

March 15, 2001

David P. Boergers
Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

RE: PJM Interconnection, L.L.C. and the Allegheny Power System operating companies: Monongahela Power Company, The Potomac Edison Company, and West Penn Power Company, all doing business as Allegheny Power; Docket Nos. ER01-____-000 and EC01-____-000

Dear Mr. Boergers:

PJM Interconnection, L.L.C. (“PJM”) and the Allegheny Power System operating companies: Monongahela Power Company, The Potomac Edison Company, and West Penn Power Company, all doing business as Allegheny Power (collectively referred to as “Allegheny”), jointly submit this filing to establish PJM as the Regional Transmission Organization (“RTO”) for Allegheny pursuant to an arrangement known as “PJM West.”

Allegheny has determined that, as a result of joining PJM under the PJM West arrangements, it stands to suffer a net revenue loss of approximately \$27.7 million per year out of total annual transmission revenues of approximately \$63 million. This revenue loss figure includes net revenue loss associated with pancake elimination and amortization of necessary start-up expenses which are assigned to Allegheny. Allegheny could not voluntarily join an RTO if it were to suffer such huge revenue losses. Therefore, as part of this joint submittal, Allegheny is filing, pursuant to Section 205 of the Federal Power Act (“FPA”), 16 U.S.C. 824d, transition rate mechanisms designed to preserve revenue neutrality.¹

Consistent with Order No. 2000, Allegheny will transfer functional control of its transmission facilities to PJM effective on January 1, 2002,² at which time PJM will

¹ PJM takes no position on Allegheny’s rate proposal.

² The requested effective date is the first day of the first calendar month following the RTO commencement date contemplated by Order No. 2000.

begin to offer service on Allegheny's facilities under the PJM Tariff. PJM and Allegheny have already begun the challenging task of revising, expanding, and updating PJM's systems as necessary to integrate Allegheny and meet the commitments in the PJM West agreements. This effort will become especially intensive by mid-year, with a substantial expenditure of funds and commitment of staff resources. In order to keep this process on track and meet the ambitious deadline of January 1st, PJM and Allegheny urge the Commission to act on this filing by no later than June 15, 2001.

I. INTRODUCTION

This filing allows the Commission to: 1) approve Allegheny's transfer of its facilities to an RTO, i.e., PJM; and 2) substantially expand the scope of PJM's existing regional market, planning process, and system operations. Through these arrangements, all "seams" between Allegheny and PJM will be eliminated.

Approval of this filing will also encourage the growth and evolution of PJM in another key respect: the PJM West agreements contemplate a "Phase II," in which one or more transmission owners would form an independent transmission company and demonstrate through further filings that they qualify to assume some of the RTO functions that would otherwise be performed by PJM. No division of functions or specific Phase II proposal is set forth in the enclosed agreements; that will only be effected through further filings. Nonetheless, this commitment by PJM to the ITC concept (which also could apply to the existing PJM transmission owners) will allow for-profit transmission companies and other market participants additional flexibility for the evolution of grid governance models that best preserve reliability, enhance competition, and meet the needs of stakeholders.

The PJM West proposal is innovative and can serve as a model for the industry. For the first time, a single regional market, with a single congestion management system, will cross multiple control areas and multiple regional reliability councils. The resulting wholesale electricity market will be, far and away, the largest in the world. The current "seams," created by control area, security coordinator, and reliability council borders, will disappear. PJM and Allegheny, working with the existing PJM transmission owners and other stakeholders, including Duquesne Light Company, a potential PJM West participant, have shown how these challenges can be overcome and they are confident that the agreed arrangements can be successfully implemented.

PJM has already shown in detail in its October 11, 2001 compliance filing in Docket No. RT01-2 how PJM satisfies all of the required minimum characteristics and functions of an RTO. This filing will establish PJM as the RTO for Allegheny, with an expected start-up date of January 1, 2002.³ Therefore, as a result of this filing, Allegheny

³ This is a slight deviation from the December 15, 2001 RTO commencement date contemplated by Order No. 2000. This will enable easier implementation of the required systems and processes at the start of a month.

will join an Order No. 2000-compliant RTO,⁴ with sufficient scope and appropriate configuration, an independent, non-stakeholder board, and a competitive non-discriminatory energy marketplace with a proven congestion management system.

In addition to bringing the benefits of an RTO to Allegheny's customers, PJM West also provides substantial benefits to PJM's existing stakeholders. PJM West will extend PJM's transmission system operations, tariff, markets, and internet tools to encompass approximately 1.4 million additional end-use customers, approximately 7,800 additional megawatts of load, approximately 5,000 additional miles of transmission lines, and approximately 9,100 additional megawatts of generation capacity. The PJM West agreements will expand the scope of PJM's operations in Pennsylvania, Maryland and Virginia and extend PJM's operations into West Virginia and Ohio.

PJM's existing stakeholders will therefore become participants in a new larger regional energy market. Seams issues along the PJM/Allegheny interface will be eliminated, with a common tariff, a common market, and common business practices and customer interface tools across PJM and PJM West. Moreover, the expanded PJM will internalize loop flows across a much larger region, and have greater resources at its disposal to preserve both short-term and long-term reliability at a lower overall cost and environmental impact. PJM's administrative costs will be shared across a larger region, reducing transaction costs and promoting efficiency.

As explained in the report that Duquesne is filing concurrently in Docket No RT01-13-000, Duquesne has participated in the negotiations on, and development of, PJM West and anticipates joining. However, Duquesne wishes first to complete a Pennsylvania Public Utility Commission-sponsored stakeholder process to resolve certain issues arising from the impact of RTO participation on its "Provider of Last Resort" settlement. The enclosed agreements and tariff amendments (including rate provisions) have been drafted so that, if and when Duquesne, or any other potential PJM West transmission owner, decides to join, the documents will require only slight modifications.

II. LIST OF DOCUMENTS SUBMITTED

This filing consists of an original and fourteen (14) copies of the following documents, in four volumes:

(Volume I)

- (1) This Filing Letter;
- (2) Contact List for Communications (Attachment A);

⁴ Regional Transmission Organizations, III FERC Stats. & Regs., Regs. Preambles ¶ 31,089 (1999), order on reh'g, Order No. 2000-A, III FERC Stats. & Regs., Regs. Preambles ¶ 31,092 (2000).

- (3) Form of Notice of Filing (Attachment B) (also provided on diskette);
- (4) PJM West Transmission Owners Agreement (Attachment C);
- (5) PJM West Reliability Assurance Agreement (Attachment D);
- (6) Proposed revisions to the existing PJM Transmission Owners Agreement (Attachment E), also shown in redlined form (Attachment F);
- (7) PJM West Implementation Agreement, provided for information only (Attachment G);
- (8) Testimony and exhibits of Allegheny in support of their rate proposal (Attachment H);
- (9) A Certificate of Service (Attachment I);

(Volume II)

- (10) Proposed Revisions to the PJM Operating Agreement⁵ (Attachment J), also shown in redlined form (Attachment K);

(Volume III)

- (11) Proposed Revisions to the PJM Tariff⁶ (Attachment L); and

(Volume IV)

- (12) Proposed Revisions to the PJM Tariff also shown in redlined form (Attachment M).

III. STAKEHOLDER PROCESS

This filing follows an intensive stakeholder process. PJM and Allegheny announced their intent to form PJM West in October of last year, subject to the negotiation of definitive agreements. Duquesne announced shortly thereafter that it would join the discussions on PJM West. A working group of representatives of PJM, Allegheny, and Duquesne met numerous times in November and December to identify

⁵ The revised and redlined Operating Agreement attachments also incorporate certain pending changes to Sheet Nos. 22, 23, 29, 32, 33, 52, 128, 163, and 177. To distinguish these from the current approved agreement provisions, they are shown in italics.

⁶ The revised and redlined Tariff attachments also incorporate certain pending changes to Sheet Nos. 81 and 82. To distinguish these from the current approved tariff provisions, they are shown in italics.

issues, attempt to resolve differences, and begin drafting the necessary agreements and amendments. The first complete working draft of all implementing documents was posted on PJM's and Allegheny's websites on January 12, 2001. Stakeholder comments and questions were invited, and the answers to those questions also were posted.

PJM, Allegheny, and Duquesne sponsored an all-stakeholders meeting in Pittsburgh on January 16, 2001. Representatives of PJM, Allegheny, and Duquesne also provided numerous briefings and status reports, and invited discussion and comment, throughout January and February at PJM's regular stakeholder meetings, including meetings of PJM's Members Committee, Energy Markets Committee, Reliability Committee, Planning Committee, Tariff Advisory Committee, Transmission Owners Committee, and Finance Committee. The parties also briefed and sought comments from the state utility regulatory commissions for the states in the proposed PJM West Region.

The implementing agreements and amendments were revised to reflect stakeholder input and other changes. The revised agreements were then posted again to the PJM and Allegheny websites, on February 1, 2001. PJM's independent Board of Managers approved the PJM West arrangements at its February 6th Board meeting. On February 8th, the PJM Members Committee met and approved the amendments to the PJM Operating Agreement by a sector vote of 3.8 to 0.2. The Members Committee also endorsed the necessary PJM Tariff amendments (not including the rate proposal by Allegheny) by acclamation. PJM, Allegheny, and Duquesne sponsored a second all-stakeholders meeting in Pittsburgh on February 22 and 23. On March 1, 2001, Allegheny's Board of Directors authorized Allegheny's execution of the PJM West agreements.

As always, PJM's stakeholder process continues on a regular basis, and PJM West implementation issues will continue to be discussed in the various PJM committees on a going forward basis. Moreover, PJM anticipates that in the next few months (even before the agreements are approved and formal meetings are authorized) PJM will arrange informal meetings of the load-serving entities in the PJM West region to continue to discuss mechanics of the implementation of the West RAA. As has been the trademark of PJM's current success, PJM will continue to evolve the PJM marketplace in an orderly and systematic fashion based on input from all members through PJM's open stakeholder process.

IV. DESCRIPTION OF PJM WEST

A. Overview

The basic agreements establishing PJM West are the "PJM West Implementation Agreement" ("Implementation Agreement"), the "West Transmission Owners Agreement among PJM Interconnection, L.L.C. and Certain Owners of Electric Transmission Facilities" ("West TOA"), and the "PJM West Reliability Assurance Agreement" ("West RAA"). The expansion of PJM also requires amendments to the Tariff, the existing PJM

Operating Agreement, and the existing PJM Transmission Owners Agreement.⁷ As amended, the PJM Tariff and PJM Operating Agreement will apply to both PJM West and existing PJM. Allegheny and all other interested PJM West market participants will sign the PJM Operating Agreement and become members of PJM.

The guiding principle for these agreements and amendments has been to apply to PJM West, as much as reasonably possible, the same rules, terms and conditions that currently apply to PJM. The PJM Tariff, including the terms and conditions of transmission and ancillary services, the market monitoring standards and procedures, and the generation interconnection rules and procedures, will apply to the expanded region. The PJM Operating Agreement, including the governance rules, the interchange energy market rules, congestion management, fixed transmission rights, the planning and expansion protocol, and the dispute resolution rules and procedures, all will apply to the expanded region.

This approach includes applying well-established PJM administrative procedures even to the limited areas where differences will continue to exist. For example, one notable difference between PJM and PJM West is the rules on installed generating capacity and reserves. Allegheny is part of the East Central Area Reliability region (“ECAR”), which uses a different reserve requirement methodology than the existing PJM load serving entities (“LSEs”), which are part of the Mid-Atlantic Area Council reliability region (“MAAC”). Therefore, the parties have developed the West RAA to apply to LSEs in PJM West. Although the reserve requirement will be different, the manner of its implementation will be similar to existing PJM procedures, including a new market in capacity credits to help LSEs in the west meet their reserve obligations.

Other differences arise from the fact that PJM West is in a different electrical control area than the existing PJM members. Therefore, for voltage regulation and a few other control-area-specific matters, the Tariff and Operating Agreement amendments establish separate requirements, and separate mechanisms for participants to meet those requirements, in PJM and PJM West.

The PJM Tariff includes similar changes as in the Operating Agreement, to expand its scope to apply to the PJM West region. Notably, the addition of Allegheny’s loads to the customers charged for PJM’s administrative costs will significantly reduce the formula-rate charges under Schedule 9 of the Tariff. PJM estimates those savings to

⁷ PJM and Allegheny also have agreed on how to coordinate their transmission service requests and generation interconnection queues and procedures for the period before the PJM Tariff becomes effective for those companies, through an “Interim Coordination Agreement,” which was filed with the Commission on February 13, 2001 in Docket No. ER01-1232-000.

be over \$11 million in 2002, increasing to \$15 million and \$16 million in 2003 and 2004, respectively.⁸

Allegheny proposes to recover its estimated lost transmission revenues from the elimination of rate pancaking as well as its start-up expenses of joining PJM. Therefore, Allegheny proposes to add to the Tariff transitional charges on all “through” or “out” firm and non-firm point-to-point service. Allegheny also proposes a separate transitional charge on megawatt hours of energy both input into the grid by generators and delivered from the grid to loads. In total, the application of the new PJM border rate along with all transitional charges will still result in significant transmission cost savings for market participants.

Consistent with PJM’s existing practice, Allegheny will be directly charged for certain expenses, such as new communications links, necessary to integrate it into PJM. Allegheny also has agreed to pay for all of PJM’s expenses for PJM West incurred before PJM West is implemented, but will recoup such amounts via the transitional charges. PJM’s capital costs of establishing PJM West will be recovered under the PJM Tariff from the PJM and PJM West market participants. However, Allegheny has agreed through the Implementation Agreement that it will reimburse PJM for all of its costs if for any reason Allegheny withdraws from the arrangements.⁹

⁸ If Duquesne joins, the savings will be even greater. PJM estimates the Schedule 9 savings with both Allegheny’s and Duquesne’s loads to be \$15 million in 2002 and approximately \$20 million in 2003 and 2004.

⁹ The Implementation Agreement is described in this letter but is not submitted for filing. The Implementation Agreement terminates once PJM becomes the transmission provider for Allegheny’s facilities, after which the submitted agreements become operative. The Implementation Agreement therefore is in the nature of a precedent agreement, committing the parties to make filings and addressing the financial consequences if the proposed arrangement does not go forward. It also is similar to agreements for reimbursement of initial costs to integrate new members into PJM’s telecommunications and information systems. The Commission does not normally require either precedent agreements or direct reimbursement agreements to be filed. A copy of the agreement is attached for informational purposes. If the Commission determines that the Implementation Agreement must be filed under FPA section 205, then Allegheny and PJM ask that the Commission accept it for filing, effective as of the date of its execution by PJM and Allegheny.

B. West Transmission Owners Agreement

The West TOA is similar to the existing transmission owners agreement (including the changes proposed to that agreement as part of PJM's October 2000 RTO compliance filing).¹⁰

Allegheny agrees in the West TOA to transfer to PJM responsibility to direct the operation of its transmission facilities, to provide service under the PJM Tariff using those facilities, and to participate in a Regional Transmission Expansion Plan that includes the PJM West region. West TOA, §§ 2.3.4, 2.3.5, and 2.3.7. Allegheny also agrees to coordinate its transmission facility maintenance through PJM. Id., § 2.3.6. The West TOA appoints PJM as the NERC security coordinator for PJM West under the rules of ECAR and for the PJM Control Area under the rules of MAAC. Id., § 4.8.

The West TOA recognizes that some or all of the PJM West Transmission Owners may seek to form an independent transmission company ("ITC") in the future. West TOA, § 5.1. The ITC may include proposals for the transfer by PJM of some of its functions to the ITC. The parties to the West TOA (including PJM) agree not to oppose formation of such an ITC, but may take any position they wish on the transfer of RTO functions to the ITC (unless they have previously come to an agreement on that transfer).¹¹ Consistent with Commission policy, any specific proposal for an ITC will be set forth in a future filing, in which the ITC proponents demonstrate that their ITC has the independence, scope, and other qualities necessary for it to assume the particular functions that are proposed for it.¹² In general, as reflected in the recital to the West TOA, it is anticipated that, among any other retained functions, PJM would continue to act as the independent administrator of the regional energy and other markets.

The West TOA provides for the "license plate" zonal transmission rate design in PJM to be extended to PJM West, with no changes to such rate design before January 1, 2005.¹³ West TOA, § 5.1. Transmission revenues for service to load within a zone will be distributed to the transmission owners in that zone. Id., § 5.3. Service to loads outside PJM will be distributed among all east and west transmission owners on a revenue requirements basis, except for the revenues from certain new transitional charges.¹⁴

¹⁰ The West TOA is PJM Rate Schedule FERC No. 33.

¹¹ These same principles could also be applied in the context of a broader ITC including the existing PJM transmission owners.

¹² See Commonwealth Edison Co., et al., 90 FERC ¶ 61,192 (2000).

¹³ This moratorium corresponds to the existing PJM transmission owners' proposal in the October RTO filing.

¹⁴ All revenues from "Transmission Revenue Neutrality" charges on firm and non-firm point-to-point service and "Market Expansion" charges on energy input into

The West TOA contains the same provisions regarding the transmission owners' obligation to build facilities as were recently proposed for the existing TOA in PJM's RTO compliance filing in Docket No. RT01-2. Id., article 7. Similarly, PJM will be a party to the West TOA with rights and obligations similar to those PJM will have under the proposed amendments to the existing TOA. Id., article 8.

The West TOA is conditioned on Commission approval of the West TOA, West RAA, amended Operating Agreement, and amended Tariff, including the proposed transitional charges. Id., article 10.

C. West RAA

The West RAA is closely patterned after the existing Reliability Assurance Agreement Among Load-Serving Entities in the PJM Control Area ("RAA").¹⁵ All LSEs in the PJM West region will become parties to the West RAA. West RAA, article 2. A separate Reliability Committee will manage the agreement, with administrative duties delegated to PJM. Id., § 7.1. The governance and voting rules and the general terms and conditions of the West RAA are virtually identical to the existing RAA.

The West RAA differs from the existing RAA, however, as a result of differences in the approaches that MAAC and ECAR use to assure reliability. ECAR and MAAC have the same fundamental reliability standard, i.e., a one-day-in-ten-years loss-of-load expectation, but they use different reserve requirement methods to meet that standard. A principal objective of the formation of PJM West is to facilitate a single regional energy market across both MAAC and a portion of ECAR. Therefore, the parties endeavored to design capacity rules for PJM West that satisfy ECAR's requirements, but that also are compatible with MAAC's requirements. Compatible reserve requirements also benefit the capacity markets, by allowing qualified resources in both areas to satisfy requirements in either area. Finally, compatible reserve rules also help avoid imbalances and ensure that one area will not unreasonably "lean" on another area.

The Reliability Committee for the existing RAA, in compliance with MAAC reliability standards, requires an installed capacity margin of 19% of the forecast annual peak load.¹⁶ ECAR control areas, like Allegheny, in compliance with ECAR reliability

and delivered from the transmission system will be distributed to Allegheny. Id. These charges are discussed in Section V of this transmittal letter.

¹⁵ The West RAA is PJM Rate Schedule FERC No. 32.

¹⁶ The installed reserve margin is set annually on a two-year forward basis by the RAA's Reliability Committee. Under the RAA, the installed reserve margin is administered in terms of "unforced" capacity, i.e., installed capacity reduced by the 12-month rolling-average forced outage rate of the resource.

standards (through ECAR Documents Nos. 2, 4, 8, and 15¹⁷), require an operating reserve margin of 4% of the forecast hourly peak load for the next day.¹⁸ The ECAR operating reserve margin must be maintained throughout the operating day.

The different methods of achieving the same fundamental reliability standard reflects that reserves can be measured at different levels over different timeframes, and by taking account of different contingencies. “Installed” reserves measure all installed resources over an annual or seasonal timeframe, whether or not those resources are available on any given day. “Unforced” reserves measure the installed reserves after allowance for typical forced outage rates.¹⁹ “Available” reserves measure the installed reserves over a shorter, day-ahead timeframe, less forced outages, planned outages, and maintenance outages. “Operating” reserves exclude from the above calculation the capacity that, on a daily basis, is not available within 10 minutes or less. In all cases, the expectation is that load-serving entities are capable of supplying the capacity and energy necessary to meet their load and their respective reserve obligations.

To ensure compatible capacity requirements and a unified energy market in existing PJM and PJM West, the basic approach of the West RAA is to set an “available capacity” requirement for PJM West of 106% of the next day’s forecast peak load. PJM has calculated that if this standard is maintained in PJM West, then PJM can meet the ECAR daily operating capacity requirement with resources nominated to meet the RAA West’s 106% day-ahead available capacity requirement. The ECAR 104% operating capacity level requires resources, i.e., either generating units or interruptible load, that can be made available in only ten minutes. The West RAA’s 106% available capacity level requires generating resources that can be made available on up to four hours notice and loads that can be interrupted on up to two hours notice. Requiring LSEs to provide resources at the 106% level that meet the 4 hour/2 hour “available” criteria ensures that PJM should have, every day, resources meeting the 10 minute “operating” criteria for at least the 104% level required by ECAR.

Moreover, the “daily available” level of 106% is generally comparable to the “annual installed” level of 119% in the existing PJM area which ensures that one area will not unreasonably “lean” on another. Furthermore, this approach allows PJM to treat qualifying resources in either area, in the aggregate, as “deliverable” to either region. In

¹⁷ The ECAR documents are available on ECAR’s website at www.ecar.org/documents/.

¹⁸ The ECAR reserve margin is comprised of 1% load and frequency regulating (spinning) reserves in the control area, 1.5% contingency spinning reserves in the control area, and 1.5% contingency supplemental reserves from inside or outside the control area.

¹⁹ For example, in PJM, the 5-year rolling average historical forced outage rate is approximately 9.5 to 10%.

other words, this standard allows qualifying capacity resources in existing PJM to participate in satisfying the capacity requirements of PJM West; and it allows qualifying capacity resources in PJM West to participate in satisfying the capacity requirements of existing PJM.

More specifically, the West RAA establishes a “Daily Available Capacity Obligation” for each LSE equal to 106% of the LSE’s estimated day-ahead contribution to the forecast peak load in its respective zone in PJM West. West RAA, § 8.1 and Schedule 3, paragraph A. Under the West RAA, LSEs can meet their capacity obligations only with resources pre-certified by PJM. *Id.*, § 1.5 and Schedule 4. Such resources may include generating units in the region, interruptible load, capacity credits from the new PJM West available capacity credit market, and capacity resources located outside the combined PJM region provided there is firm transmission service to, and ATC at, the border to bring such capacity into the expanded PJM. *Id.*; see also §§ 1.36 and 1.37 and Operating Agreement Schedule 11A.

If an LSE does not satisfy its capacity obligation, it must pay a deficiency charge in the amount of \$11,680 per MW of deficiency for each day it is deficient. West RAA, § 9.1 and Schedule 3, paragraph E. As under the existing RAA, this penalty is based on the estimated costs of a new combustion turbine-generating unit. Under the existing RAA, the estimated annual costs of a new generating unit are spread over an entire year, reflecting the annual installed capacity requirement, resulting in a daily deficiency rate of \$160/MW. However, because the West RAA’s 106% available capacity obligation is based on developing the required ECAR operating reserves from day-ahead nominated available capacity resources, the failure of an LSE to meet this obligation is approximately equivalent to the control area being short of operating reserves on a peak energy day during the year. Since there are historically, on average, five annual peak energy days per year, the single day deficiency rate is set at 20% of the annual cost of a new combustion turbine generating unit. Therefore, to compute an appropriate deficiency charge under the West RAA, where only daily rather than annual capacity must be provided, the annual costs of a new unit are spread over five days, producing a higher daily deficiency penalty.

In response to concerns expressed during the stakeholder process, the filed proposal incorporates several features to mitigate the necessary high deficiency charge associated with a daily “available capacity” approach. First, LSEs will not be forced into deficiency as a result of unexpectedly high loads. PJM will forecast the peak load level for four-month periods, three times each year. West RAA, §§ 1.17 and 1.18, and Schedule 3, paragraph F(2). The available capacity required from an LSE each day can not exceed 106% of that LSE’s seasonal peak loads, as previously forecast for the current four-month period.²⁰ *Id.*, Schedule 3, paragraph A. Second, an LSE can elect each

²⁰ The loads for which an LSE is responsible may vary from day to day, however. In such cases, the LSE’s available capacity obligation is capped by 106% of the seasonal forecast for its revised customer base.

season, as an “insurance policy,” to instead maintain an installed reserve margin equal to a specified percentage of the seasonal peak forecast for its loads.²¹ Id., Schedule 3, paragraph F(5). So long as the LSE maintains, and does not delist, those installed reserves, then it will pay a deficiency charge of only \$160 per MW-day on any day to the extent it falls short of its 106% available capacity obligation. Id., Schedule 3, paragraph F(8). The \$160/MW charge is the same as the deficiency charge under the existing RAA’s installed capacity rules. Third, if an LSE experiences a forced outage of a generating resource, it will be permitted to take advantage of a portion of the PJM capacity benefit margin for a limited period of time (not to exceed six weeks) as necessary for the LSE to rely on external capacity resources during the outage and avoid a deficiency charge. West RAA, § 1.6 and Schedule 6, § 2(n).

D. Operating Agreement Amendments

The amendments to the Operating Agreement broaden its scope so that it applies to the PJM West control area, instead of applying only to the existing PJM Control Area. In most instances, a reference to the “PJM West Region” (see OA, § 1.36A) was added to any reference to the “PJM Control Area.” Numerous key terms, such as “Electric Distributors” (Id., § 1.8), “Internal Market Buyers” (Id., Schedule 1, § 1.3.10), “End Use Customer” (OA, § 1.11), “Transmission Facilities” (Id., § 1.44), etc. were redefined to encompass PJM West market participants and facilities in addition to those in the existing PJM Control Area. Definitions and cross-references were added for the new agreements. Existing references to MAAC were replaced with references to a new, broader term, “Applicable Regional Reliability Council” (see OA, § 1.5A).

A number of revisions were made to accommodate the West RAA. For the most part, these involved pairing references to “Capacity Resources” under the RAA with references to “Available Capacity Resources” (OA, § 1.5B) under the West RAA. In addition, for three Operating Agreement schedules (i.e., 8, 9, and 11) that relate directly to the existing RAA, parallel schedules (8A, 9A, and 11A) were added to accommodate the slightly different terms of the West RAA. The most significant of these, new Schedule 11A, creates a new market in “Available Capacity Credits” as an option for LSEs in the west to satisfy their capacity obligations under the West RAA.

Schedule 6 of the Operating Agreement, the Regional Transmission Expansion Planning Protocol, provides for a single plan covering the entire expanded area (see Schedule 6, § 1.1). However, the plan will separately identify enhancements and expansions for the PJM West Region and those for the existing PJM control area (see

²¹ The specific level (expected to be in the range of 16 to 19%) will be set later this year and will be subject to review and adjustment each year by the Reliability Committee. As is the case with the existing RAA, key actions of the Reliability Committee will be subject to review by the PJM Board of Managers. See West RAA, § 7.4.3

Schedule 6, § 1.5.6(a)). The revised Protocol then prescribes separate cost allocation for the facilities in the east and those in the west (Id., § 1.6(b)).

Other east-west distinctions in the amended Operating Agreement include:

- a separate regulation requirement and separate cost-based market for regulation in the west (see OA, Schedule 1, §§ 1.7.18, 1.10.1A(e), 3.2.2A, and 3.3.2A);
- determination of West region operating reserves objectives based on ECAR requirements and allocation of certain operating reserves costs for western resources to western loads and for eastern resources to eastern loads (Id., Schedule 1, §§ 1.7.17(b) and 3.2.3(j),(k));
- allocation of 500 kV and 345 kV losses in the PJM West Region to electric distributors in the PJM West Region that report hourly net energy flows from metered tie lines, paralleling the treatment of similar 500 kV “backbone” lines in the existing PJM control area (id., Schedule 1, § 3.2.5(d)).
- distinct requirements for underfrequency relays, so that Electric Distributors in the east meet the MAAC requirement and Electric Distributors in the West meet the ECAR requirement (see OA, Schedule 7); and
- a provision that PJM will shed load in the affected control area when load shedding is needed to alleviate an emergency (see OA, Schedule 1, § 1.7.11).

In addition, in reviewing the Operating Agreement for all necessary conforming changes for PJM West, it was noted that several provisions or references appear to be no longer necessary. Schedule 1, section 2.3 includes a sentence noting the number of nodes in the “current” version of the state estimator. Rather than update this sentence, it was deleted. Schedule 2, Exhibit A, concerning calculation of emissions allowances, includes some background information that appears to have outlived its usefulness, and so those few sentences were deleted. Finally, section 11.5(c) of the OA consists of a clarification relating to the initial implementation of LMP which includes a cross-reference to a section that no longer exists and that in general appears not to have any continuing relevance.

E. Tariff Amendments

The changes to the Tariff are similar to those for the Operating Agreement, although less extensive. Defined terms were expanded, as necessary, to include the PJM West Region, and references were added to the new agreements and to the new concepts under those agreements, such as “Available Capacity Resource” (§ 1.3B) and “Applicable Regional Reliability Council” (§ 1.2A). The term “Regional Transmission

Owner,” which currently is used throughout the Tariff, was changed to “Transmission Owner” (§ 1.45A) or, where appropriate, “West Transmission Owner” (§ 1.49A) or “East Transmission Owner” (§ 1.10A).

The separate regulation requirement for the PJM West Region was added to ancillary service Schedule 3 (“Regulation and Frequency Response Service”). The recently approved MAAC charge (Tariff Schedule 10) is clarified so that it only applies to loads in MAAC, and not to the PJM West Region.²²

This filing also will affect the charges under existing Schedule 9, by which PJM recovers its administrative costs through unbundled formula rates. Although PJM’s costs will increase somewhat to establish and administer the new area, that increase will be more than offset by the increased loads in the denominators of the formula rates. The net result will be a significant reduction (\$11-16 million if Allegheny joins; \$15-20 million if both Allegheny and Duquesne join) in the rates charged to customers under Schedule 9.²³ In addition, two of the administrative services, i.e., Schedule 9.2 and 9.7, relate to costs to administer the RAA and existing capacity credit market. PJM will now apportion these administrative costs between the PJM Control Area and the PJM West Region.

The amended Tariff also incorporates Allegheny’s transitional rate proposal, as discussed below, including changes to section 27A on non-firm transmission revenue distribution, changes to Schedules 7 and 8, new Schedule 11, and a new Attachment H-11 for Allegheny’s network service rates.

F. Implementation Agreement

The Implementation Agreement commits PJM and each West Transmission Owner to initiate all necessary regulatory proceedings for approval from the Commission of PJM West by March 15, 2001. Implementation Agreement, § 3.1.2. The Implementation Agreement also commits PJM to upgrade and expand its systems and facilities as necessary for PJM to operate as the Regional Transmission Organization (“RTO”) for the PJM West region and to undertake the expanded obligations imposed by the West TOA, West RAA, amended Operating Agreement and amended Tariff. Id., § 3.2.1.

²² The enclosed revisions include conforming changes to Schedule 1A of the Tariff. However, those sheets have been superceded on an interim basis by interim settlement rates pursuant to a June 24, 1999 letter order in Docket No. ER99-396-000. Those sheets will be permanently replaced if the Commission grants final approval to the pending settlement in that docket, which will moot the attached revisions to Schedule 1A.

²³ As discussed below, Allegheny proposes to set the revenue requirement under its proposed “Transitional Market Expansion Charge” so that it is equal to a portion of these savings.

The Implementation Agreement also establishes the responsibility of Allegheny for PJM's costs to implement PJM West. Each month during PJM's development of the necessary systems and facilities upgrades, Allegheny will reimburse PJM for (1) all costs, whether accounted for as capital or expense, that PJM incurs for telemetering and similar costs that, in keeping with past practice, are directly assigned to facility owners that join PJM, and (2) all other PJM West costs that are incurred by PJM prior to PJM West implementation and that are classified as expenses.²⁴ Id., Article 4. Allegheny will seek to recover these costs through the transitional charges.

The other PJM West costs that are capitalized by PJM will be recovered by PJM from market participants (both east and west) under the formula rates for PJM's various unbundled administrative services in Schedule 9 of the PJM Tariff after PJM West is implemented. Id., § 4.1.4.2. However, if a West Transmission Owner that has signed the West TOA does not transfer control of its facilities to PJM, or otherwise withdraws, then it must reimburse PJM for its share of any unrecovered PJM West capital costs. Id., § 5.4.2.1.

G. Transmission Owners Agreement

The PJM Transmission Owners Agreement is being revised on the assumption that the Commission will accept the new PJM West arrangements and that the West Transmission Owners will then participate in the distribution of revenues from PJM Tariff transmission services. PJM is submitting these changes on behalf of, and at the direction of, the PJM Transmission Owners Administrative Committee. Although PJM is not authorized to represent that the PJM transmission owners are taking any position on any other aspects of the new PJM West arrangements, PJM is authorized to state that they have conferred and informally approved (conditioned on formal approval) the changes shown on Attachments E and F to this filing. The next regularly scheduled meeting of the Transmission Owners Administrative Committee is April 11, 2001, at which time they expect to formally approve these amendments to the TOA. The attached revised sheets to the TOA incorporate the changes that were submitted and are still pending in Docket No. RT01-2.

V. RATE MECHANISMS AND OTHER TRANSITIONAL ISSUES

A. Allegheny's Rate and Tariff Transition Proposals

When Allegheny joins PJM West, it will become part of a larger integrated system. Allegheny will be incorporated into PJM's existing approved license-plate rate design, thereby eliminating transmission rate pancaking across a large region. Its transmission revenue requirement will be incorporated into the system-wide PJM OATT and recovered largely through zone of delivery charges. Certain classes of transmission transactions will be eliminated, revenues derived for other transactions will be distributed on a different basis, and Allegheny will incur significant start-up costs in the

²⁴ If Duquesne joins, it will share in these costs.

implementation of the PJM West arrangement. To satisfy revenue-loss concerns that otherwise could prevent the formation of PJM West, Allegheny proposes transitional charges that satisfy the principles established in the Commission's recent Alliance order.²⁵

1. Rate Proposals

Upon joining PJM, the Allegheny system will become a zone within PJM, with individual zonal rates similar to those used by PJM's current transmission-owning members. Allegheny proposes a point-to-point transmission rate of \$1.752/kW/month, calculated on the same basis as rates for existing PJM zones, as the point-to-point rate for delivery to its zone. Consistency with the existing PJM zonal point-to-point rates is necessary for development of the PJM region-wide point-to-point rate. Customers will obtain point-to-point transmission service through a revised PJM region-wide rate for through or out service (a.k.a. the "border rate"). The new border rate recalculated to include Allegheny will be \$1.765/kW/month (reduced from the existing rate of \$1.767/kW/month). See Exhibit No. JFB-1 at 7; Schedule 7 of the proposed PJM OATT. The practice in PJM regarding network service zone of delivery charges has been to establish a unit rate in place of the pro forma load ratio share calculation and Allegheny has implemented this change by converting its current OATT load ratio share method to a network unit rate of \$1.49/kW/month. See Exhibit No. JFB-1 at 8; Schedule 2 of Exhibit JFB-2.

Service charges for ancillary services provided by Allegheny:

With respect to Allegheny's contribution to PJM's ancillary services, Allegheny is not proposing a schedule 1A (scheduling, system control and dispatch service) charge in this filing. Allegheny anticipates that it will examine its costs of providing scheduling and dispatch service and may make a future rate proposal with respect to this particular ancillary service. With respect to schedule 2 (reactive supply and voltage control service) Allegheny requests approval of the Commission for the PJM formula to include a revenue requirement for Allegheny for this service of \$9,048,720. This revenue requirement is based upon the application of Allegheny's currently effective OATT charge of \$.08 per kW for reactive support to Allegheny's calendar year 2000 billing determinants. The \$.08 is a result of a settlement in Docket No. ER96-58-000. As explained by Mr. Baier (Exhibit No. JFB-1 at 10), application of a revenue requirement associated with the \$.08 on the basis of calendar year 2000 billing determinants is the equivalent of a no-rate increase or decrease for this service.

²⁵ PJM takes no position on Allegheny's rate proposal.

2. Transitional Impacts and the Revenue Neutrality Mechanism

(a) Revenue Shortfall

In Order No. 2000 the Commission required the elimination of rate pancaking in order to qualify as an RTO. Order No. 2000 at 31,174; Order No. 2000-A at 31,383. The stated objective for this policy is to improve competition in power supply markets by placing more resources on an equal footing to serve the same load, at least with respect to the cost of transmission service. See Id. at 31,174–75. This will tend to increase the number of power supply options in the market and thereby restrain energy prices. Id. at 31,175. However, membership in an RTO and the elimination of rate pancaking also will impact Allegheny's transmission rates and revenues. The need for Allegheny to contribute to PJM's administrative costs will also have an impact on rates. In the long term, Allegheny can accommodate these impacts through the design of its rate structure. However, due to constraints at the state level, Allegheny cannot do so in the near term and must instead craft an interim solution.

Testimony concerning the impact on Allegheny's revenues due to its joining PJM West and a proposed mechanism for preserving Allegheny's revenue neutrality during a transitional period has been provided by Joseph F. Baier, Cost Allocation Director, Allegheny Energy in Exhibit No. JFB-1. Mr. Baier identifies an estimated annual revenue shortfall of \$27.7 million for Allegheny that will occur during a transition period following the creation of PJM West and explains a rate proposal that would offset this shortfall without compromising the Commission's policy objectives.

As noted above, upon joining PJM West, Allegheny will collect (i) no revenues from Allegheny–PJM transactions because these transactions will become internal to the PJM RTO and (ii) reduced revenues from transactions going through or out of Allegheny because of the end result of sharing the lower PJM border rate revenues with other PJM transmission owners.

Other losses occur on account of Allegheny's inability to pass through the costs associated with implementing PJM West and certain PJM administrative expenses. Allegheny's present retail rates are the product of settlements in restructuring and other proceedings as described in the testimony of Mr. Baier. In Pennsylvania, Maryland, Ohio, and Virginia, rate caps are in place. The rate cap periods vary from January 1, 2006 in Pennsylvania and Ohio to January 1, 2004 in Virginia with a possible extension to January 1, 2007, and a straight four year freeze in West Virginia from the date customer choice commences. During the various transition periods Allegheny would serve as the power supplier of last resort to customers not choosing an alternate supplier. See Exhibit No. JFB-1 at 3-4.

Pursuant to the Implementation Agreement with PJM, Allegheny will pay PJM (i) for certain directly assigned costs, mainly communications equipment, estimated to total approximately \$100,000, and (ii) PJM's expenses to implement PJM West incurred this year. PJM's capital costs incurred this year for PJM West implementation will be

recovered through PJM's unbundled administrative charges under Schedule 9 after PJM West is implemented.

Allegheny's load serving affiliates, who are obligated to serve as provider of last resort, will be assessed their share of these and all other PJM Schedule 9 charges. Allegheny here seeks recovery only for the upfront expenditure of \$10 million, which it is providing to PJM under the Implementation Agreement in order to achieve the timely implementation of PJM West.

(b) Revenue Neutrality Proposal

The Commission has stated that its policy is to preserve revenue neutrality for transmission owners seeking to create RTOs. Alliance Companies, et. al., 94 FERC ¶ 61,070, at 61,311 (2001) ("Alliance III") (citing Alliance Companies, et al., 89 FERC at 61,922 (1999) ("Alliance I")); see also Order No. 2000 at 31,172. The preservation of revenue neutrality does not conflict with the Commission's goal of eliminating rate pancaking in order to restrain energy prices through improved markets, and it is consistent with the Commission's overall program to promote the development of RTOs on a voluntary basis. Id. Neither Allegheny, nor in all likelihood any other public utility faced with revenue losses of the magnitude described herein, could voluntarily choose to join an RTO consistent with its fundamental business interests. Allegheny therefore includes in this filing a transitional revenue neutrality mechanism designed to keep it whole without interfering, even during the transitional period, with the achievement of the fundamental objectives of Order No. 2000.

The proposal for preserving revenue neutrality during the transition period consists of two major components. The first component is a modest uniform adjustment to PJM's border rate that will collect some additional revenues to be allocated to Allegheny. See Exhibit JFB-1 at 10. The proposal is to add \$.30/kW/month to the firm rate (bringing it up from \$1.765 to \$2.065/kW/month) and \$.33 per Mwh to the typical PJM charge for non-firm transactions bringing it up from \$.67 to \$1.00 per Mwh. [Id.] Based on the application of this adjustment to billing determinants taken from data for calendar year 2000, Allegheny anticipates that it will collect \$13.6 million annually under these adders to apply towards its revenue shortfall. See Exhibit No. JFB-1 at 11.

The second component of the transitional revenue neutrality mechanism is a market expansion adjustment contained in the new Schedule 11 to the PJM Tariff. This adjustment is designed to temporarily retain for revenue neutrality maintenance purposes, an amount equal to part of the estimated savings that will accrue from the broader allocation of PJM's administrative expenses as a result of the expansion. Savings will result from expansion because the additional administrative costs of incorporating Allegheny into PJM will be more than offset by the addition of Allegheny loads to the loads in PJM collectively bearing these costs. Accordingly, the charges calculated under the formula rates in Schedule 9 of PJM's Tariff will be automatically reduced as a result of the commencement of PJM West. PJM has estimated that, if Allegheny and Duquesne join PJM, the annual estimated savings are \$15 million in 2001 and approximately \$20

million annually thereafter. See Exhibit No. JFB-1 at 11; Schedule 4 of Exhibit No. JFB-2. In order to capture these savings to preserve Allegheny's revenue neutrality, Allegheny proposes to add a uniform charge of \$0.0070 for each megawatt hour of generation and \$0.0381 for each megawatt hour of load. These charges reflect PJM's estimate that generators supply approximately 15% of the revenues under all schedule 9 charges and loads provide approximately 85% and therefore they should pay the market expansion adder charges in roughly that proportion. Application of these unit rates to calendar year 2000 billing determinants (i.e., all generation and all loads including through and out) results in the collection of approximately \$15 million. Although this \$15 million represents virtually all of the projected savings in the first year of transition, it is only approximately 80 percent of the projected second and third year savings. Thus, generators and loads likely will benefit from savings of administrative costs prior to the end of the transition period.

The annual revenue target is based upon the annual revenue shortfall demonstrated in Schedule 1 of Mr. Baier's Exhibit No. JFB-2., and an annual amortization (in the amount of \$3.18 million) over a four year transition period of the calendar year 2001 expenditures being provided by Allegheny. Allegheny proposes that the transitional revenue neutrality mechanisms remain in place for sufficient time to produce a four year total recovery target amount, i.e., through calendar year 2005. This reflects a reasonable approximation of the average end point of the retail rate freezes imposed in Allegheny's host states.

Allegheny is proposing a sunset type true-up mechanism. This true-up mechanism states a four year total revenue recovery target for Allegheny (based on the annual target times four) and then tracks the annual recovery effected by both the through and out system rate adders and the market expansion adder. The sunset provision automatically terminates both the through and out adders in schedules 7 and 8, and the market expansion adder in schedule 11, once the four year target is reached. This may occur several months before or after the end of the nominal four year transition period.

As further described in the testimony of Mr. Baier (Exhibit No. JFB-1 at 15), the savings engendered under PJM's Schedule 9 charges as a result of Allegheny joining PJM are less than the total savings which would accrue to existing PJM users if both Allegheny and Duquesne join. As explained above, Allegheny anticipates that Duquesne will be submitting, by separate letter, a statement indicating its position with respect to when and if it will join PJM under the PJM West arrangement. Allegheny hopes that Duquesne will be able to join shortly. In the event, however, that Duquesne does not join, Allegheny is not proposing to adjust any of the rates filed herein. As explained in Mr. Baier's testimony (Exhibit No. JFB-1 at 15), the sunset mechanism as filed would terminate all transitional charges at whatever point in time Allegheny's four year revenue neutral maintenance target is met. If Duquesne does join, that sunset provision will have to be adjusted to include a total revenue target which recognizes Duquesne's revenue losses and that a portion of the collected revenues will be allocated to Duquesne. Allegheny expects that Duquesne and Allegheny will file such a proposal when and if Duquesne seeks to join PJM.

In short, most customers will pay lower rates for transmission during the transition period. Only one class of customers may receive a slight increase as a result of the reduction in the border rate in conjunction with the adder for revenue neutrality—those requesting service for export from the expanded PJM to the South, West and North. *See* Exhibit No. JFB-2, Schedule 6. Even in this case, the resulting final rate is still at or less than several of the zone of delivery rates within the existing PJM and has the added benefit of being a uniform rate (Exhibit No. JFB-1 at 11). Consequently, the concern expressed by the Commission in the recent Alliance Order about a wide disparity between the zonal rates and the through and out (or border) rate is not present here. Alliance Companies, 94 FERC ¶ 61,070, at 61,311 (2001).

3. Grandfathered Contracts

Upon creation of the PJM RTO including PJM West, certain contracts under which Allegheny provided transmission service will remain effective and will be grandfathered into the new arrangement wherein PJM assumes the role of Transmission Provider for the PJM West Region. These twelve contracts pre-date Order No. 888 (“Pre-Order 888 Contracts”), and they are discussed in detail in testimony provided by Ms. Terri J. Grabiak, General Manager, Transmission Marketing, Exhibit No. TJG-1 and a summarizing chart she prepared (Exhibit No. TJG-2).

Many of the Pre-Order 888 Contracts have been in place for some time and provide for service arrangements between neighboring systems and supply resources that remain mutually beneficial to the parties. Service under these contracts will continue. PJM will continue these pre-existing arrangements by not imposing congestion charges on the firm delivery services under these contracts.²⁶

²⁶ These twelve Pre-Order 888 contracts include: APS-PEPCO Power Resale Agreement, dated March 18, 1997; Transmission Agreement among Duquesne Light Company, Monongahela Power Company, and West Penn Power Company, dated March 15, 1967; Standard Transmission Service Agreement between PECO Energy Company, West Penn Power Company, Potomac Edison Company and Monongahela Power Company, dated January 2, 1995; Transmission Facilities Exchange Agreement between Monongahela Power Company, The Potomac Edison Company and Virginia Electric and Power Company, dated June 17, 1981; OVEC Operating Agreement between the U.S. Atomic Energy Commission and Monongahela Power Company, The Potomac Edison Company, West Penn Power Company and twelve other investor-owned utilities, dated October 1, 1952; Borderline Interchange Agreement between the Potomac Edison Company and Virginia Electric and Power Company, dated July 15, 1968; Schedule E to the Operating Agreement among the APS Parties and Virginia Power, dated January 1, 1973; Schedule F of the Interchange Agreement between West Penn Power and Duquesne Light Company, dated February 1, 1968; Settlement Agreement between West Penn Power Company and Allegheny Electric Cooperative (AEC), Inc., dated January 16, 1968; Settlement Agreement between West Penn Power

There are two Pre-Order 888 Contracts that are of critical importance to the arrangement whereby Allegheny and PJM would create PJM West by the end of this year. Both the APS-PEPCO Power Resale Agreement, dated March 18, 1987²⁷ (“PEPCO Contract”) and the Standard Transmission Service Agreement between PECO Energy Company, West Penn Power Company, Potomac Edison Company and Monongahela Power Company, dated January 2, 1995 (“PECO STS Contract”) are important sources of transmission revenues for Allegheny. Together, they account for approximately \$27,450,040 (Exhibit No. TJG-1 at 4) in annual revenues and constitute a major component of Allegheny’s earnings.

These contracts must be grandfathered through their terms or Allegheny would suffer substantial additional revenue losses as a result of joining PJM West. These losses would have to be made up through the imposition of significantly higher rate adjustments in order to preserve Allegheny’s revenue neutrality.

The PEPCO Contract will expire December 31, 2005 and the PECO STS Contract will expire January 1, 2006. The remaining terms thus coincide (except by one day for the PECO STS contract) with the critical four year transition period after the establishment of PJM West during which Allegheny’s operating companies will have their retail rates capped as part of the retail choice programs implemented in its host states. During this period Allegheny will have no opportunity to re-design its rates to account for revenues lost as the result of the elimination of rate pancaking and the loss of the revenues from these contracts would require a sharp increase in the proposed rate adjustments to preserve Allegheny’s revenue neutrality.

4. Network Integration Transmission Service Agreements

Allegheny provides Network Integration Transmission Service to various cooperatives and municipalities pursuant to contracts filed under Allegheny’s OATT (“NITSA Contracts”).²⁸ Upon the creation of PJM West, PJM will become the

Company and the Borough of Chambersburg, dated September 16, 1994; and, Settlement Agreement between West Penn Power Company and the Borough of Mont Alto, dated March 31, 1993.

²⁷ In 1996, PEPCO filed a complaint at the Commission seeking a reduction in its rates under this contract. The Commission denied the petition, and it was upheld in a decision by the United States Court of Appeals for the District of Columbia issued May 2, 2000. Potomac Electric Power Company v. FERC, 210 F.3d 403 (D.C. Cir. 2000).

²⁸ Parties to the NITSA Contracts: Counter parties to contracts with Allegheny include the Old Dominion Electric Cooperative, the Town of Front Royal, the City of Hagerstown, the Town of Thurmont, the Town of Williamsport, the Borough of Tarentum, Letterkenny Industrial Development Authority, the City of

transmission provider on the Allegheny system offering service under the PJM OATT. Meanwhile, Allegheny's OATT will be withdrawn. All service agreements filed pursuant to Allegheny's OATT, including the NITSA Contracts, will then terminate. Allegheny proposes to transfer service for these customers to the PJM OATT. The customers will be asked to execute service agreements under the PJM OATT which would bind them to the PJM OATT terms and conditions and also give them the expanded transmission service and market opportunities associated with PJM. The changes that these customers would see are 1) the change from a load ratio share to a unit rate for network service; 2) they will be required to pay their share of the PJM administrative costs and overheads contained in Schedules 9 and 11 of the PJM OATT and acquire ancillary services at the PJM rates and 3) they are potentially liable for congestion charges under the PJM requirements.

The Commission should be aware that the implementing documents, including specifically the West Transmission Owners Agreement, and the West Reliability Assurance Agreement, are conditioned upon the Commission accepting the agreements in their entirety, without change or condition. In the event the Commission does not do so, Allegheny is committed to attempting to renegotiate the agreements to satisfy the Commission's concerns. However, if the Commission were to not allow grandfathering of either of the two Pre-Order 888 contracts that are major revenue sources for Allegheny, or otherwise alter the revenue neutrality rate proposal, Allegheny would be faced with the significant possibility of incurring a severe revenue shortfall. In these circumstances, Allegheny would have no choice but to reconsider its options. Even increased rate adjustments may not be a solution since high rate adjustments pose the risk of dampening the level of transactions and reducing revenues, frustrating their purpose.

B. Transition Issues Under the PJM Tariff

In addition to the grandfathering and transition issues described above for Allegheny, certain transition issues arise under the PJM Tariff.

1. Generation interconnection requests that pre-date the Interim Coordination Agreement.

The Interim Coordination Agreement effectively creates a single consolidated queue for all generation interconnect requests received by Allegheny and PJM after the effective date of the ICA.²⁹ PJM has a small number of interconnect requests that were pending at that date and that conceivably could be affected by one or more requests that were pending with Allegheny at that time.

Philippi, the Harrison Rural Electrification Association, and the City of New Martinsville.

²⁹ For Allegheny and PJM, the effective date is February 14, 2001.

Until further studies are performed, it is not known whether any of those pending requests could adversely affect one another. The projects may not affect each other at all, or they may even benefit one another, by resulting in cost-sharing for upgrades that would be required in any event for either project standing alone. If issues are identified as a result of the further studies, PJM will address them directly with the affected parties. If any associated issues remain unresolved after such discussions, PJM will make a subsequent filing proposing a resolution.

2. Pre-Order No. 888 contracts.

As discussed above, Allegheny has a number of service agreements that predate Order No. 888. These contracts (listed above in footnote 26) are grandfathered and are deemed to be served outside Allegheny's Open Access Transmission Tariff. Allegheny proposes to maintain the grandfathered status of these contracts. From PJM's perspective as transmission provider, this means that service under those contracts will be treated as separate from the PJM Tariff. Those customers will not pay PJM's administrative or other charges. They will not pay congestion charges. The historical firm nature of the service under those contracts will be respected. As an internal matter, the firmness of the service can be recognized by a combination of assigning FTRs to the contract and/or by decrementing the ATC available under the OATT by the amount of capacity assigned to those contracts. In either case, the governing principle is that Allegheny's transfer of its transmission provider responsibilities to PJM does not affect the firmness of the service under those grandfathered contracts.

3. Existing point-to-point service agreements.

Allegheny also has several existing point-to-point ("PTP") service agreements and several requests for point-to-point service that were pending when the ICA took effect. Some of these existing contracts or pending requests involve receipts or deliveries at the PJM-Allegheny interface. In some cases, the same customer also has an existing point-to-point or network service agreement with PJM. In other cases, the customer has obtained transmission service across the PJM or Allegheny system and has no corresponding service on the other system. In addition, PJM also has a small number of existing point-to-point service agreements that may be affected by the expansion of PJM.

Some of these existing agreements may no longer be necessary after the PJM Tariff is extended to include Allegheny. A customer with transmission on both systems may only need one service agreement under the PJM Tariff (unless the separate agreements are both grandfathered). Where different customers have related arrangements on the two systems, only one may need to retain its agreement. Moreover, PJM does not have sufficient transmission capacity to deem all such existing PJM agreements and their corresponding Allegheny agreements automatically entitled to the same transmission capacity in the combined region. If the transmission rights of the existing PJM customer and the existing Allegheny customer were both automatically expanded to span the entire combined system, then the two customers would have duplicative rights that would exceed the capacity of the system.

There is no “one-size-fits-all” solution to these point-to-point service transitional issues. PJM therefore proposes to address and resolve these issues directly with the affected customers. This will allow PJM, Allegheny, and the affected market participants the maximum flexibility to restructure the existing arrangements so as to continue to satisfy the needs of the market. If any issues remain unresolved after such discussions, PJM will make a subsequent filing proposing a resolution.

With regard to pending requests, any submitted after the effective date of the Interim Coordination Agreement (“ICA”) will be handled in accordance with the provisions of the ICA. Moreover, even requests that were pending on the ICA’s effective date may need, as a practical matter, to be addressed under the ICA’s terms. Requests submitted to Allegheny for service beginning after the commencement of PJM West may, as a practical matter, be meaningless if PJM does not have capacity available at the PJM/Allegheny interface to accommodate the request.

Issues concerning such pending requests have already been raised in the proceedings on the ICA in Docket No. ER01-1232-000. That docket is the appropriate forum for resolving transition issues concerning point-to-point service requests.

4. Fixed Transmission Rights

The new PJM West market participants will obtain fixed transmission rights on the same terms as the existing PJM customers. New firm point-to-point customers and new network transmission customers will be assigned FTRs with their service agreements, if available. FTRs for existing network customers will be subject to annual reallocations, under procedures recently approved by the Commission.³⁰ PJM will conduct later this year an interim allocation for network customers in the PJM West Zone or Zones to be effective from January 1, 2002, until the next regularly scheduled annual FTR allocation in the spring of 2002.³¹ The interim allocation will use the same allocation rules as in the approved Tariff.

VI. ALLEGHENY IS TRANSFERRING FUNCTIONAL CONTROL OF ITS TRANSMISSION FACILITIES TO AN ORDER NO. 2000-COMPLIANT RTO.

PJM already has shown in its RTO compliance filing in Docket No. RT01-2 that PJM satisfies the minimum required characteristics and functions of an RTO. By this filing, Allegheny now requests authority under section 203 of the Federal Power Act, 16 U.S.C. §. 824b, to transfer functional control of its jurisdictional transmission facilities to PJM as an Order No. 2000-compliant RTO, under the terms and conditions of the West TOA and amended Operating Agreement.

³⁰ PJM Interconnection, L.L.C., 93 FERC ¶ 61,254 (2000).

³¹ Any issues concerning FTRs for existing firm point-to-point customers will be handled as described in the previous section.

In most respects, the analysis of PJM's RTO compliance in Docket No. RT01-2 applies equally to PJM West, because the same relevant rules, terms, and conditions will apply under the PJM Tariff and PJM Operating Agreement. In other respects the PJM West arrangements will enhance PJM's compliance with Order No. 2000, and benefit PJM and its existing stakeholders. Most notably, Allegheny will enlarge PJM's scope and promote interregional coordination. Moreover, the PJM West arrangements provide further evidence of PJM's commitment to open architecture.

A. Independence

PJM's governance structure is unchanged; PJM will still be governed by its independent, non-stakeholder board of managers. Allegheny and other interested PJM West market participants will become members of PJM, with the same rights and essentially the same responsibilities as the existing members. See RTO Compliance Filing at 14-20.

B. Scope and Configuration

PJM and PJM West combined will serve 11 million customers in an area with 26.1 million people, or nearly 10% of the country's population. The new, enlarged PJM will serve all of the District of Columbia, Delaware, and Maryland, nearly all of New Jersey and Pennsylvania, large portions of West Virginia, and parts of Virginia and Ohio. PJM will operate 13,100 miles of transmission lines, in an area of 79,000 square miles. The expanded PJM region includes 594 generating units with a generation capacity of 66,070 megawatts. The region's most recent peak load was 59,931 megawatts and the area consumes 298,011 gigawatthours of electricity annually.

Moreover, Allegheny and the existing PJM transmission owners' facilities are highly interconnected. The systems have four 115-kV interconnections, two 138-kV interconnections, eight 230-kV interconnections, and three 500-kV interconnections, with a total transfer capability of approximately 13,000 megawatts. This level of interconnection is at least as strong as the interconnections between many of the existing PJM transmission owners, who have been members of a "tight" power pool for decades.

On each of the scope and configuration factors identified in Order No. 2000, the combination of PJM and PJM West will advance the Commission's RTO objectives. See RTO Compliance Filing at 21-30. PJM already operates the largest and most successful wholesale electricity market in the country. Inasmuch as encompassing an appropriate market is the most important determinant of RTO scope and configuration, PJM's existing size clearly is appropriate for an RTO. As a result of this filing, PJM will be even larger. The larger region will allow PJM to internalize more loop flows, better manage transmission congestion, extend the elimination of rate pancaking, and more efficiently plan grid enhancements.

C. Operational Authority

PJM will have the same operational authority for Allegheny's facilities as it currently has for the existing PJM facilities. See RTO Compliance Filing at 31-32.

D. Short-Term Reliability

PJM will have the same responsibility for short-term reliability, including the same authority to order redispatch, the same authority as to transmission and generator maintenance coordination, the same role as to facility ratings, and the same commitment to abide by relevant reliability standards. See RTO Compliance Filing at 32-38. Notably, PJM's responsibility for interchange scheduling will be expanded, because PJM will now operate multiple control areas. PJM will operate them as a "virtual" single control area, by dynamically scheduling all interties between the control areas that PJM operates. Moreover, PJM's reliability role will be expanded in that PJM will now apply relevant ECAR standards and guidelines for PJM West.

E. Tariff Administration

PJM will have the same responsibilities for tariff administration and design, including handling all transmission service and generation interconnect requests. See RTO Compliance Filing at 38-40. Under the terms of the Interim Coordination Agreement, PJM will integrate the Allegheny and PJM queues into a single queue by January 1, 2002. Thus, generation project developers will face only one set of interconnection rules and procedures across the entire region.

F. Congestion Management

PJM will apply the same locational-marginal-price congestion management system, including financial rights (FTRs), to the expanded region. See RTO Compliance Filing at 40-41.

G. Parallel Path Flows

Because PJM will operate the control areas as a virtual single control area, with a single energy market and congestion management system, PJM will internalize parallel path flows from all transactions between companies in the combined PJM-PJM West region. See RTO Compliance Filing at 41-42.

H. Ancillary Services

PJM also will maintain the same framework for ancillary services. See RTO Compliance Filing at 43-47. The only changes for PJM West are those necessary to reflect ancillary services that are control-area-specific. Thus, although the same basic rules and procedures will apply to load and frequency regulation in the east and in the west, each control area will have its own regulation objective, to be satisfied by the LSEs in that control area. See Operating Agreement, Schedule 1, §§ 3.2.2A and 3.3.2A. PJM

will establish a separate regulation market for the west, but bids in the west will be cost-capped in accordance with Section 3.2.2A until such time as market-based pricing is approved.

Similarly, certain costs of operating reserves (i.e., those incurred when PJM must order units to run out of economic merit order to satisfy MAAC or ECAR spinning reserve requirements) will be segregated between the east and the west. LSEs in the west will bear such costs when PJM incurs them to meet the ECAR spinning reserve requirement and LSEs in the east will bear such costs when PJM incurs them to meet MAAC requirements. Id., Schedule 1, § 3.2.3(j), (k). In the very near future, PJM anticipates tracking and allocating such costs to the responsible parties, i.e., those that fail to provide sufficient spinning reserves. Existing PJM stakeholders already have discussed the establishment of a separate spinning reserve market by the summer of 2002. Market participants in the west have now suggested that a similar concept be implemented, possibly even earlier, for PJM West.

I. OASIS

PJM will operate a single OASIS site for the expanded region, and will independently calculate ATC and TTC. See RTO Compliance Filing at 47-49. PJM will enhance its award-winning suite of e-business tools to accommodate the PJM West market participants and will add new features and capabilities to administer the new capacity market and new regulation market in the west.

J. Market Monitoring

PJM's existing approved market monitoring unit will now extend its responsibilities to include the PJM West region. See RTO Compliance Filing at 49-52.

K. Planning and Expansion

Similarly, PJM's existing approved planning and expansion process will now include Allegheny's transmission facilities. See RTO Compliance Filing at 52-56. Schedule 6 of the PJM Operating Agreement, setting forth the planning protocol, has been amended to address facilities cost responsibilities among the existing transmission owners and among the West Transmission Owners.

L. Interregional Coordination

The establishment of PJM West is a major step forward in interregional coordination. Today, the parties are in separate control areas, under separate security coordinators, and part of separate reliability councils. Under the PJM West arrangements, the "seams" created by those boundaries will be eliminated or overcome. The single PJM Operating Agreement and the single PJM Tariff will apply to both regions. PJM will operate the control areas as a virtual single control area, dynamically scheduling all inter-control-area ties at least every five minutes. PJM will become the NERC security coordinator for both regions. And PJM will ensure compliance with

MAAC and ECAR standards and guidelines by using compatible business rules in the east and the west, such as the compatible requirements of the RAA and RAA-West. Moreover, as discussed above, the license-plate rate design will apply to the combined area, eliminating interregional rate pancaking.

In addition, PJM also notes that it and the sponsors of the Alliance RTO have initiated the interregional coordination process, in accordance with the Commission's directive in the recent Alliance order.

Approval of this filing in no way affects any action the Commission may take concerning interregional coordination to the north of Allegheny and PJM. All options remain open in that regard.

M. Open Architecture

As discussed above, the West TOA recognizes that some or all of the PJM West Transmission Owners may seek to form an independent transmission company ("ITC") in the future. The agreement establishes this as "Phase II" of PJM West, to allow time for the initial establishment of the larger regional energy market, under an LMP-based congestion management system. The LMP congestion pricing, once it is established in the PJM West Region, will provide clear price signals to for-profit transmission companies regarding opportunities for new transmission construction, facilitating development of such companies.

The ITC may include proposals for the transfer by PJM of some of its functions to the ITC. The parties to the West TOA (including PJM) agree not to oppose formation of such an ITC. Moreover, these same principles could apply equally to the transmission facilities that PJM already operates.

VII. COMPLIANCE WITH THE COMMISSION'S FILING REQUIREMENTS

A. Persons To Whom Communications Should Be Addressed

Correspondence and communications regarding this filing should be directed to the representatives of PJM and Allegheny as set forth on Attachment A.

B. Persons to Whom The Filing Is Being Sent

PJM and Allegheny are serving a paper/electronic copy of this filing on all state public utility commissions having jurisdiction over Allegheny or over any of the existing PJM transmission owners, on all PJM members, and on all of Allegheny's transmission customers. Each of the recipients will receive a paper copy of this transmittal letter plus a compact disc containing an electronic version (in PDF format) of the transmittal letter and all attachments. PJM and Allegheny request partial waiver of the service rules (18 C.F.R. § 385.2010), to the extent deemed necessary, to permit service in this fashion. In this submission, PJM is refile, in redlined and revised forms, its entire Tariff and Operating Agreement in addition to filing several new agreements. This large

submission is being delivered by PJM and Allegheny to well over 400 recipients. Accordingly, the proposed method of service is timely, cost-effective, and convenient for the recipients and should be allowed. In addition, this entire filing is being posted on the PJM website.

C. Effective Date

The Commission is requested to accept this filing effective as of January 1, 2002. To facilitate the extensive systems work that is needed to create PJM West and facilitate Allegheny's integration into PJM, the Commission is requested to act on this filing by no later than June 15, 2001. To the extent necessary, PJM and Allegheny request waiver of 18 C.F.R. § 35.3(a) to permit the requested effective date.

D. Electronic Submittals

A diskette containing an electronic copy of the form of Notice of Filing is enclosed. In addition, as suggested by the Commission in its July 20, 2000 order concerning RTO compliance filings, an electronic copy of the entire filing is enclosed in a separate enclosed diskette.

VII. RELIEF REQUESTED

For the reasons stated above, PJM and Allegheny respectfully request that the Commission approve, by no later than June 15, 2001, the transfer of operational control of Allegheny's transmission facilities to PJM pursuant to the terms of the enclosed agreements; find that Allegheny has thereby transferred control of its facilities to an Order No. 2000-compliant RTO; accept for filing and approve the enclosed West Transmission Owners Agreement and West Reliability Assurance Agreement; and accept for filing and approve the enclosed revisions to the PJM Tariff, PJM Operating Agreement, and Transmission Owners Agreement. Allegheny further requests that the Commission accept for filing and approve its proposed transitional charges that are necessary preconditions to the formation of PJM West.

Respectfully submitted,

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**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

PJM Interconnection, L.L.C.,)	
Allegheny Power System operating companies:)	
Monongahela Power Company,)	Docket Nos. ER01-____-000
The Potomac Edison Company)	and EC01-____-000
West Penn Power Company)	

NOTICE OF FILING

Take notice that on March 15, 2001, PJM Interconnection, L.L.C. (“PJM”) and the Allegheny Power System operating companies: Monongahela Power Company, The Potomac Edison Company, and West Penn Power Company (hereinafter referred to collectively as “Allegheny”), jointly submitted a filing to establish PJM as the Regional Transmission Organization (“RTO”) for Allegheny pursuant to an arrangement known as “PJM West.”

PJM and Allegheny propose an effective date of January 1, 2002.

A copy of this filing was served on all state public utility commissions having jurisdiction over Allegheny or over any of the existing PJM transmission owners, on all PJM members, and on Allegheny’s transmission customers, in addition to being posted on the PJM website.

Any person desiring to be heard or to protest this filing should file a petition to intervene or protest with the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426, in accordance with Rules 210, 211 and 214 of the Commission's Rules of Practice and Procedure (18 C.F.R. §§ 385.210, 385.211, 385.214). All such petitions or protests should be filed on or before _____ . Protests will be considered by the Commission in determining the appropriate action to be taken, but will not serve to make protestants parties to the proceeding. Any person wishing to become a party must file a petition to intervene. Copies of this application are on file with the Commission and are available for public inspection. This filing may also be viewed on the Internet at <http://www.ferc.fed.us/online/rims.htm> (call 202-208-2222 for assistance).

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all state public utility commissions having jurisdiction over Allegheny or over any of the existing PJM transmission owners, on all PJM members, and on all of Allegheny's transmission customers.

Dated at Washington, D.C., this 15th day of March, 2001.

Paul M. Flynn

Attorney for
PJM Interconnection, L.L.C.

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**APPLICATION FOR COMMISSION APPROVALS
TO EXPAND SCOPE OF
PJM INTERCONNECTION, L.L.C.
UNDER “PJM WEST” ARRANGEMENT**

Volume I of IV

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On behalf of Allegheny Power

March 15, 2001

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