

April 24, 2007

The PJM Board of Managers
PJM Interconnection, L.L.C.
955 Jefferson Avenue
Valley Forge Corporation Center
Norristown, PA 19403-2497

To The PJM Board of Managers:

American Electric Power (“AEP”) appreciates the opportunity to provide comments regarding the PJM 2007 Strategic Report Recommendations. AEP recognizes the importance PJM has placed on working with stakeholders to refine its vision for the next ten years. AEP has reviewed the Report and would like to offer the following key points for the Board’s consideration.

- PJM’s strategic planning and long term goals must focus and center on achieving **operational excellence** in the promotion of the core fundamental requirements, which are system reliability, market operations, and regional planning within the scope of current Tariffs. Achieving excellence in these foundational core requirements must be a pre-requisite for any future expansion of scope.
- PJM must recognize **regulatory diversity** of its broad-based customer community while planning and implementing any new schemes or products. PJM must determine the potential cost impacts that its market policy and system operational decisions have on its diverse members and must reflect the heterogeneous culture in the PJM footprint
- PJM should offer a **voluntary menu of products and services**. The PJM Members must have an option to select services and then pay only for such selected services. These service costs should not be socialized across all PJM members.
- PJM should consider an alternative **voting structure** that recognizes assets given to PJM for functional control and the associated risk inherent in transfer of such assets.
- PJM should have **transparent performance metrics** that are the primary vehicle for determination of appropriate incentive compensation for PJM management and staff. These performance metrics, among other measures, should include accountability for enhancing reliability, and minimizing or eliminating NERC reliability standards violations, while minimizing administrative costs for PJM members.
- AEP appreciates PJM’s current effort in the investigation of the independence of the MMU. We believe that the PJM **Market Monitoring Unit (MMU) structure** should be independent of PJM management and should report directly to the FERC.

These points are further described in the sections that follow.

Operational Excellence and Smart Grid

AEP is celebrating a century of leadership in technological innovations; as a Transmission Owner that has developed and applied smart grid technologies, AEP is fully supportive of PJM’s consideration of facilitating the adoption of cost effective “smart grid” technologies. We encourage PJM to investigate ways in which it can facilitate the efforts of participants, regulatory agencies, and the rest of the industry to foster the adoption of technological advances. Transmission owners, working in conjunction with industry organizations, are uniquely qualified to provide leadership for smart grid technologies. Transmission owners have the advantage of technical expertise with respect to equipment and first hand experience with the design and operational performance of their system. PJM should leverage on TOs’ expertise. PJM should give serious consideration as to whether the scope of its smart grid facilitation should be limited to

transmission or expand, as suggested, to also include generation plants, the distribution system, and end-use customers.

AEP believes that PJM should work to facilitate the development and application of smart grid technologies throughout the PJM transmission system, but should: i) avoid the prescriptive requirement that PJM asset owners and operators use smart grid technologies; ii) avoid putting itself in the position of being a data management provider for market participants; and iii) avoid mandating the smart grid options to all its members. PJM should take a voluntary approach where a user has the option to buy the service if a value is recognized. Also, cost/benefit studies need to be conducted for the smart grid related activities and the results of such studies be made available to the PJM stakeholders.

PJM should focus on core objectives of assuring regional system reliability while improving market operations, regional planning, and facilitating open access to the transmission system. PJM's main contributions to the future development of smart grid technology should be to identify ways of encouraging Transmission Owners to develop and adopt the use of such technologies, and leave it up to the users to decide if it cost effective to select smart grid options. In addition, PJM's role as an independent and objective entity should be used to further educate State and Federal regulators/policy-makers to the need and advantages of certain technologies, and leverage upon utilizing such expertise and knowledge. These discussions must take place so that Transmission Owners receive full and timely rate recovery of costs associated with these improvements.

Regulatory Diversity

Prior to the PJM west expansion, PJM's footprint was comprised of deregulated states. The expansion of the PJM footprint introduced the inclusion of regulated states, including vertically integrated utilities such as AEP. PJM needs to be cognizant of this fact while developing new products and services and realize that certain policies and market programs necessary in deregulated states may not be desired as may not be cost effective or could be provided for via other mechanisms in regulated states. Participants that operate in regulated states often have reliability and resource requirements that may not exist in unregulated states. For example, regulated states typically require incumbent utilities to file resource plans and maintain adequate generation and transmission capacity to assure reliable operation.

Advocating wholesale demand response (DR) programs to retail customers is another example of a program that must address the needs of customers and participants in both deregulated and regulated states. While AEP supports DR, customers in regulated states typically are not exposed to market prices and have access to lower-cost power provided under bundled state tariffs. Any DR program must ensure that regulated, tariff-rate power is not resold by regulated customers into the wholesale market unless the profits created by the resale go directly to the entity providing the power thereby sharing the benefits with other customers as well.

Voting Structure

AEP encourages the Board to be cognizant of the imbalances within the current voting structure. While AEP acknowledges the report recommendation of posting minority positions on key voting items, we believe the Board should be open to considering recommendations that would modify the existing voting structure.

While AEP believes that the current two-thirds majority is satisfactory, controls are necessary to limit the size of block voting by a single representative, on behalf of many passive members, who can then exercise undue control over the resolution of the issue. AEP is concerned that asset owners do not have an appropriate voting weight in the decision-making process. For example, AEP has nearly 25% of the transmission assets in PJM, but has roughly a 2% stake in the voting structure. The asset owners have considerable operational and financial risk as a result of giving functional control of such assets to PJM. On the other hand, non-asset owning members have

relatively low financial and no operating risk, although they have considerable control in the outcome of votes.

Transparent Performance Metrics

AEP understands that the report is intended to address future goals and objectives for the PJM system. In striving for opportunities for improvement, PJM should not lose sight of the fact that its fundamental purpose is to ensure the reliability of the region and to achieve operational excellence, market efficiency, and reduce delivered cost of electricity to its customers.

AEP is encouraged that PJM is seeking operational excellence and in furtherance of that objective encourages PJM to create operational metrics within the stakeholder process. AEP recommends these metrics be: i) designed to achieve tangible benefits; ii) improve reliability; and iii) lower costs for PJM stakeholders and end-use customers. The metrics should be developed through a stakeholder process which is focused on ensuring transparency and accountability within the PJM organization.

Market Monitoring Unit Structure

Comments of Joseph Bowring at the April 5, 2007 Technical Conference on the Review of Market Monitoring Policies revealed issues that result from the MMU reporting to PJM. An effective MMU unit must be independent not only of market participants but also from the RTO management. Mr. Bowring's example of how market reports can be unduly influenced by PJM's management illustrates that structural changes are necessary. Ideally, all MMUs should be independent and report directly to FERC. This would ensure not only independence, but would also provide uniformity, transparency, and appropriate oversight. In addition, the costs of the MMU could be incorporated into the overall FERC operating budget.

Conclusion

AEP appreciates the PJM Board of Manager's request of stakeholder perspectives regarding PJM 2007 Strategic Report Recommendations. AEP is available for continued dialogue as the Board considers: the need for PJM to focus on achieving operational excellence in its core fundamental requirements, the impact of a regulatory diverse footprint, the need for a voluntary menu of products and services, the need for an alternative voting structure that better recognizes the assets given to PJM for functional control and the associated risk inherent in transfer of such assets, the need for transparent performance metrics that are utilized to determine PJM management compensation, and the need for a MMU that is independent of market participants and PJM management.

Respectfully submitted,

J. Craig Baker
Senior Vice President - Regulatory Services

cc: Phillip G. Harris
Audrey Zibelman
Vincent P. Duane, Esq.