

**PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
CHARLESTON**

At a session of the PUBLIC SERVICE COMMISSION OF WEST VIRGINIA in the City of Charleston on the 2nd day of April 2012.

CASE NO. 11-1775-E-P

APPALACHIAN POWER COMPANY and
WHEELING POWER COMPANY both dba
AMERICAN ELECTRIC POWER

Petition for evaluation of possible merger.

COMMISSION ORDER

The Commission grants interventions and holds this matter in abeyance for ninety days.

Background

Wheeling Power Company (WPCo) and Appalachian Power Company (APCo) (collectively, the Companies) are separate corporations within the American Electric Power (AEP) System. Although they are separate corporate entities, the Commission consolidated the rates of the two Companies, effective July 28, 2006, such that retail customers of both Companies pay the same retail tariff rates. Notwithstanding the consolidated rates, the two Companies have maintained their historically separate and distinct corporate identities and power supply arrangements. APCo supplies its West Virginia retail customers through a combination of its own generation resources and power supplied under the AEP Interconnection (AEP Pool) Agreement. WPCo has no generation resources and has relied on a full-requirements wholesale interconnection agreement with another affiliated AEP company, Ohio Power Company (OPCo) for all its power supply needs. WPCo's power supply arrangement with OPCo has been in effect since 1949.

Case No. 08-1101-E-GI

By Order issued on July 1, 2008, the Commission initiated Case No. 08-1101-E-GI, a general investigation exploring options to meet the future Power supply requirements of WPCo's service territory. The general investigation arose out of an Expanded Net Energy Cost proceeding docketed as Appalachian Power Co. and Wheeling Power Co. Case No. 08-0278-E-GI (the 2008 ENEC case), which was resolved by Commission adoption of a Joint Stipulation. Comm'n Order June 26, 2008. In the 2008 ENEC case, APCo and WPCo informed the Commission that OPCo had provided notice of termination of the power supply contract with WPCo.

The terms of the power supply agreement between OPCo and WPCo allowed termination on three years' notice. On December 31, 2007, OPCo provided WPCo with notice that the contract would terminate on December 31, 2010. After OPCo provided the notice of termination, in May 2008 OPCo filed a new formula-based contract at the Federal Energy Regulatory Commission (FERC) that, if approved, would have increased WPCo's energy supply rates by \$32 million per year. The Joint Stipulation in the 2008 ENEC case resulted in OPCo's withdrawal of the FERC filing in July 2008 based on the parties' agreement to explore power supply options for WPCo. See, Joint Report of AEP and WPCo Regarding Various Options for Meeting the Future Power Supply Requirements of WPCo, filed in Case No. 08-1101-E-GI on January 5, 2009, at 1 footnote 1.

On January 5, 2009, the Companies filed a Joint Report of AEP and WPCo regarding various options for meeting the future power supply requirements of WPCo. The report stated four possible options, and discussed potential cost impacts and pros and cons of each option. Under Option No. 1, OPCo would continue to supply WPCo's load under a FERC-approved formula-based wholesale contract. Under Option No. 2, APCo would supply WPCo's load under a FERC-approved formula-based wholesale contract. Under Option No. 3, WPCo would merge into APCo, and WPCo's traditional service territory would be supplied from APCo's existing legal and contractual power supply resources. Under Option No. 4, WPCo would merge into APCo with incremental power supplies to serve WPCo acquired from the competitive market. The Companies initially did not state which of the options it preferred.

On November 4, 2009, the Companies, the Commission Consumer Advocate Division (CAD), and Staff filed a further Joint Status Report and Joint Stipulation in Case No. 08-1101-E-GI. The West Virginia Energy Users Group (WVEUG) did not sign the stipulation, but did not object to the filing. The Joint Report and Stipulation provided that APCo and WPCo would proceed with merger as outlined in Option No. 3, and would merge and operate as a single public service utility. The former WPCo customers would be supplied with power from APCo's existing legal and contractual power supply resources. The Joint Report and Stipulation provided that the merger would not take place before January 1, 2012. Between January 1, 2010, and the merger date, the parties proposed that OPCo would continue to supply WPCo's power supply needs pursuant to a revised power supply agreement with increased rates by \$24 million to take effect as of January 1, 2010.

By Order issued November 6, 2009, the Commission required the Companies to be prepared to respond to certain questions regarding the Joint Stipulation at a future hearing.

In a filing by the Companies on November 13, 2009, APCo and WPCo provided written responses to Commission questions set forth in the November 6, 2009 Order.

By Order issued November 30, 2009, in Case No. 08-1101-E-GI, the Commission agreed that the best course was Option No. 3 because the merger would result in the lowest overall rate impact of the four options considered by the parties and result in administrative and regulatory efficiency. The Commission stated its concern, however, that it was asked to agree to the reasonableness of a \$24 million rate increase for OPCo that would impact purchased power costs passed to West Virginia customers. Accordingly, the Commission denied the request that it file either an intervention without objection or an executed certificate of concurrence with respect to the increased rates contemplated by the revised OPCo/WPCo power supply contract. The Commission also expressed concern about the timing of the proposed merger taking place no sooner than January 1, 2012. The Commission stated that the interest of West Virginia customers would be best served if the merger occurred as quickly as possible. Although recognizing that other regulatory approvals were required, the Commission stated it would not approve a condition that required the merger not take place until January 1, 2012. The Commission instead, determined that APCo and WPCo should make every reasonable effort to accomplish the merger as quickly as possible, including appropriate filings in West Virginia and Virginia.

The Commission also stated that its approval of the Option No. 3 merger proposal should not be construed as pre-approval of the future petition for approval of the corporate merger transaction to be filed by the Companies as required by W. Va. Code § 24-2-12. In the future merger filing, all interested parties would have an opportunity to submit evidence and argument for or against the merger, and any rate impacts of the merger would be considered, as appropriate, in future rate proceedings.

The instant Case No. 11-1775-E-P

On December 6, 2011, APCo and WPCo filed a petition for an evaluation of a possible merger and direct testimony of Chris Potter, Vice President – Regulatory and Finance, of APCo. The petition included financial information, an unsigned agreement for merger, and an exhibit comparing the pre- and post-merger revenue requirements at differing power supply options for WPCo using 2010 historical data. The petition explained what had been taking place since the Commission's November 30, 2009 Order in Case No. 08-1101-E-GI. The petition also explained that the filing was not a petition for final approval of a merger and noted that events during the past two years had caused APCo and WPCo to question whether or not the merger is in the best interests of the Companies and the ratepayers. Specifically, the Companies were uncertain whether they could meet the statutory requirement that the merger will not adversely affect the public in West Virginia. The petition stated that several significant events are affecting or will affect the future operations of the Companies. Those include the still struggling economy, possible elimination and/or major reconfiguration of the AEP Pool Agreement, developments in Ohio regarding the corporate separation of generation assets within Ohio subsidiaries, and emerging environmental requirements and the impacts on existing and future generation resources. The petition further stated that one or more AEP Companies would soon file with the FERC for approval of a reconfiguration of the AEP Pool

Agreement, probably within the first quarter of 2012. The petition stated that the filing at FERC would seek approval of an APCo/WPCo merger.

Three entities have filed petitions to intervene in this case: the CAD; WVEUG; and Steel of West Virginia, Inc. Petitions filed December 19, 2011, December 30, 2011 and January 18, 2012.

On January 20, 2012, Commission Staff filed an initial memorandum. Staff recommended that the Commission direct APCo and WPCo to file both a copy of the FERC filing and revised direct testimony in this case on the same date that they made the referenced AEP Pool Agreement filing at the FERC. Staff stated that the direct testimony should state in detail the impacts of the FERC filing on the merger. Staff also recommended that the Commission approve a general structure, without specific dates, of a procedural schedule for this case including revised testimony, rebuttal testimony, and a hearing date. Finally, Staff recommended that the Commission grant the three pending petitions to intervene.

Staff also provided information regarding a FERC Order issued January 8, 2010, accepting OPCo's filing of an Amended and Restated Interconnection Agreement between OPCo and WPCo effective January 1, 2010. The Amended Agreement provided for a \$24 million increase in annual non-fuel generation rates to be paid by WPCo and for WPCo to pay for transmission service pursuant to the PJM Interconnection, LLC Open Access Transmission tariff. Staff noted that the term of the Amended Agreement was from January 1, 2010, through December 31, 2011, continuing for successive one-year terms unless terminated in accordance with Article 19 of the Amended Agreement.

On February 10, 2012, AEP filed with the FERC an Application for Authorization to Transfer Jurisdictional Facilities of WPCo to APCo under Section 203 of the Federal Power Act, FERC Docket No. EC12-69-000 (the FERC merger filing). Also on February 10, 2012, AEP made other filings at the FERC relating to asset transfers, a corporate reorganization of OPCo, termination of the AEP Pool Agreement, and replacement of that AEP Pool Agreement with a new power sharing arrangement with new agreements. On February 21, 2012, the Commission intervened in each of the FERC docketed proceedings. Commission Notices of Intervention filed February 21, 2012 in FERC Docket Nos. EC12-69-000 through EC12-71-000 and ER12-1041-000 through ER12-1049-000 (collectively "the AEP 2012 FERC filings").

On February 28, 2012, AEP filed with the FERC a Notice of Withdrawal of the AEP 2012 FERC filings. The filing, titled "Notice of Withdrawal of Application for Authorization Under Section 203 of the Federal Power Act and Agreements and Notices of Termination Under Section 205 of the Federal Power Act," stated that AEP is reconsidering the terms of the proposed corporate reorganization. AEP explained that the withdrawal stems from recent action of the Public Utilities Commission of Ohio (PUCO) which entered an order on rehearing in its Case No. 11-5333-EL-UNC that revoked PUCO approval of the Corporate Reorganization. AEP stated that it intends to pursue the

matters covered by the withdrawn filings at a later date and will make the necessary FERC filings at that time.

On March 5, 2012, the CAD filed a Motion to Clarify Scope of Proceeding. CAD stated that the AEP Pool Operating Committee held a meeting on December 17, 2010, for the purpose of considering a single agenda item: Termination of the AEP Pool Agreement. The Operating Committee considered the recommendation to terminate the AEP Pool Agreement, and on that same day the representative of each member of the AEP Pool executed a notice of termination of the AEP Pool Agreement. The terms of the AEP Pool Agreement require three-years' advance notice to terminate the AEP Pool Agreement. CAD stated that the AEP Pool Agreement remains in effect until January 1, 2014.

CAD further stated that APCo has a significant capacity deficiency. APCo's December 2010 peak was 7,542 MW. CAD stated that APCo currently has only 6,377 MWs (CAD corrected this to 6,975 MW by filing on March 6, 2012) of generation and purchase power contract capacity. CAD explained that because the AEP Pool members, including APCo, have elected Fixed Resource Requirement (FRR) status with PJM, APCo cannot procure energy or capacity from the PJM wholesale markets until it foregoes its FRR status. The election to forego FRR status and enter the markets must be made 60 days before the PJM capacity market (Reliability Pricing Model or RPM) auction takes place (Base Residual Auction or BRA). The PJM wholesale market is a three year forward market. CAD stated that this is particularly problematic because as of January 1, 2014, APCo will be capacity deficient by approximately 2,300 MW annually (CAD corrected this to 1,700 MW in its March 6, 2012 filing). Even though the AEP Pool Agreement terminates January 1, 2014, APCo could not have gone to market to secure this deficiency until June 1, 2015, at the very earliest, if APCo had chosen to deselect FRR status on March 7, 2012, which it did not do. Accordingly, APCo will not be permitted to participate in the PJM markets in 2015/2016. APCo may next deselect FRR status in March 2013, which will allow it to take market deliveries during the 2016/2017 year. The gap between the PJM 2013/2014 delivery year and the PJM 2016/2017 delivery year (collectively, "Gap") means APCo cannot go to market to secure its Gap deficiency that will occur commencing January 1, 2014. This shortfall in meeting West Virginia's retail load is of great concern to the CAD.

CAD asked the Commission to clarify that the scope of this proceeding must include an analysis of options available to the Companies to meet the requirements of APCo's and WPCo's customers with or without the merger. CAD noted that there is currently uncertainty surrounding how and whether 1) the AEP Pool Agreement can be reconfigured, 2) assets will ultimately be transferred from OPCo to APCo, and 3) there will be a Bridge Pool Agreement. All of these are all important, but those uncertainties do not detract from the basic analyses of capacity and energy options APCo/WPCo face in light of the annual MW deficiency the Companies are facing. Accordingly, CAD asked the Commission to clarify that that the scope of this proceeding is not merely to evaluate the merger but will also include energy and capacity options available to

APCo/WPCo given the Companies' clear intent to terminate the AEP Pool Agreement and their inability to participate in the PJM markets before the 2016/2017 delivery year.

On March 6, 2012, CAD filed a correction letter stating that it failed to account for the new Dresden 580 MW facility when calculating the APCo generation and purchase power contract capacity. Inclusion of the Dresden facility reduces the capacity deficiency from approximately 2,300 MW to approximately 1,700 MW.

On March 15, 2012, APCo and WPCo filed a Response to the CAD Motion to Clarify. The Companies acknowledged that it is difficult to analyze meaningfully the merger petition due to the interrelated nature of the various measures that, until recently, were pending before the FERC. On February 23, 2012, however, PUCO rescinded its approval of a Stipulation that had resolved approximately ten dockets pending before the PUCO. Elements of that Stipulation were underlying assumptions for some of the AEP filings before the FERC that dealt with the OPCo corporate separation, the transfer of generating assets to APCo and Kentucky Power Company, a new Power Cost Sharing Agreement to replace the AEP Pool Agreement, the proposed merger of APCo and WPCo, and other matters. With the PUCO's February 23, 2012 action, the AEP System now has to revisit these matters.

The Companies stated that on February 28, 2012, AEP filed a Notice of Withdrawal without prejudice for the twelve FERC dockets. On March 5, 2012, OPCo filed with the PUCO a Notice of Intent to submit an application to establish a Standard Service Offer pursuant to Ohio statutory law, in the form of a modified Electric Security Plan. OPCo plans to make this submission by March 30, 2012, and to request expedited consideration to enable the modified Electric Security Plan to go into effect by June 1, 2012. OPCo also intends to file a separate application with the PUCO with regard to generation divestiture and the ultimate disposition of generation assets.

Based on the foregoing actions and plans, the Companies argue that the related matters are in flux at the present time and that the instant proceeding relating to merger of APCo and WPCo cannot realistically progress in a meaningful fashion.

In response to the CAD concern as to the alleged 1,700 MW APCo capacity deficiency, the Companies note that in some of the withdrawn FERC dockets the parties had proposed that APCo acquire the Amos Unit No. 3 capacity currently owned by OPCo (864 MWs) and 80% of the capacity of Mitchell (1,248 MWs) or a total of 2,112 MWs – which would entirely eliminate the APCo capacity deficit.

The Companies suggested to the Commission that the most sensible course of action is to hold further action in abeyance for ninety days to enable filings before other forums to proceed. The Companies state that once some of these essential matters have been clarified and compatible new FERC filings developed, the Companies can assess the situation and provide updated information and testimony on the proposed APCo/WPCo merger. The Companies represent that they will supply the Commission and the parties with updated information in a timely manner.

On March 26, 2012, CAD filed a Reply to the Companies' March 15, 2012 Response. CAD stated that if the case is held in abeyance, CAD should be permitted full and fair discovery of the facts that underlie the Companies' decisions concerning satisfaction of the energy supply shortfall. CAD asked that the Commission permit it to begin that discovery now.

DISCUSSION

The petition filed on December 16, 2011, stated that the filing was not a petition for final approval of a merger and that the Companies were not confident that they could make one of the three showings required under W. Va. Code § 24-2-12(d), namely that the merger would not adversely affect the public in West Virginia. The FERC merger filing, made two months following the filing of the instant petition, indicated that the Companies believed the merger was in the public interest. AEP has since withdrawn the FERC merger filing and the other AEP 2012 FERC filings.

More than two years have passed since the Commission's November 30, 2009 final Order in Case No. 08-1101-E-GI, and the Commission at that time required the Companies to proceed as soon as possible with the regulatory filings needed to accomplish the merger. After reviewing the petition, the Staff memorandum, the AEP 2012 FERC filings including the FERC merger filing, the AEP withdrawal of the AEP 2012 FERC filings, the CAD Motion to Clarify, and the Companies' Response, it is apparent that considerable uncertainty exists with respect to a future merger and future power supply options to meet the needs of APCo and WPCo customers either with or without a merger. It is therefore appropriate to hold further action in this proceeding in abeyance for ninety days as requested by the Companies. Regardless of whether the merger ultimately occurs, the Commission is concerned about the uncertainty of the Companies' future power supplies and what the options to address the looming capacity deficiency may be. This proceeding will necessarily include analyses of these issues, and the Commission expects the Companies in future filings to address how they plan to remedy the capacity deficiency issue raised by CAD and various power supply options and costs either with or without a merger. The future filings should provide relevant information including cost implications regarding updates and modifications to the AEP Pool Agreement, acquisition of additional generation capacity, and other options that may be available to APCo and WPCo to address the generation capacity deficiency and energy requirements with or without a merger.

CAD seeks permission to begin discovery immediately, regardless of whether the Commission holds the case in abeyance for ninety days. The Commission will allow CAD to begin discovery now, and the Companies should provide responses to the extent possible. CAD should understand that, given the uncertainty as to both the future decision of whether to move toward merger or how, in the absence of merger, the Companies will address the capacity deficiency and energy supply requirements, it is likely that some of the information that CAD may request in its discovery will be either

incomplete or nonexistent at this time. If that is the case, the Companies may say so in their responses to the discovery.

The CAD, WVEUG and Steel of West Virginia, Inc. have a legal interest in this proceeding and the Commission will grant their respective petitions to intervene.

At the end of the abeyance period, the Commission will require the Companies to file a status report that includes the status of the capacity and energy supply options under consideration and indicates whether the Companies are ready to go forward to address their capacity and energy needs, either through merger or as separate corporate entities. Following receipt of the status report, the Commission will establish a procedural schedule.

FINDINGS OF FACT

1. The Commission final Order in Case No. 08-1101-E-GI ordered APCo and WPCo to merge in order to satisfy WPCo's future power supply needs and required them to proceed to obtain all necessary approvals as soon as possible. Comm'n Order November 30, 2009.

2. Over two years elapsed before APCo and WPCo filed the instant petition in this case.

3. This is not a petition for approval of a merger, but rather a petition for Commission evaluation of a possible merger, and the petition stated that the Companies were not confident that they could make one of the three showings required under W. Va. Code § 24-2-12(d), namely that the merger would not adversely affect the public in West Virginia.

4. Subsequent to filing the instant petition, AEP made the FERC merger filing as part of the AEP 2012 FERC filings and indicated that the merger of APCo and WPCo is in the public interest.

5. AEP withdrew the FERC merger filing and the other AEP 2012 FERC filings on February 28, 2012.

6. CAD sought clarification of the scope of this proceeding and asserted that the Companies face an annual energy deficiency of 1,700 MW upon termination of the AEP Pool Agreement. CAD Motion to Clarify Scope of Proceeding filed March 5, 2012; CAD correction letter filed March 6, 20-12.

7. The Companies asked the Commission to hold this proceeding in abeyance for ninety days. Response filed March 15, 2012.

8. CAD seeks to begin discovery even if the case is held in abeyance.

CONCLUSIONS OF LAW

1. CAD, WVEUG and Steel of West Virginia, Inc. have a legal interest in this proceeding and the Commission will grant their respective petitions to intervene.
2. The Commission clarifies that regardless of whether the merger ultimately occurs, the Commission is concerned about the uncertainty of the Companies' future power supplies and will require additional information regarding the options to address the looming capacity deficiency. This proceeding will necessarily include analyses of these issues with or without a merger of APCo and WPCo. The future filings by the Companies must address how they plan to remedy the capacity deficiency issue raised by the CAD Motion to Clarify Scope of Proceeding. The future filings should provide relevant information including cost implications regarding updates and modifications to the AEP Pool Agreement, acquisition of additional generation capacity, and other options that may be available to APCo and WPCo to address the generation capacity deficiency and energy requirements with or without a merger.
3. This matter will be held in abeyance for ninety days.
4. CAD may begin discovery now, and the Commission expects the Companies to provide responses to the extent possible.

ORDER

IT IS THEREFORE ORDERED the petitions to intervene filed by CAD, WVEUG and Steel of West Virginia, Inc. are granted.

IT IS FURTHER ORDERED that this matter will be held in abeyance until further order of the Commission.

IT IS FURTHER ORDERED that the Companies file a status report on or before June 26, 2012 that includes the status of the capacity and energy supply options under consideration and indicates whether the Companies are ready to go forward to address their capacity and energy needs, either through merger or as separate corporate entities. Following receipt of the status report, the Commission will issue a further order establishing a procedural schedule.

IT IS FURTHER ORDERED that filings by the Companies after the end of the abeyance period will address capacity deficiency issues and energy supply options, and provide relevant information including cost implications regarding updates and modifications to the AEP Pool Agreement, acquisition of additional generation capacity, and other options that may be available to APCo and WPCo to address future power supply needs with or without a merger.

IT IS FURTHER ORDERED that the parties may engage in discovery during the abeyance period.

IT IS FURTHER ORDERED that the Commission Executive Secretary serve a copy of this Order on all parties of record that have filed an e-service agreement, or by United States First Class Mail on parties that have not provided the Commission with an e-mail address, and on Staff by hand delivery.

A True Copy, Teste:


Sandra Squire
Executive Secretary

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