

**APPENDIX E**  
**DIRECT TESTIMONY OF**  
**STEPHAN T. HAYNES**

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

**Pioneer Transmission, LLC**

**| Docket No. ER09-\_\_\_\_-000**

**PREPARED DIRECT TESTIMONY OF  
STEPHAN T. HAYNES**

**October 15, 2008**



1 Program at the University of Virginia and the AEP Management Program at The  
2 Ohio State University.

3 I have held my current position since January 2008. Prior to that, I served  
4 four years as Vice President and Assistant Treasurer of AEPSC, and prior to that I  
5 spent six years in market risk oversight, first as managing Director-Risk Oversight  
6 and later as Vice President-Market Risk Oversight. I have also held the positions  
7 of Managing Director-Corporate Finance, Manager-Corporate Finance, and  
8 positions in investor relations and information systems within AEPSC, where I  
9 was initially hired in 1984. Prior to starting at AEPSC, I was a systems analyst  
10 with Arthur Andersen in its consulting division for approximately one year.

11 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY BEFORE ANY**  
12 **REGULATORY AUTHORITY?**

13 A. Yes. I have filed testimony with the Public Utility Commission of Texas as a  
14 witness in Docket No. 33734, Application of Electric Transmission Texas, LLC  
15 for Regulatory Approvals and Initial Rates and as a witness in Docket No. 35665,  
16 Commission Staff's Petition for the Selection of Entities Responsible for  
17 Transmission Improvements Necessary to Deliver Renewable Energy from  
18 Competitive Energy Renewable Zones. I also filed testimony in Docket No.  
19 33541, Application of AEP Texas Central Company for a Final Accounting of  
20 Up-Front Qualified Costs. I also filed testimony in Docket No. 24195,  
21 Application of Central Power & Light Company to Implement the Fuel Factor  
22 Component of Price to Beat Rates, Docket No. 24335, Application of West Texas  
23 Utilities Company to Implement the Fuel Factor Component of Price to Beat

1 Rates, and Docket No. 24449, Application of Southwestern Electric Power  
2 Company to Implement the Fuel Factor Component of Price to Beat Rates. I filed  
3 testimony as the return on equity witness in the Public Utilities Commission of  
4 Ohio Case No. 05-376-EL-UNC for Columbus Southern Power & Ohio Power  
5 seeking approval to recover costs during the construction of an Integrated  
6 Gasification Combined Cycle (“IGCC”) plant in Ohio. In addition, I filed rebuttal  
7 testimony for Appalachian Power Company in Virginia State Corporation  
8 Commission Case No. PUE-2006-00065 on investors’ rationale when valuing  
9 debt securities, the impact and importance of rate relief on credit rating, cost of  
10 funds and ability to raise capital, cost of capital, and capital structure.

11 **II. PURPOSE OF TESTIMONY**

12 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

13 A. The purpose of my testimony is to discuss the financial risks that AEP and Duke  
14 Energy Corporation (“Duke”) will undertake in developing the 765 kV  
15 transmission project in Indiana (the “Project”) proposed by their new affiliate,  
16 Pioneer Transmission, LLC (“Pioneer”). Along with testimony submitted by  
17 Ms. Geiger and Ms. Barton, my testimony will illustrate the extraordinary nature  
18 of the Project and the role that transmission rate incentives will play in helping  
19 Pioneer develop and finance the Project. Specifically, I will discuss the risks and  
20 challenges that Pioneer faces as a startup company with a single project that will  
21 need to raise massive amounts of capital, and how the rate incentives that Pioneer  
22 requests will help support reasonable credit ratings and support its ability to issue  
23 debt capital on reasonable terms. I also will discuss the proposed capital structure

1 and cash flows that Pioneer will need to obtain debt financing on reasonable terms  
2 and to generate retained earnings to be used for equity.

3 **III. OVERVIEW OF THE PROJECT**  
4 **AND THE POTENTIAL FINANCIAL RISKS**

5 **Q. PLEASE DESCRIBE PIONEER'S OWNERSHIP STRUCTURE.**

6 A. Pioneer's members are AEP Transmission Holding Company, LLC, a wholly  
7 owned subsidiary of AEP, and Duke Energy Transmission Holding Company,  
8 LLC, an indirect wholly owned subsidiary of Duke. Each of these companies has  
9 a 50% ownership share. Ms. Geiger discusses certain advantages of AEP and  
10 Duke working together to develop the Project.

11 **Q. PLEASE PROVIDE AN OVERVIEW OF THE FINANCIAL RISKS AND**  
12 **CHALLENGES FACED BY PIONEER.**

13 A. It can be a daunting task to raise the level of capital required by such a significant  
14 undertaking, such as the Project. Unquestionably this is a start-up company with  
15 no business history, no credit rating, no debt repayment history and no significant  
16 financial guarantees from its members. Pioneer's ability to obtain financing  
17 primarily will be based on the Project's own merit and largely on projections of  
18 future cash flow from the Project. This risk is exacerbated by the fact that, at least  
19 initially, Pioneer will have all of its business invested in a single project. In  
20 addition, from the perspective of investors and lenders, a start-up company does  
21 not have an established credit rating or a debt repayment or earnings history. To  
22 fund the project spending that occurs before all necessary approvals are received  
23 (such as ordering equipment), Pioneer will want to obtain financing before it has  
24 all required approvals, which I will discuss in more detail later in my testimony.

1 For all these reasons, receiving clear and unequivocal regulatory authority from  
2 the Commission will be essential to financing the Project.

3 Moreover, this is clearly not a routine or typical utility transmission  
4 project. The Project will cost approximately \$1.0 billion and require construction  
5 of approximately 240 miles of new 765 kV transmission line and related facilities  
6 in Indiana. In addition, as Ms. Geiger discusses, Pioneer faces significant  
7 uncertainty in terms of obtaining necessary approvals and acquiring the necessary  
8 right-of-way. In addition, Ms. Geiger notes that the Project needs to be included  
9 within the expansion plans of the two Regional Transmission Organizations  
10 (“RTOs”) (PJM and Midwest ISO) and needs to obtain approval of an allocation  
11 of the costs and benefits between the two RTOs. Also, the high-cost, long-lead  
12 time equipment and risks of cost escalation and obtaining skilled labor are all key  
13 risk factors more fully discussed by Ms. Geiger. Ms. Barton discusses the risks  
14 posed by Pioneer’s proposal to employ various advanced technologies.

15 **Q. WILL THE ABSENCE OF A FINANCIAL TRACK RECORD PRECLUDE**  
16 **REASONABLE FINANCING FOR PIONEER?**

17 A. No. Financing for start-ups is available based on an assessment of the project  
18 risks and projections of cash flows that assume that the formula rate is in place.  
19 However, the absence of established financial strength indicators such as bond  
20 ratings will result in the close examination by lenders of the expected future cash  
21 flows of Pioneer.

22 The difficult credit market conditions being experienced during the current  
23 credit crisis make it more difficult to satisfy the criteria that will be reviewed by

1 lenders for the Project. The current credit crisis raises the bar for virtually every  
2 project that requires substantial capital to get completed, so the financial risks  
3 associated with this Project will be amplified.

4 **Q. CAN YOU PROVIDE A PRAGMATIC EXAMPLE OF WHAT LENDERS**  
5 **WILL EXAMINE?**

6 A. Yes. When considering the risk of a prospective loan and the cost of borrowing  
7 that the lender should charge a business for assuming the associated risk, lenders  
8 will closely scrutinize forecasts of the business' future cash flow and the ability of  
9 these cash flows to cover future interest and debt principal payments. In a rate-  
10 regulated service such as transmission, lenders recognize that future cash flow is  
11 heavily dependent on the overall allowed return on investment. The future stream  
12 of revenues that will be available to cover the contracted debt payment will vary  
13 with the authorized return on equity ("ROE") and rate structure approved by the  
14 regulator. As the ROE is increased, there are more cash flows available to the  
15 business to satisfy its debt obligations in a timely manner. In their financial  
16 review, prospective lenders will look at key credit metrics of the business that are  
17 indicators of a business's ability to satisfy its debt obligations.

18 **Q. HOW WILL PIONEER'S CASH FLOW FROM OPERATIONS COMPARE**  
19 **TO ITS FINANCING NEEDS?**

20 A. Assuming that the Commission allows Pioneer to recover its costs during the pre-  
21 commercial period, revenue will still be limited to a return on construction work  
22 in progress ("CWIP") and an amount equal to early stage expenses. Pioneer's net  
23 cash flow will consist of this revenue less the substantial outflows for constructing

1 the project. Even with CWIP authority, these net cash flows will be significantly  
2 negative throughout construction. This is one of the reasons that Pioneer needs  
3 the Commission to approve the requested incentives. Of course, in the absence of  
4 such authority, Pioneer will have no revenues and only cash outflows for both  
5 construction and development expenses. Therefore, Pioneer will rely on the  
6 return on CWIP as well as the members' equity contributions and debt borrowings  
7 to finance these large negative cash flows. The return on CWIP incentive reduces  
8 the financing need, and in conjunction with the remaining requested incentives,  
9 enables Pioneer to obtain the required debt financing.

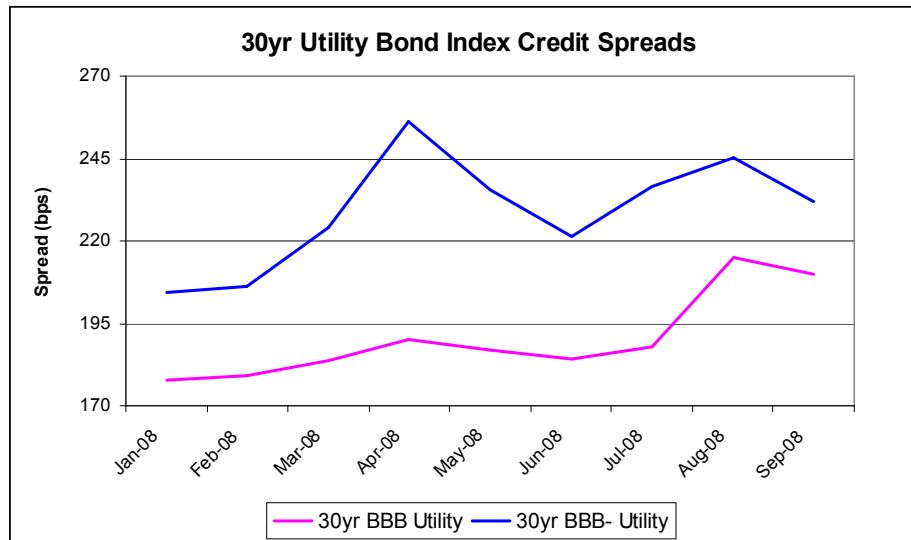
10 Post-construction (operating), Pioneer's cash flow must be sufficient to  
11 cover on-going maintenance capital expenditures and scheduled debt service  
12 (interest and principal), and lenders will require an excess of periodic cash flow  
13 over the venture debt obligations (i.e., this excess constituting a return to the  
14 members after all of the venture's current obligations are satisfied).

15 **Q. WHAT CREDIT RATING ARE YOU TARGETING FOR PIONEER?**

16 A. Credit ratings are assigned by the credit rating agencies as an indication of a  
17 company's ability to meet its financial obligations. Investment or high grade  
18 credit ratings range from the lowest rating of BBB- to the highest rating of AAA.  
19 Non-investment grade ratings range from CCC to BB+. In order for Pioneer to  
20 have access to the capital markets at all times and to be able to raise capital on  
21 reasonable terms, it should target credit ratings of at least one notch above  
22 minimum investment grade, which is BBB. As evidenced by recent capital  
23 markets conditions, at times Pioneer may not be able to obtain debt capital if it

1 does not have an investment grade credit rating. My experience tells me that the  
2 regulatory authority Pioneer is seeking coupled with the target 50/50  
3 capitalization should earn ratings of such a level. Chart 1 below displays the  
4 credit spreads on utility long-term debt for BBB and BBB- companies. These  
5 spreads represent the cost charged by debt investors for the credit risk from  
6 investing in utility debt.

7 Chart 1



8  
9 As displayed in this chart, the average difference in credit spreads between  
10 the 30-year BBB and BBB- Utility Bond Indices has roughly been 40 bps during  
11 2008. This translates to \$2 million dollars of additional annual debt service on  
12 \$500 million of outstanding debt. There will be a significant increase in debt cost  
13 for credit ratings below BBB.

14 **Q. WHY IS IT IMPORTANT TO EARN INVESTMENT GRADE RATINGS?**

15 A. Investment grade ratings would result in lower borrowing costs, increase  
16 Pioneer's access to capital markets and provide an operating margin to withstand

1 the business risk of unforeseen events, while still allowing Pioneer to meet  
 2 minimal expectations of capital providers. As benchmarks for comparisons, the  
 3 median credit ratings for electric utility companies and gas companies, as well as  
 4 the credit ratings for the two largest transmission companies, are specified in  
 5 Table 1 below. The incentives being requested in this filing make a significant  
 6 contribution to Pioneer's financial strength such that it can obtain an investment  
 7 grade rating.

8 **Table 1**  
 9 **Credit Ratings**

	Secured		Unsecured	
	S&P	Moody's	S&P	Moody's
Electric Utility Companies (EEI members)	BB+	Baa1	BBB	Baa2
Gas Companies (AGA members)	BBB+	A	BBB	Baa2
American Transmission Company	A+	A1		
ITC Holdings Corp.	A-	A3		

11 Sources: Bloomberg, Standard and Poor's, Moody's Investors Services

12 **IV. INCENTIVE PACKAGE FOR THE PROJECT**

13 **Q. PLEASE DESCRIBE THE PACKAGE OF RATE INCENTIVES THAT**  
 14 **PIONEER PROPOSES FOR THE PROJECT.**

15 A. Pioneer is requesting an incentive ROE of 13.5%, which is in the range of  
 16 reasonableness determined by Dr. Avera. Dr. Avera determined the range of  
 17 reasonableness to be 8.2% to 15.2% with the midpoint being 11.7%. Pioneer  
 18 supports the use of the midpoint as a starting point. If the Commission agrees that  
 19 the midpoint is the appropriate starting point, Pioneer is seeking a 50-basis point  
 20 adder to that midpoint for RTO participation and a 130-basis point adder for both  
 21 advanced technology and as an investment incentive. If the Commission were to

1 determine that the median, which is 10.8%, is a more appropriate starting point,  
2 the requested 13.5% ROE remains just and reasonable, as it represents a 50-basis  
3 point adder for RTO participation, a 50-basis point adder for advanced  
4 technology, and a 170-basis point adder as an investment incentive.

5 In addition to the ROE incentive, Pioneer is requesting authorization to  
6 recover 100% of CWIP in rate base and permission to file for recovery for all  
7 prudently incurred development and construction costs if the Project must be  
8 abandoned due to factors beyond Pioneer's reasonable control. Pioneer is also  
9 seeking approval to establish a regulatory asset that will include expenses not  
10 included in CWIP that are incurred in connection with developing the Project  
11 prior to the date that the formula rates are made effective under PJM's and  
12 Midwest ISO's open access transmission tariffs. The regulatory asset will be  
13 amortized with interest and recovered over a five-year period.

14 **Q. HOW DID PIONEER DETERMINE WHAT INCENTIVES TO SEEK IN**  
15 **THIS PROCEEDING?**

16 A. The Commission requires that a total package of incentives requested be tailored  
17 to address the demonstrable risks or challenges faced by the applicant. The  
18 members evaluated the risks of the Project and, based on their experiences dealing  
19 with lenders on other large utility projects, concluded that the overall package of  
20 incentives requested in this application was appropriate to meet those concerns  
21 and make it more likely that the Project could be successfully developed; i.e., that  
22 the members could reasonably commit equity capital on competitive terms and  
23 that Pioneer could attract necessary debt capital on reasonable commercial terms.

1 **Q. PLEASE ELABORATE ON THAT POINT.**

2 A. The members face competing demands on their capital. For AEP to participate, it  
3 had to determine that investing in Pioneer would be in the best interest of its  
4 shareholders and customers. AEP must continually evaluate how best to allocate  
5 capital consistent with its service obligations and duties to shareholders, given an  
6 assessment of the risks and potential returns that potential investment choices  
7 present. The availability of rate incentives for certain new transmission  
8 infrastructure is an important consideration for AEP as it evaluates how best to  
9 deploy its investment capital across the spectrum of opportunities. Duke  
10 undertook the same evaluation, so together we crafted a package of incentives that  
11 we believe are necessary to allow Pioneer to compete for equity capital on terms  
12 at least as favorable as AEP's and Duke's other projects. In addition, the Project  
13 will be competing with other companies and projects for debt capital based on the  
14 relative risks and the availability of capital. The requested incentives will  
15 facilitate cash flows and financial risks that allow the Project to compare  
16 sufficiently to attract debt capital.

17 **Support for ROE Incentives**

18 **Q. WHY IS IT APPROPRIATE FOR PIONEER TO OBTAIN A BASE ROE**  
19 **TOWARD THE UPPER END OF THE ZONE OF REASONABLENESS?**

20 A. As the Commission has explained, the primary purpose of an incentive ROE is to  
21 help attract capital investment that can offset the risks and challenges faced by a  
22 non-routine, large-scale transmission project such as the project Pioneer proposes  
23 to build. Pioneer seeks an incentive ROE to offset the substantial risks and

1 challenges that the Project will face, such as those that I discussed above and are  
2 discussed by Ms. Geiger and Ms. Barton.

3 **Q. EXPLAIN WHETHER THE START-UP NATURE OF PIONEER**  
4 **REQUIRES THE COMMISSION TO DISTINGUISH ITS ANALYSIS OF**  
5 **THE REQUIRED INCENTIVE ROE FOR PIONEER.**

6 A. Some have argued that approval of 100% CWIP in rate base and ability to recover  
7 prudently incurred abandonment costs makes it appropriate to discount the  
8 incentive ROE. Considering that Pioneer is a start-up venture, I do not believe  
9 that this is appropriate. As I discuss below, 100% CWIP in rate base provides  
10 benefits to ratepayers; it does not change the net present value to shareholders of  
11 the cash flow. Approval for the recovery of abandonment costs creates the  
12 conditions necessary for Pioneer to raise debt prior to obtaining required legal  
13 approvals and, as I discussed later, the option of financing prior to obtaining these  
14 legal approvals would be extremely expensive and difficult to obtain without the  
15 cancelled plant recovery approval. This situation contrasts with that of an  
16 established utility that can borrow based on its existing plant and established  
17 credit history. The Commission recently ordered a reduction in ROE incentive  
18 for projects to be developed by Southern California Edison Company. As a new  
19 venture, however, Pioneer has neither the credit history nor operating set of assets  
20 that are available to a utility such as Southern California Edison Company.

21 **Support for CWIP Incentive**

22 **Q. PLEASE EXPLAIN WHY PIONEER SEEKS TO RECOVER 100% CWIP**  
23 **IN RATE BASE.**

1 A. The Project represents an enormous transmission investment that will require  
2 large capital expenditures during the construction period. As the Commission has  
3 noted, this can create significant pressure on cash flows, especially for projects  
4 that involve a long lead time; the Project is not expected to be in service until at  
5 least 2014. Granting the 100 percent CWIP recovery will help alleviate the  
6 financial risks that the Project will impose upon Pioneer, and will provide the  
7 financial certainty that will help Pioneer complete the Project. This also alleviates  
8 the amount of capital required from debt financing and equity capital  
9 contributions from the members. These benefits reduce the cash needed from the  
10 members and therefore improve the financial ratios and reduce the possibility of a  
11 negative impact on the members' credit ratings. The same benefits will provide  
12 Pioneer the best opportunity to achieve an investment grade rating.

13 **Q. HOW WILL THIS INCENTIVE AFFECT RATEPAYERS?**

14 A. Permitting Pioneer to include 100% of CWIP in rate base will lower costs to  
15 transmission customers, because it will enable Pioneer to obtain lower-cost  
16 financing. By avoiding the capitalization of interest on the debt and AFUDC  
17 (equity), the total revenue requirement of the life of the assets is reduced (while  
18 the risk-adjusted, economic returns to investors are unchanged). Without the  
19 CWIP incentive, investor exposure during the high-risk, pre-commercial period  
20 necessitates higher required returns for debt and equity capital, all else being  
21 equal, as well as greater total investment that must be recovered over time from  
22 customers.

1           **Support for Recovery of Abandonment Costs**

2           **Q.    WHAT IS THE BENEFIT OF PIONEER HAVING THE AUTHORITY TO**  
3           **SEEK TO RECOVER COSTS IN THE EVENT OF ABANDONMENT?**

4           A.    There are two principal benefits, both of which relate to the ability of AEP and  
5           Duke to move forward with development at this time. AEP and Duke will be  
6           working with PJM and Midwest ISO to determine the in-service date of the  
7           Project, with the earliest possible completion in 2014 or 2015. The assurance that  
8           prudently incurred costs can be recovered should abandonment be required for  
9           reasons beyond Pioneer's reasonable control will facilitate Pioneer's ability to  
10          finish the Project within the reliability-driven timeframe. First, the assurance that  
11          prudently incurred costs will be recoverable allows Pioneer to order equipment,  
12          reserve labor, and purchase rights-of-way at the appropriate time in order to meet  
13          the in-service date. This situation will allow Pioneer to be ready to begin the  
14          physical process of construction promptly after obtaining all necessary approvals  
15          and acquiring the rights-of-way. A second and equally important consideration is  
16          that the prospect for cost recovery has prompted potential lenders to proceed with  
17          financing in advance of the required legal approvals. In my discussions with  
18          lenders who are willing to finance transmission projects, the prospect for recovery  
19          of prudently incurred costs, should abandonment be required for reasons beyond  
20          the developer's control, in conjunction with the entire package of incentives, has  
21          been instrumental in the willingness of lenders to proceed in advance of the  
22          developer obtaining all required regulatory approvals. The lenders want  
23          assurance of their ability to recoup monies lent should abandonment occur.



1 rating. Thus, access to the capital markets on favorable terms will be facilitated  
2 by this capital structure.

3 **Q. WILL THE CAPITAL STRUCTURE OF PIONEER VARY FROM THE**  
4 **RECOMMENDED CAPITAL STRUCTURE DURING THE**  
5 **CONSTRUCTION PHASE?**

6 A. Yes. Until such time as more definitive project work begins, it is not cost-  
7 effective to borrow the large sums required to fund the entire project.  
8 Consequently, for the time being Pioneer will operate with the infusion of equity  
9 from Duke and AEP. Duke and AEP expect to operate Pioneer with largely  
10 equity through at least the fourth quarter of 2009 and possibly longer, until  
11 Pioneer spends sufficient dollars to justify a financing transaction and then  
12 complete financings for Pioneer. However, once the need to make substantial  
13 expenditures for right-of-way acquisition and construction becomes imminent,  
14 significant borrowings will need to be made. While construction proceeds, the  
15 precise debt-to-equity ratio will vary as new borrowings are made and new equity  
16 infusions (including infusions required by lenders) occur. Subject to the  
17 completion of financings by Pioneer, our intent is to maintain the targeted 50-50  
18 debt-to-equity ratio during the project construction period as much as is  
19 commercially and practically feasible. When the Project is completed and placed  
20 into service, the target capital structure for Pioneer will be 50% debt and 50%  
21 equity.

22 **Q. PLEASE EXPLAIN WHY PIONEER IS SEEKING APPROVAL NOW OF**  
23 **THE ULTIMATE CAPITAL STRUCTURES FOR PIONEER.**

1 A. The best financing terms for the Project can be obtained utilizing a formula rate.  
2 The formula rate is based on the capital structure that will exist for Pioneer until  
3 the Project is placed in service. Using the proposed capital structure will also  
4 facilitate servicing of the borrowings by Pioneer during the construction period by  
5 producing 1) cash flows consistent with its final capital structure, 2) cash flow  
6 stability, and 3) enhanced ability to obtain the best financing terms.

7 **Q. PLEASE DESCRIBE HOW PIONEER WILL OBTAIN EQUITY**  
8 **FUNDING AND TRANSITION TO THE ULTIMATE CAPITAL**  
9 **STRUCTURE.**

10 A. Current financial projections include equity contributed by the members. As  
11 construction commences, we anticipate that Pioneer will use a combination of  
12 debt financing and additional equity contributions in the proportions consistent  
13 with the target capital structure.

14 **Q. WHAT IS THE LIKELY FORM OF THE PROJECT DEBT FINANCING?**

15 A. Our expectation is that Pioneer will arrange for debt financings that contemplate  
16 both the construction phase as well as the early phase of commercial operations.  
17 Until negotiations are complete with lenders, we cannot predict whether this will  
18 be achieved with one or more than one vehicle, such as a revolving credit facility  
19 and/or a term loan that covers both such phases. A likely scenario is that Pioneer  
20 will enter into an agreement with a syndicate of lenders that will cover both  
21 phases. Once the Project is complete and no longer in the early phase of  
22 commercial operations, Pioneer will likely seek to refinance the credit facility and

1 term loan with traditional long-term debt (i.e., bonds or debentures) in the capital  
2 markets.

3 As discussed above, if the Commission were to grant Pioneer authority to  
4 begin recovering costs during the pre-commercial period, the likelihood that  
5 Pioneer could obtain financing on commercially reasonable terms and achieve its  
6 target capital structure of 50% debt and 50% equity would improve significantly  
7 because investors would receive a return on their investment currently rather than  
8 accrue returns over an extended construction period and thereby increase their  
9 economic exposure to the project prior to the successful achievement of  
10 commercial operations.

11 **Q. WHAT IS THE CAPITAL STRUCTURE THAT WILL BE USED TO**  
12 **CALCULATE AFUDC AND THE RETURN ON CWIP IN RATE BASE**  
13 **DURING THE CONSTRUCTION PHASE?**

14 A. The 50% debt and 50% equity capital structure discussed above will be used. In  
15 his testimony, Mr. Wiles describes how Pioneer will use accounting records to  
16 include a return on CWIP during the construction period. He also describes the  
17 measures adopted to ensure that Pioneer will cease calculation of Allowance for  
18 Funds Used During Construction (“AFUDC”) for inclusion in the asset balances,  
19 once the formula rate is placed into effect.

20 **Q. PLEASE EXPLAIN WHY THE USE OF THE ULTIMATE CAPITAL**  
21 **STRUCTURE FOR THE CALCULATION OF AFUDC AND RETURN ON**  
22 **CWIP IN RATE BASE IS REASONABLE.**

1 A. There are two primary reasons to adopt this approach. First, as discussed above,  
2 during the construction period the debt-to-equity ratio will be “lumpy,” changing  
3 several times as new borrowings and new retained earning or equity infusions are  
4 added. Precisely tracking temporal variations in the debt-to-equity ratio in order  
5 to calculate the AFUDC and the return on CWIP would be complicated and  
6 would serve no financial purpose. Secondly, such an exercise would not reflect  
7 the capital structure on which financing will be premised. The terms of any debt  
8 financing will depend highly on lenders’ expectations for the stream of cash flows  
9 generated by the Pioneer-filed formula rate. Having the certainty associated with  
10 using the target 50-50 capital structure in the calculation of AFUDC and CWIP  
11 over the entire construction period, instead of allowing it to vary, will likely result  
12 in a more predictable and steady cash flow stream from formula rate revenues.  
13 We believe this will improve Pioneer’s ability to negotiate favorable terms from  
14 prospective lenders.

## 15 VI. CONCLUSIONS

### 16 Q. DO YOU HAVE ANY FINAL OBSERVATIONS?

17 A. Facilitating the construction of needed transmission enhancements is a clear  
18 priority of the Commission, and also of the Congress as evidenced by the Energy  
19 Policy Act of 2005. As demonstrated in witnesses Fallon’s and Barton’s  
20 testimonies, the Project is a highly visible, and greatly needed, enhancement to  
21 the PJM and Midwest ISO systems and to the nation’s transmission system as a  
22 whole. Its completion will benefit, directly and indirectly, literally millions of  
23 people in the upper Midwest and mid-Atlantic regions. However, it is also a high-

1 risk project due to its size, its cost, the time it will take to complete, and the  
2 advanced technology employed, and especially due to the multiple RTOs and  
3 service territories through which the Project will pass. It is essential, therefore,  
4 both for this Project and for future transmission investments that will be required  
5 elsewhere in the country, to attract the capital markets to participate in these  
6 projects, and to do so on terms that will be most beneficial to those assigned cost  
7 responsibility for the projects. Approval of the capital structure described herein  
8 and the ratemaking incentives requested in this application are necessary and  
9 proper means to achieve that goal.

10 **Q. DOES THAT CONCLUDE YOUR TESTIMONY?**

11 A. Yes.

UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

Pioneer Transmission, LLC

Docket No. ER09-\_\_\_-000

State of Ohio

County of Franklin

I, Stephan T. Haynes, being first duly sworn, on oath state that I am the Vice President of Strategic Initiatives and Chief Credit Risk Officer of American Electric Power Service Corporation whose prepared direct testimony was served on all parties to the above reference proceeding. If asked the questions contained in the text of the testimony, I would give the answers that are herein set forth and I adopt the aforesaid answers as my direct testimony in this proceeding.

*Stephan T Haynes*

Subscribed and sworn before me this 9<sup>th</sup> day of October, 2008.

*Charmaine S. Hamilton*  
Notary Public

My Commission expires on:



CHARMAINE S. HAMILTON  
Notary Public, State of Ohio  
My Commission Expires 05-14-

2012