As the primemovers in the claimed need for TrAIL, this responsibility should rest with the Company and the PJMRTO.

7.0 CAUSES AND IMPLICATIONS OF PLANNING DEFICIENCIES

Q. ARE YOU ABLE TO EXPLAIN, DR. ILEO, THE CAUSE OF THE FAILURE TO CONSIDER OPTIONS OTHER THAN TRANSMISSION IN THE PLANNING OF TRAIL?

A. Yes, although only again as an economist who has practiced in the field of electric utility regulation for many years. There also may be specific legal reasons, on which I am not qualified to express an opinion, that explain why the PJM does not consider new generation, DSM programs, and other options in its planning.

Available documents in this proceeding as to the purpose, structure, and operation of the PJM, suggest that it has little ability to require PJMRTO members to add generation (as contrasted with transmission) facilities in meeting load growth or system reliability requirements. Much the same appears to be true for DSM programs, although some comparatively minor efforts in this regard are identified as discussed later in my testimony. The resulting DSM impacts on Summer Peak electricity consumption, accordingly, are relatively small in the load forecasts of the PJMRTO.

The lack of least-cost IRP by the PJM and related federal agencies appears to stem from two forces. First, in the interest of promoting competition in electric generation markets, federal policy has sought to separate generation and transmission decision-making. This is an extraordinarily difficult task, as suggested by the experience of the various states that undertook specific electric industry restructuring, stranded generation cost recovery mechanisms, and related retail competition initiatives in the mid to late 1990s. In large part, these experiments have yet to realize the anticipated benefits of competition, including that downward pressures on generation prices have failed to materialize. That the vast bulk of generation assets in the U.S. remains under the ownership and/or control of electric utilities additionally complicates efforts to separate the generation and transmission sectors of the

electric business. The logic of attempts to sever generation and transmission decision-making also remains debatable, at least viewed from a regional planning perspective.

Second, the institution of DSM programs that could meaningfully impact load growth are subject to state jurisdictional authority. More specifically, in that retail end-use on the East Coast of the U.S. is the primary cause of the Summer Peak electrical demands faced by the PJMRTO, only a collective approval of DSM programs by state regulators (e.g., in New Jersey, Pennsylvania, Maryland, Washington, DC, and Virginia) could produce a material slowing of peak load growth. However, if the PJM possessed a DSM authority similar to what prevails for transmission, the likelihood of state regulatory approval in each jurisdiction of a standardized DSM program sponsored by the PJMRTO would be materially enhanced in my judgment.

Q. PLEASE EXPLAIN YOUR UNDERSTANDING OF THE EXPERIENCES IN STATES THAT UNDERTOOK EFFORTS TO PROMOTE ELECTRIC COMPETITION.

A. Having been a student of the electric business for many years, as well as participated in numerous industry restructuring cases before state regulators, I am generally familiar with the outcomes to date of electric competition experiments throughout the U.S. These initiatives have met with highly limited success, if not disappointment, as suggested below from the June 5, 2006 Draft Report To Congress On Competition In The Wholesale And Retail Markets For Electricity ("Draft Report"):

> In most profiled states, retail competition began in the late 1990s. States implemented retail rate caps and distribution utility obligations to serve, which are now just ending, that make it difficult to judge the success or failure of retail competition. Few alternative suppliers currently serve residential customers, although industrial customers have additional choices. To the extent that multiple suppliers serve retail customers, prices have not decreased as expected, and the range of new options and services is limited. Since retail competition began, most distribution utilities in the profiled states have either sold most of their generation assets or transferred them to unregulated affiliates (pgs. 4-5).

The "profiled states" cited in the Draft Report consist of Illinois, Maryland, Massachusetts, New Jersey, New York, Pennsylvania, and Texas, where the most extensive experiments with competition have been undertaken. The reference to the selling or transferring of generation assets in the Draft Report is indicative of the notion that the separation of generation from other functions of electric utilities will serve to foster competition within the electric industry.

Q. IN CITING AN ABSENCE OF LEAST-COST IRP AT THE FEDERAL LEVEL, TO WHAT DO YOU REFER?

A. Current federal policy with respect to resource planning in the electric industry is best reflected in the recent National Electric Transmission Congestion Report ("NETC Report") published by the U.S. Department of Energy ("DOE" or "Department") in the Federal Register ("FR") on October 5, 2007. The requirement for the DOE to produce a NETC Report stems from a 2005 added Section 216 to the Federal Power Act ("FPA"). More specifically, upon the designation of National Corridors by the DOE that are subject to electric transmission congestion, the NETC Report sets in motion a procedural process by which developers of new transmission facilities in these National Corridors may gain approval for these projects from state and/or federal regulators. The latter is the Federal Energy Regulatory Commission ("FERC").

Nearly at the outset of the NETC Report (i.e., in I. Background, A. Statutory Framework, at FR Page 56993), the DOE makes clear its interpretation of new FPA Section 216:

> FPA section 216(a) does not shift to the Department the roles of electric system planners or siting authorities in evaluating solutions to congestion and constraint problems. Transmission expansion is but one possible solution to a congestion or constraint problem. Other potential solutions include increased demand response; improved energy efficiency; deployment of advanced technology; and siting of additional generation, including distributed generation, close to load centers. Nothing in FPA section 216 requires or suggests that the Department should engage in a comparison of the relative merits of these different solutions to easing congestion in a specific geographic area.

DOE immediately goes on to explain the basis of its interpretation. Among other things, the DOE cites the provision in new FPA Section 216 that the congestion study (i.e., the NETC Report) required therein is described as "a study of electric transmission congestion, rather than a study of either the solutions to congestion or the need for transmission." DOE then proceeds to re-emphasize its interpretation by the following at FR Page 56994:

> Whether a particular transmission project, some other transmission project, or a non-transmission project is an appropriate solution to a congestion or constraint problem identified by a National Corridor designation is a matter that market participants, applicable regional planning entities, State authorities, and potentially FERC will consider and decide before any project is built.

Much of the remaining parts of the NETC Report, which essentially reiterates prior FERC policies in many respects, is devoted to refuting the claims of commentors on the initial (draft) National Corridor study published by the DOE in May 2007. For instance, regarding matters captioned as Consideration of Alternatives Under FPA Section 216(a)(2) at FR Page 57010, the DOE responds as follows:

> The Department concludes that consideration of non-transmission solutions to the congestion problems facing the Mid-Atlantic Critical Congestion Area is neither required nor necessary . . .
>
> Numerous commentors would have us interpret the phrase to mean alternative solutions to congestion or constraint problems, which would then necessitate a comparison of non-transmission solutions against transmission solutions. Nothing in the language of FPA section 216 requires or suggests such an interpretation.
>
> Not only does the statue not require the Department to analyze non-transmission alternatives, such analysis is also not warranted as a matter of discretion.

Use of the word "discretion" above suggests that the DOE could have interpreted new FPA Section 216 to require analyses of alternative means (in addition to transmission facilities) by which the East Coast power problem might be addressed. And, had the DOE and other federal agencies pursued this latter course of action, the void in relevant IRP information and data likely would not exist in this proceeding.

Q. PLEASE EXPLAIN YOUR COMMENT THAT THE NETC REPORT REITERATES PRIOR FERC POLICY.

A. In various decisions regarding RTOs (such as the PJM) or RTO members, the FERC has taken the position that in its evaluation of proposed transmission projects, consideration as to whether such projects are prudent (in terms of being the most cost-effective solution to a reliability concern) need not be made. A recent FERC decision involving transmission ratemaking matters applicable to TrAIL underscores the historical position of FERC on such IRP issues.

A May 31, 2007 Order of the FERC in Docket Nos. ER 07-562-000 and 001 dismissed claims that no showing had been made as to the prudence (i.e., cost-effectiveness) of TrAIL, including within the context of both the indicated Dockets and the planning of the PJM that gave rise to TrAIL. In its dismissal of these IRP issues at Paragraphs 64-72, the FERC cites its prior generic Order Nos. 679 and 679-A, which interpreted provisions of the Energy Policy Act of 2005 with respect to incentive-based rate treatments for new transmission projects. As noted by the FERC, these two Orders established procedures for public utilities to request incentive rate treatments of proposed new transmission project costs upon demonstrations that these proposed facilities "either ensure reliability or reduce the costs of delivered power by reducing transmission congestion" (¶ 65). Since the FERC had already found that TrAIL met this requirement through the planning process of the PJM, claims that TrAIL had yet to be shown as "prudent or the most cost-effective alternative" were denied by the FERC -- further noting that such claims constituted an "impermissible collateral attack" on prior FERC Orders (¶ 67).

Q. AS AN ECONOMIST, HOW DO YOU VIEW THE IMPLICATIONS OF THE FEDERAL POLICIES EXPRESSED IN THE NETC REPORT AND FERC OPINIONS?

A. In the first instance, current federal policies cause the unusual circumstances confronted in this case -- at least in part. Put otherwise, since federal policy neither requires the DOE or PJM to consider alternatives other than transmission, nor permits parties to raise IRP issues in FERC proceedings, the information and data necessary to evaluate whether TrAIL is truly an economical (cost-effective) solution to the East Coast power problem are missing. This situation likely would not prevail had the DOE exercised its "discretion" differently in interpreting new FPA Section 216.

These federal policies also effectively serve to shift the responsibility for ensuring that rational economic decisions are made in deploying electric utility resources to state regulators, such as the Commission. However, few (if any) state regulatory agencies possess the capabilities to gather necessary data and conduct requisite cost-effectiveness studies for the numerous markets and suppliers in a geographical area as large as that served by the PJMRTO. Only the PJM itself (or possibly the DOE) has that capability.

Moreover, in that the PJM is able to penalize its members for not pursuing designated transmission solutions to the East Coast power problem, it should bear responsibility for demonstrating that these projects are economical. Neither by Allegheny nor the PJM has this demonstration been made in this proceeding with respect to TrAIL.

Q. DO YOU FORESEE AN UNDERMINING OF COMPETITION GOALS FOR THE ELECTRIC INDUSTRY WERE AN IRP PROCESS UTILIZED BY THE PJM?

A. No. Indeed, my judgment is that not only would a properly structured regional planning process promote competition, but it would further greatly facilitate the ability of state regulators to reach appropriate decisions regarding electric utility resource deployment. I say this for two major sets of reasons.

First, under present conditions, an economic bias in favor of transmission facilities is incorporated in federal policies and PJM planning. Incentive ratemaking treatments of

transmission project costs by the FERC, for example, encourages electric utilities to pursue transmission solutions over other feasible options in resolving the East Coast power problem. Much the same is true of the penalties that the PJMRTO is able to impose on its members if steps to build designated new transmission facilities are not taken.

Second, if the planning of the PJMRTO embodied IRP concepts, this would serve to meaningfully identify feasible options other than only transmission, which would relieve a major obstacle in assessing potential economic opportunities by market participants. As things stand, federal planning relieves only the burden of identifying needed transmission facilities for resolving the East Coast power problem in the absence of considering other feasible solutions. And, of course, if the planning of the PJM extended to new generation, transmission upgrades, DSM programs, etc., a relevant data problem might not exist in this proceeding.

In my view, a material pro-competitive benefit would be conferred on producers and consumers in the electric industry (including state regulatory agencies) if federal policies and planning embraced IRP concepts. This is not to say that the PJMRTO should, upon identifying reliability problems, immediately designate a member responsible for developing a cost-effective generation, transmission, or DSM solution. To the extent no action is taken in this regard after some reasonable period of time, such a designation and enforcement similar to what is presently done with respect to only transmission facilities would not be inconsistent with competitive goals.

Q. PLEASE EXPLAIN YOUR COMMENTS ABOUT POSSIBLE PROJECT DESIGNATIONS AND ENFORCEMENTS BY THE PJM.

A. Consider one of the findings reached in the accompanying testimony of Mr. Lewis. Analyses of the load flow model utilized by Allegheny and the PJMRTO lead him to conclude that new generation in the range of ****** located in the vicinity of the Doubs Substation in Northern Virginia would alleviate the transfer capability shortfall reported by the Company for 2011. The identification of such a project by the PJM several years in advance of when it might be needed, along with other potential generation and transmission

solutions including TrAIL, would impart valuable knowledge to all participants in the electric industry.

Acting in light of this information, some participants are likely to further pursue the feasibility of new generation close and connected to the Doubs Substation. And, if investigations in this regard establish the viability of this generation project, attendant actual planning is also likely to ensue. Such an outcome would also suggest that the marketplace has found ****** of new generation capacity at the Doubs Substation to be a cost-effective solution to the transfer capability deficiency.

On the other hand, if no evidence of actual planning becomes apparent after several years, this outcome would suggest that market forces have determined that the potential new generation project in question is not feasible. Armed with this information, as well as similar knowledge pertaining to other potential solutions previously identified, resulting decisions of the PJM will be more consistent with both competitive outcomes and IRP principles. For instance, if certain identified projects have been pursued in the marketplace, while others have not, the latter should only be mandated by the PJM when an overriding public interest concern is posed; i.e., a public need that cannot be fulfilled by the "invisible hand of competition." If such conditions pertained to the Doubs generation project or to TrAIL, an enforcement of either project would not be inconsistent with competitive goals, as a reliance on market forces over several years has yet to produce desired results.

8.0 SENSITIVITIES OF THE TRANSER CAPABILITY PROBLEM

Q. HAS ALLEGHENY REPORTED A SPECIFIC TRANSFER CAPABILITY PROBLEM IN CONNECTION WITH ITS CLAIMED NEED FOR TRAIL?

A. Yes. In response to discovery, the Company has presented data showing that west to east transmission flows in the PJM System will be deficient by about ******* in 2011; e.g., see Tab: Summary Sheet in Attachment Staff-2-6-A of Allegheny response to Staff-2-6-(c). TrAIL is slated to fill this void, along with being shown as creating an additional electric power transfer capability of roughly ********, such that the total capacity of TrAIL