkholder explained that in the Settlement Agreement, I&M agreed to waive the right to seek recovery of post-June 30, 2010 formation costs associated with obtaining necessary state or local approvals from the Commission.

Mr. Burkholder requested the Commission find the Settlement Agreement to be reasonable and in the public interest and to approve the Settlement Agreement in its entirety, without modification.

B. I&M. Mr. Marc Lewis, I&M's Vice President External Relations, explained from I&M's perspective why approval of the Settlement Agreement is in the public interest. He reiterated witness Chodak's testimony that I&M faces financial challenges in undertaking a substantial capital expenditure program over the next several years to meet the needs of its customers for affordable, reliable electric service and to comply with regulations of state and federal agencies. Mr. Lewis testified the creation of IM Transco will allow I&M to spread needed transmission investments to an affiliate, lowering the overall cost to I&M's customers and protecting I&M's financial health. He stated that by decreasing the transmission capital burdens on I&M, the creation of IM Transco will allow more financial flexibility to make the necessary generation and distribution investments to maintain I&M's reliability and low costs. He stated his belief that Commission approval of the Settlement Agreement will provide benefits to I&M and its Indiana customers with little or no impact on retail rates. He noted the Settlement Agreement contains provisions recognizing the Commission's jurisdiction over IM Transco and I&M, and ensures the operations of IM Transco and I&M will remain transparent and accessible. He explained that as part of the Settlement Agreement, I&M agrees to meet with the OUCC and IM Transco to keep the OUCC informed regarding IM Transco's operations. Mr. Lewis stated the Settlement Agreement also provides that I&M will not sell, lease or otherwise transfer its used or useful utility plant in service to IM Transco without first obtaining Commission approval.

Mr. Lewis also discussed the Settlement Agreement provisions regarding affiliate agreements. He stated the Settlement Agreement provides that the following affiliate agreements will be deemed filed with the Commission and therefore effective on February 25, 2011, as required by Ind. Code § 8-1-2-49: (1) Services Agreement between I&M and IM Transco; (2) Service Agreement between AEPSC and IM Transco; and (3) the Joint License Agreement between I&M and IM Transco. He explained the February 25, 2011 date referred to in the Settlement Agreement is the date the agreements were transmitted to the Commission in accordance with the above referenced statute. He explained why the terms and length of these agreements are reasonable. He added that to ensure the Commission is kept informed of the status of the affiliate agreements, the Settlement Agreement provides that IM Transco and I&M shall notify the Commission at least ninety (90) days prior to the termination date, if the agreements are terminated for any reason.

Mr. Lewis concluded the Settlement Agreement is reasonable, in the public interest, and will benefit I&M, its customers and the state of Indiana. He recommended the Commission approve the Settlement Agreement in its entirety without modification.

C. **OUCC.** Mr. Ronald L. Keen, Senior Analyst within the Resource Planning and Communications Division at the OUCC, testified that while the establishment of IM Transco is unique, the OUCC recommends the Commission approve the Settlement Agreement without change or exception. He explained the Settlement Agreement provides a mechanism for IM Transco to report a number of metrics and data points to both the Commission and OUCC to facilitate monitoring of IM Transco's construction, operation and maintenance of new and existing transmission infrastructure. He added that the Settlement Agreement recognizes the Commission has ongoing jurisdiction over I&M and IM Transco as provided by law. He explained the Settlement Agreement provides for I&M and IM Transco to meet with the OUCC to ensure the OUCC remains informed regarding IM Transco operations, and specifies the frequencies of such meetings. He noted the Settlement Agreement commits IM Transco to fully reimburse the OUCC and the Commission for all travel expenses incurred while inspecting IM Transco's books and records outside the State of Indiana. He testified the Settlement Agreement also commits IM Transco to reimburse the OUCC and Commission up to a combined total amount of $25,000 for travel expenses incurred to participate in IM Transco proceedings before FERC during a five year period. In his view, this provision serves the public interest in knowing that IM Transco is delivering on its representations that its operations will provide benefits.

Mr. Keen testified the OUCC believes the Settlement Agreement, in conjunction with the Commission's jurisdiction over I&M Transco and I&M's continuing responsibility to furnish reasonably adequate service and facilities, will assure the continuation of appropriate service to I&M's Indiana customers. He cautioned that it is important the Commission be able to review all aspects of each individual case where such a fundamental restructuring is proposed before reaching any conclusions in future cases.

Mr. Keen testified the OUCC believes IM Transco can achieve some type of cost benefit which could not be otherwise achieved by leaving all transmission assets under the control of I&M. He explained that I&M has outlined in testimony that over the next several years, I&M expects it will need to undertake a very substantial capital expenditure program to insure service reliability, as well as to comply with emerging environmental and nuclear regulations. He explained a transmission only entity may appeal to certain investors as a simpler type of investment with a more narrowly defined range of risks than other utility entities, which has potential to enhance AEP's overall investment opportunities. He stated it is the OUCC's expectation that the formation of IM Transco would therefore reduce somewhat the overall capital investment pressure on the AEP operating companies. He stated that while the OUCC invested considerable effort in reviewing the issue, its considered opinion is that the reduced capital investment pressure on one hand, and the greater business visibility on the other, should reduce overall costs in the long run. While the OUCC expects overall cost reductions in the long run, he stated other aspects of the Settlement Agreement are vital to ensuring that customers do indeed benefit from the Joint Petitioners' proposal.

Mr. Keen testified the Settlement Agreement's reporting requirements help insure transparency to I&M and IM Transco operations, investments and benefits. In his view, these aspects of the Settlement Agreement will enable the OUCC and the Commission to monitor the effect to the ratepayer. Mr. Keen explained the OUCC considers the five (5) year reporting period to be reasonable because it allows IM Transco time to complete its start-up period and be fully operational well before the fifth year, and will therefore provide IM Transco a fair opportunity to show the OUCC and Commission its value. He noted the Settlement Agreement also provides for the possible extension of the reporting period.

Mr. Keen also explained that the Settlement Agreement provision providing for IM Transco's participation in I&M rate cases over a three year period will permit IM Transco to update the Commission on IM Transco's operation. He believes such participation is particularly important in the first years following the creation of IM Transco in order to be able to evaluate the impact of the new structure. He further noted the Settlement Agreement does not preclude participation beyond the required three (3) year period, and that such continuation may be appropriate depending on the parties' experience. Mr. Keen concluded that the guarantee of at least three (3) years is yet another safeguard to ensure transparency and continuing accountability to the OUCC and the Commission.

6. **Commission Discussion and Findings.** Settlements presented to the Commission are not ordinary contracts between private parties. *U.S. Gypsum, Inc. v. Ind. Gas Co.,* 735 N.E.2d 790, 803 (Ind. 2000). When the Commission approves a settlement, that settlement "loses its status as a strictly private contract and takes on a public interest gloss." *Id.* (quoting *Citizens Action Coalition v. PSI Energy,* 664 N.E.2d 401, 406 (Ind. Ct. App. 1996)). Thus, the Commission "may not accept a settlement merely because the private parties are satisfied; rather [the Commission] must consider whether the public interest will be served by accepting the settlement." *Citizens Action Coalition,* 664 N.E.2d at 406.

Furthermore, any Commission decision, ruling, or order – including the approval of a settlement – must be supported by specific findings of fact and sufficient evidence. *U.S. Gypsum,* 735 N.E.2d at 795 (citing *Citizens Action Coalition v. Pub. Serv. Co.,* 582 N.E.2d 330, 331 (Ind. 1991)). The Commission's own procedural rules require that settlements be supported by probative evidence. 170 IAC 1-1.1-17(d). Therefore, before the Commission can approve the Settlement Agreement, we must determine whether the evidence in this Cause sufficiently supports the conclusions that the Settlement Agreement is reasonable, just, and consistent with the purpose of Indiana Code ch. 8-1-2, and that such agreement serves the public interest.

Joint Petitioners' requested relief represents a significant departure from traditional electric utility operation in Indiana wherein the investor-owned electric utilities are vertically integrated, i.e., consisting of generation, distribution and transmission facilities. Consequently, such corporate restructuring has the potential to impact not only the reliability and provision of electric service, but also the retail rates for such service. Although I&M will continue to own its transmission assets currently in service, Joint Petitioners' proposal anticipates that, in the future, significant capital-intensive transmission investments in I&M's service territory would be made by IM Transco, a transmission only public utility subject to FERC oversight. However, we note that like I&M, IM Transco is ultimately a subsidiary of AEP and will be making the transmission investments needed in I&M's electric service area. In addition, I&M will continue to add transmission capital assets, but these will be more routine in nature, and I&M will not sell, lease or otherwise transfer its used and useful utility plant in service to IM Transco without first obtaining Commission approval. Also, IM Transco will seek Commission approval before it transfers functional control of its transmission assets to an RTO other than PJM.

I&M presented evidence indicating it expects to make substantial capital investments over the next several years to comply with environmental regulations, replace aging infrastructure and invest in new generation, transmission and distribution facilities. Joint Petitioners believe that financing of the combined capital expenditures may place considerable stress on I&M's credit metrics, especially cash flow, and potentially result at some point in a downgrade of I&M's debt ratings, which would increase I&M's cost of debt. The creation of IM Transco may reduce the likelihood of a downgrade of I&M's debt by shifting the financing of significant future transmission investments from I&M to IM Transco. Consequently, if I&M can spread a small part of its total capital investment burden to an affiliate, I&M customers may benefit from a lower cost of financing.

The record also demonstrates that investments by IM Transco will result in a slight increase in retail rates for I&M customers as compared to the retail rates that would apply if the same investments were made by I&M. Such an impact, however, is expected to be offset by a reduction in potential increase in retail rates that would be caused by a credit downgrade. The OUCC, after consideration and review, concurs with I&M's assessment and expects a reduction in overall costs to occur in the long run.

The Settlement Agreement presented by the parties in this Cause provides for Commission approval of IM Transco's status as a transmission only public utility in Indiana, including the right to exercise the power of eminent domain. Consequently, IM Transco will be accountable as a public utility subject to the Commission's jurisdiction. Furthermore, I&M will remain responsible for providing adequate service, including transmission service, to retail customers. In an effort to ensure the operations of IM Transco and I&M are transparent and accessible, the Settlement Agreement also contains provisions relating to the reporting of investments, operations and benefits; communication with the OUCC; regulatory oversight; maintenance of IM Transco's books and records; affiliate agreements; reimbursement of travel expenses for FERC proceedings; and waiver of recovery of IM Transco's formation costs incurred after June 30, 2010.

With respect to affiliate agreements, we note that the agreements filed with the Commission in accordance with Ind. Code § 8-1-2-49 were also included in the evidence filed in this Cause. While we recognize the term of the affiliate agreements is longer than the five year (or shorter) term generally considered by the Commission in its General Administrative Order 2010-1 to be in the public interest, we find the longer term to be reasonable based upon the evidence presented and the nature of these particular agreements. In addition, we note the Settlement Agreement also specifically includes a requirement that I&M and IM Transco notify the Commission at least ninety (90) days prior to the termination date of an affiliate agreement if the agreement is terminated for any reason.

Based on the evidence presented, we find the Settlement Agreement is a reasonable, balanced and comprehensive resolution of the issues in this Cause. The creation of IM Transco does not solve the challenges I&M must face in financing a significant capital program across its generation, transmission, and distribution systems, but we consider it to be a constructive action that may improve I&M's financial flexibility. While an independent transmission company is a significant departure from the traditional regulatory construct in Indiana, the Commission finds it to be acceptable in this instance, in which the formation of IM Transco may prevent or diminish the financing challenges I&M must face, providing sufficient potential benefits in the public interest to warrant this departure from a vertically integrated utility. In addition, the Settlement Agreement gives further assurance and provides that IM Transco's operations, like I&M's, should be transparent, accountable and compliant with the Commission's regulations and should not adversely affect Indiana consumers. The Settlement Agreement also provides for ongoing communication among the parties and the filing and sharing of information related to IM Transco's operations. Taken together, the terms of the Settlement Agreement serve the public interest, satisfy the important public policy of fostering settlement over litigation and should provide benefits to Indiana. Therefore, the Commission finds that the Settlement Agreement is reasonable, in the public interest and should be approved.

Finally, the parties agree that the Settlement Agreement should not be used as precedent in any other proceeding or for any other purpose, except to the extent necessary to implement or enforce its terms. Consequently, with regard to future citation of the Settlement Agreement, we find that our approval herein should be construed in a manner consistent with our finding in *Richmond Power & Light*, Cause No. 40434, (IURC March 19, 1997).

IT IS THEREFORE ORDERED BY THE INDIANA UTILITY REGULATORY COMMISSION that:

1. The Settlement Agreement shall be and hereby is approved in its entirety.

2. The terms and conditions of the Settlement Agreement shall be and hereby are incorporated herein as a part of this Order and the Parties therefore shall abide by the terms thereof.

3. This Order shall be effective on and after the date of its approval.

ATTERHOLT, BENNETT, LANDIS, MAYS AND ZIEGNER CONCUR:

APPROVED: NOV 0 2 2011

I hereby certify that the above is a true and correct copy of the Order as approved.

Brenda A. Howe

Brenda A. Howe,
Secretary to the Commission

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

VERIFIED JOINT PETITION OF AEP INDIANA MICHIGAN TRANSMISSION COMPANY, INC. ("IM TRANSCO"), AND INDIANA MICHIGAN POWER COMPANY ("I&M"), BOTH INDIANA CORPORATIONS, FOR INDIANA UTILITY REGULATORY COMMISSION APPROVAL, TO THE EXTENT NECESSARY, OF IM TRANSCO'S STATUS AS A TRANSMISSION ONLY PUBLIC UTILITY; FOR AUTHORITY TO MAINTAIN IM TRANSCOS BOOKS AND RECORDS OUTSIDE THE STATE OF INDIANA; AND FOR THE COMMISSION'S CONSENT TO BOARDS OF COUNTY COMMISSIONERS FOR IM TRANSCO TO OCCUPY THE PUBLIC RIGHTS-OF-WAY PURSUANT TO IC 36-2-2-23.	)	IURC ~~PETITIONER'S~~ Settling Parties EXHIBIT NO. 1 8-16-11 DATE lL REPORTER CAUSE NO. 44000 OFFICIAL EXHIBITS

STIPULATION AND SETTLEMENT AGREEMENT

THIS AGREEMENT is made and entered into by and among Indiana Michigan Power Company ("I&M"), AEP Indiana Michigan Transmission Company, Inc. ("IM Transco") and the Indiana Office of Utility Consumer Counselor ("OUCC") (collectively the "Parties" and individually "Party"). The Parties having been duly advised by their respective staff, experts and counsel, and solely for purposes of compromise and settlement, stipulate and agree that the terms and conditions set forth below represent a fair, just and reasonable resolution of the matters in this proceeding pending before the Indiana Utility Regulatory Commission ("Commission"), subject to their incorporation into a final, non-appealable order ("Final Order") of the Commission without modification or further condition that may be unacceptable to any Party. If the Commission does not approve this Stipulation and Settlement Agreement ("Settlement"), in its entirety, the entire Settlement shall be null and void and deemed withdrawn, unless otherwise agreed to in writing by the Parties.

WITNESSETH:

WHEREAS, I&M and IM Transco have petitioned the Commission for approval, to the extent necessary, of IM Transco's status as a transmission only public utility and for related regulatory relief as set forth in the Petition in this Cause dated March 1, 2011 and have supported such request with prepared testimony and exhibits filed in this proceeding;

WHEREAS, the OUCC has analyzed the Joint Petitioners' filing, conducted discovery and otherwise given consideration to the relief sought by Joint Petitioners in this Cause;

WHEREAS, the OUCC desires to have available to it information necessary for the OUCC to understand and assess IM Transco's operations on a forward going basis;

WHEREAS, the OUCC believes that IM Transco's, like I&M's, operations should be transparent, accountable and compliant with the Commission's regulations and should not adversely affect Indiana consumers;

WHEREAS, I&M and IM Transco agree that information regarding IM Transco and its relationship to I&M's provisions of retail electric service should continue to be made available to the OUCC and the Commission as provided below and otherwise required by law.

NOW, THEREFORE, in consideration of the premises and the mutual covenants herein contained, the Parties hereto, for themselves, their successors and assigns, do hereby covenant and agree as follows:

A. TERMS AND CONDITIONS OF FINAL ORDER

1. **Public Utility Status.** The Commission will approve IM Transco's status as a transmission only public utility in Indiana. This status includes the right to exercise the power of eminent domain. The Commission will also give its consent to Boards of County Commissioners of all Indiana counties to grant IM Transco such licenses, permits or franchises

as may be necessary for IM Transco to occupy and use county roads, highways and other public rights-of-way for the provision of its services and facilities pursuant to IC 36-2-2-23.

2. **Reporting of Investment, Operations and Benefits**. IM Transco will submit a report to the Commission regarding the following and provide a copy to the OUCC:

a. For IM Transco's transmission projects that began construction in the last calendar year:

i) project description and purpose;

ii) type and scope of project;

iii) projected capital cost and operation and maintenance ("O&M") expense;

iv) description of the amount and percentage of Smart Grid technologies, if any;

v) key project target dates;

vi) any other alternatives considered; and

vii) a description of the application of the Transco Project Selection Guidelines ("PSG") for the various project components of the transmission project. In other words, an explanation of why the project components that are to be funded and owned by IM Transco qualified under the PSG and why any other project components did not qualify under the PSG. For example, in the case of a hypothetical complete line rebuild, the new line component would qualify for the

Transco under section 2.3.2 of the PSG (Facility Replacement). But, there may also be some limited work to existing substations required as part of the project which may not qualify under the PSG and would be funded by I&M. The final result is a clearly identifiable differentiation of assets: IM Transco would own the complete new line and I&M would continue to own all of the substation assets.

b. For IM Transco projects completed in the last calendar year, the total capital cost and O&M expense of the project;

c. For IM Transco projects that were ongoing as of December 31 of the last calendar year, the estimated completion percentage as of December 31 of the last calendar year as well as the total capital cost and O&M expense incurred to that date. This information for IM Transco will also be split to separately show projects in Indiana and Michigan;

d. Miles of transmission, by voltage level, owned by each of the subsidiary companies of AEP Transmission Company LLC ("AEP Transco"), including IM Transco, at the end of the last calendar year;

e. Actual annual investment by each AEP Transco subsidiary company at the end of the last calendar year;

f. IM Transco will provide analysis that compares the total AEP transmission system total capital cost and O&M expense per line mile of transmission to the peer group in the attached Exhibit 1. This analysis will include a specific description of the calculation methodologies and source of all data. IM Transco will notify the

OUCC if the peer group changes over time due to acquisition, consolidation and data availability. IM Transco will comply with reasonable requests by the OUCC to include additional peer companies in the analysis for which data is publicly available;

g. Copy of the latest AEPTCo Project Selection Guidelines;

h. Changes in IM Transco's corporate structure in the past calendar year;

i. Long term debt issuances by AEP Transco or any of the AEP Transco subsidiary companies, including IM Transco, made in the last calendar year including information comparing the cost of debt and underlying spread versus the comparable US Treasury bond to those of any issuance, within thirty (30) days before or after the date of Transco's issuance, by other vertically integrated utility companies within one credit rating level up or down of I&M, as defined by Moody's and S&P;

j. A listing of IM Transco's planned projects in Indiana for the current year. Each project will be designated as a Baseline Upgrade, Network Upgrade, Direct Connection Upgrade, Supplemental Upgrade, or Non-RTO Project, as defined in the 2010 PJM Regional Transmission Expansion Plan. This planned project listing represents AEP's best available information at that time, is subject to change, and does not represent a guarantee of the final project list;

k. A description of the practices taken to provide for the lowest reasonable cost consistent with industry practices and operational requirements, including any use of competitive bidding practices; and

1. A copy of the most recently available Independent Auditors' Report for IM Transco.

The report shall be submitted to the Commission for a period of five (5) years following the date of a Final Order approving this Settlement. So that IM Transco's report may take into consideration information provided annually in the Federal Energy Regulatory Commission ("FERC") Form 1, IM Transco's report to the Commission shall be submitted by July 1 of each year of the five (5) year period. IM Transco shall provide the OUCC an opportunity to review IM Transco's report fifteen (15) days prior to submitting it to the Commission. Upon expiration of the five (5) year period, this reporting requirement may be extended by agreement of the Parties or Commission order.

3. **Communication with the OUCC.** IM Transco and I&M will meet with the OUCC as reasonably requested to keep the OUCC informed as to IM Transco's operations. Such meetings may be conducted in person and/or via telephone conference. During the eighteen (18) months following a Final Order in this Cause meetings should be conducted in six (6) month intervals or as otherwise agreed to by the Parties. So as to facilitate such meetings, IM Transco and I&M will respond to reasonable requests by the OUCC for information and IM Transco will provide an overview of recent activities at the meetings.

4. **Regulatory Oversight.**

a. The Parties recognize that both I&M and IM Transco are subject to the Commission's ongoing jurisdiction to the extent provided by law.

b. IM Transco agrees to file a petition to intervene in I&M's next general rate case and any other future I&M general rate case filed during a period of three (3) years following the date of a Final Order approving this Settlement. If granted leave by the Commission to intervene, IM Transco will file testimony updating the Commission on the status of IM Transco's operations. Upon expiration of the three (3) year period, this agreement to intervene in future general rate cases may be extended by agreement of the Parties.

c. I&M and IM Transco will provide the OUCC a copy of all affiliate agreements filed with the Commission.

d. I&M will not sell, lease or otherwise transfer its used or useful utility plant in service to IM Transco without first obtaining Commission approval.

e. IM Transco will seek Commission approval before it transfers functional control of its transmission facilities to an RTO other than PJM or to an independent transmission company.

f. The foregoing requirements are enumerated herein for clarification. The foregoing list is not intended to represent a comprehensive list of the regulatory requirements that may be applicable to IM Transco and will not be construed to relieve IM Transco of any obligations under Indiana law.

5. **<u>IM Transco's Books and Records.</u>** IM Transco's request to maintain its books and records out of state will be approved. IM Transco agrees to produce in Indiana, upon reasonable notice, duplicate copies of those portions of its books and records necessary for the

OUCC and the Commission to perform their statutory duties. To the extent it presents an undue burden on IM Transco to produce in Indiana the books and records, IM Transco commits to fully reimburse the OUCC and Commission for all travel expenses, including travel fare, mileage, lodging and meals, incurred while inspecting IM Transco's books and records outside of Indiana.

6. **Affiliate Agreements.** The following affiliate agreements will be deemed filed with the Commission and therefore effective on February 25, 2011, as required by IC 8-1-2-49:

a. Services Agreement between Indiana Michigan Power Company and AEP Indiana Michigan Transmission Company, Inc.;

b. Service Agreement between American Electric Power Service Corporation and AEP Indiana Michigan Transmission Company, Inc.; and

c. The Joint License Agreement between Indiana Michigan Power Company and AEP Indiana Michigan Transmission Company.

IM Transco and I&M shall notify the Commission at least ninety (90) days prior to the termination date of the agreements if the agreements are terminated for any reason. The notice shall reference Cause No. 44000 and a copy of the notice shall be served on the OUCC.

7. **Reimbursement of Travel Expenses for FERC Proceedings.** IM Transco agrees to reimburse the State of Indiana up to a total amount of $25,000 for travel expenses incurred by the OUCC or the Commission to participate in IM Transco proceedings before the FERC during the five years from the date of a Final Order approving this Settlement.

8. **Waiver of Recovery of TRANSCO Formation Costs by I&M.** In a settlement agreement approved by the FERC in the FERC proceeding approving Transco's rates and charges for transmission service, Docket No.ER10-355-000 ("FERC Settlement"), IM Transco agreed, among other things, that costs related to the formation of the Transco organizations incurred after June 30, 2010 would not be included in FERC-regulated rates. The FERC Settlement also stated:

> AEP reserves the right to seek recovery of post-June 30, 2010 formation costs associated with obtaining necessary state or local approvals (regarding state-related costs) from the applicable state regulatory commission. (FERC Settlement, p.25).

I&M agrees to waive the right to seek recovery of post-June 30, 2010 formation costs associated with obtaining necessary state or local approvals from the Commission.

B. PRESENTATION OF THE SETTLEMENT TO THE COMMISSION

1. The Parties shall support this Settlement before the Commission and request that the Commission expeditiously accept and approve the Settlement. This Settlement is not severable and should be accepted or rejected in its entirety without modification or further condition(s) that may be unacceptable to any Party.

2. The Parties shall jointly move for leave to file this Settlement and supporting evidence. Such evidence will be offered into evidence without objection and the Parties hereby waive cross-examination. The Parties propose to submit this Settlement and evidence conditionally, and that, if the Commission fails to approve this Settlement in its entirety without any change or with condition(s) unacceptable to any Party, the Settlement and supporting evidence shall be withdrawn and the Commission will continue to hear Cause No. 44000 with the proceedings resuming at the point they were suspended by the filing of this Settlement.

3. A Final Order approving this Settlement shall be effective immediately, and the agreements contained herein shall be unconditional, effective and binding on all Parties as an Order of the Commission.

4. The Parties shall jointly agree on the form, wording and timing of public/media announcement (if any) of this Settlement and the terms thereof. No Party will release any information to the public or media prior to the aforementioned announcement. The Parties may respond individually without prior approval of the other Parties to questions from the public or media, provided that such responses are consistent with such announcement and do not disparage any of the Parties. Nothing in this Settlement shall limit or restrict the Commission's ability to publicly comment regarding this Settlement or any Order affecting this Settlement.

C. EFFECT AND USE OF SETTLEMENT

1. It is understood that this Settlement is reflective of a negotiated settlement and neither the making of this Settlement nor any of its provisions shall constitute an admission by any Party to this Settlement in this or any other litigation or proceeding. It is also understood that each and every term of this Settlement is in consideration and support of each and every other term.

2. This Settlement shall not constitute and shall not be used as precedent by any person in any other proceeding or for any other purpose, except to the extent necessary to implement or enforce the terms of this Settlement.

3. This Settlement is solely the result of compromise in the settlement process and except as provided herein, is without prejudice to and shall not constitute a waiver of any

position that any of the Parties may take with respect to any or all of the items resolved here and in any future regulatory or other proceedings.

4. The Parties agree that the evidence in support of this Settlement constitutes substantial evidence sufficient to support this Settlement and provides an adequate evidentiary basis upon which the Commission can make any findings of fact and conclusions of law necessary for the approval of this Settlement, as filed. The Parties shall prepare and file an agreed proposed order with the Commission as soon as reasonably possible.

5. The communications and discussions during the negotiations and conferences and any materials produced and exchanged concerning this Settlement all relate to offers of settlement and shall be privileged and confidential, without prejudice to the position of any Party, and are not to be used in any manner in connection with any other proceeding or otherwise.

6. The undersigned Parties have represented and agreed that they are fully authorized to execute the Settlement on behalf of their designated clients, and their successors and assigns, who will be bound thereby.

7. The Parties shall not appeal or seek rehearing, reconsideration or a stay of the Final Order approving this Settlement in its entirety and without change or condition(s) unacceptable to any Party (or related orders to the extent such orders are specifically implementing the provisions of this Settlement). The Parties shall support or not oppose this Settlement in the event of any appeal or a request for a stay by a person not a party to this Settlement or if this Settlement is the subject matter of any other state or federal proceeding.

8. The provisions of this Settlement shall be enforceable by any Party before the Commission and thereafter in any state court of competent jurisdiction as necessary.

9. This Settlement may be executed in two (2) or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

ACCEPTED and AGREED as of the 18th day of July, 2011.

AEP INDIANA MICHIGAN TRANSMISSION COMPANY, INC.

Name: Jeffrey D. Cross
Its: Vice President

INDIANA MICHIGAN POWER COMPANY

Name: Marc E. Lewis
Its: Vice President, External Relations

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

A. David Stippler

Name: A. David Stippler
Its: Utility Consumer Counselor

ACCEPTED and AGREED as of the ____th day of July, 2011.

AEP INDIANA MICHIGAN TRANSMISSION COMPANY, INC.

Name: Jeffrey D. Cross
Its: Vice President

INDIANA MICHIGAN POWER COMPANY

Name: Marc E. Lewis
Its: Vice President, External Relations

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

Name: A. David Stippler
Its: Utility Consumer Counselor

ACCEPTED and AGREED as of the ____th day of July, 2011.

AEP INDIANA MICHIGAN TRANSMISSION COMPANY, INC.

Name: Jeffrey D. Cross
Its: Vice President

INDIANA MICHIGAN POWER COMPANY

Name: Marc E. Lewis
Its: Vice President, External Relations

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

Name: A. David Stippler
Its: Utility Consumer Counselor

Exhibit 1.

Peer Group for item 2.f.

- Berkshire Hathaway Inc
- Dominion Resources Inc
- Duke Energy Corp
- Edison International
- Energy Future Holdings Corp
- Entergy Corp
- Exelon Corp
- FirstEnergy Corp
- ITC Holdings Corp
- National Grid Plc
- NextEra Energy Inc
- Northeast Utilities
- Pepco Holdings Inc
- PG&E Corp
- Progress Energy Inc
- Southern Co
- Wisconsin Energy Corp
- Xcel Energy

INDS01 1282393v2

EXHIBIT 3

<u>**EXHIBIT 3**</u>

**POST-HEARING BRIEF OF
AEP KENTUCKY TRANSMISSION COMPANY, INC.**

Offer Of Additional Conditions To Order Approving Application
And Granting AEP Kentucky Transmission Company, Inc. A Certificate Of Public Convenience
And Necessity To Provide Wholesale Transmission Service in Kentucky

1. **<u>Reporting of Investment, Operations and Benefits</u>**. Beginning July 1, 2012, AEP Kentucky Transmission Company, Inc. ("KY Transco" will submit a report to the Commission regarding the following matters and concurrently provide a copy to the Office of the Attorney General ("AG") and Kentucky Utility Customers, Inc. ("KIUC"):

a. For KY Transco's transmission projects that began construction in the last calendar year:

i) project description and purpose;

ii) type and scope of project;

iii) projected capital, and operations & maintenance ("O&M") costs;

iv) key project target dates;

v) any other alternatives considered; and

vi) a description of the application of the Transco Project Selection Guidelines ("PSG") for the various project components of the transmission project.

b. For KY Transco projects completed in the last calendar year, the total capital cost and O&M expense of the project;

c. For KY Transco projects that were ongoing as of December 31 of the last calendar year, the estimated completion percentage as of December 31 of the last calendar year as well as the total capital cost and O&M expense incurred to that date;

d. Miles of transmission, by voltage level, owned by each of the subsidiary companies of AEP Transmission Company LLC ("AEP Transco"), including KY Transco, at the end of the last calendar year;

e. Actual annual investment by each AEP Transco subsidiary company at the end of the last calendar year;

f. KY Transco will provide analysis that compares the total AEP transmission system total capital cost and O&M expense per line mile of transmission to the peer group in the attached Exhibit 1. This analysis will include a specific description of the calculation methodologies and source of all data. KY Transco will notify the Commission, the AG and KIUC if the peer group changes over time due to acquisition, consolidation and data availability. KY Transco will comply with reasonable requests by the AG and KIUC to include additional peer companies in the analysis for which data is publicly available;

g. Copy of the latest AEPTCo Project Selection Guidelines;

h. Changes in KY Transco's corporate structure in the past calendar year;

i. Long term debt issuances by AEP Transco or any of the AEP Transco subsidiary companies, including KY Transco, made in the last calendar year including information comparing the cost of debt and underlying spread versus the comparable US Treasury bond to those of any issuance, within thirty (30) days before or after the date of issuance by AEP Transco or any of the AEP Transco subsidiary companies, including KY Transco, by other vertically integrated utility companies within one credit rating level up or down of Kentucky Power, as defined by Moody's and S&P;

j. A listing of KY Transco's planned projects in Kentucky for the current year. Each project will be designated as a Baseline Upgrade, Network Upgrade, Direct Connection Upgrade, Supplemental Upgrade, or Non-RTO Project, as defined in the 2010 PJM Regional Transmission Expansion Plan. This planned project listing represents AEP's best available information at that time, is subject to change, and does not represent a guarantee of the final project list;

k. A description of the practices taken to provide for the lowest reasonable cost consistent with industry practices and operational requirements, including any use of competitive bidding practices; and

l. A copy of the most recently available Independent Auditors' Report for KY Transco.

The report shall be submitted to the Commission and provided concurrently to the AG and KIUC for a period of five (5) years following the date of a Final Order approving this Settlement. So that KY Transco's report may take into consideration information provided annually in the Federal Energy Regulatory Commission ("FERC") Form 1, KY Transco's report to the

Commission shall be submitted by July 1 of each year of the five (5) year period. Kentucky Transco shall provide the AG and KIUC an opportunity to review Kentucky Transco's report fifteen (15) days prior to submitting it to the Commission. Upon expiration of the five (5) year period, this reporting requirement may be extended by agreement of the Parties or Commission order.

2. **Communication with the AG and KIUC.** KY Transco and Kentucky Power will meet with the AG, KIUC and Commission Staff as reasonably requested to keep the AG, KIUC and Commission Staff informed as to KY Transco's operations. Such meetings may be conducted in person and/or via telephone conference. During the eighteen (18) months following a Final Order in this Cause meetings should be conducted in six (6) month intervals or as otherwise agreed to by the Parties. So as to facilitate such meetings, KY Transco and Kentucky Power will respond to reasonable requests by the AG, KIUC and Commission Staff for information and KY Transco will provide an overview of recent activities at the meetings.

3. **Regulatory Oversight.**

a. The Parties recognize that both Kentucky Power and KY Transco are subject to the Commission's ongoing jurisdiction to the extent provided by law.

b. KY Transco agrees to file a petition to intervene in Kentucky Power's next general rate case and any other future KY general rate case filed during a period of three (3) years following the date of a Final Order approving this Settlement. If granted leave by the Commission to intervene, KY Transco will file testimony updating the Commission on the status of KY Transco's operations. Upon expiration of the three (3) year period, this agreement to intervene in future general rate cases may be extended by agreement of the Parties.

c. Kentucky Power and KY Transco will seasonably provide the AG, KIUC and Commission Staff a copy of all affiliate agreements between KY Transco and Kentucky Power.

d. Kentucky Power will not sell, lease or otherwise transfer its used or useful utility plant in service to KY Transco without first obtaining Commission approval.

e. Kentucky Transco will seek Commission approval before it transfers functional control of its transmission facilities to an RTO other than PJM or to an independent transmission company.

f. The foregoing requirements are enumerated herein for clarification. The foregoing list is not intended to represent a comprehensive list of the regulatory requirements that may be applicable to KY Transco and will not be construed to relieve KY Transco of any obligations under Kentucky law.

4. KY Transco's Books and Records. KY Transco agrees to produce in Kentucky and the offices of the Commission, the AG, and KIUC, upon reasonable notice, duplicate copies of those portions of its books and records necessary for the AG and the Commission to perform their statutory duties.

5. Waiver of Recovery of TRANSCO Formation Costs by Kentucky Power. In a settlement agreement approved by the FERC in the FERC proceeding approving Transco's rates and charges for transmission service, Docket No.ER10-355-000 ("FERC Settlement"), KY

Transco agreed, among other things, that costs related to the formation of the Transco organizations incurred after June 30, 2010 would not be included in FERC-regulated rates. The FERC Settlement also stated:

> AEP reserves the right to seek recovery of post-June 30, 2010 formation costs associated with obtaining necessary state or local approvals (regarding state-related costs) from the applicable state regulatory commission. (FERC Settlement, p.25).

Kentucky Power and KY Transco agree to waive the right to seek recovery of post-June 30, 2010 formation costs associated with obtaining necessary state or local approvals from the Commission.

7. **Reimbursement of Travel Expenses for FERC Proceedings**. KY Transco will reimburse the Commonwealth of Kentucky, on behalf of the Commission and the AG, and KIUC, $25,000 in the aggregate for travel expenses incurred by KIUC, the AG and the Commission to participate in KY Transco proceedings before FERC for five years following the entry of a final order granting the application in this proceeding. The $25,000 in aggregate reimbursements will be allocated as agreed to by the AG, the Commission and KIUC.