American Electric Power
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AMERICAN ELECTRIC POWER

July 30, 1997

Mr. William F. Stephens, Director
Division of Energy Regulation
State Corporation Commission
P. O. Box 1197
Richmond, VA 23209

R. Daniel Carson, Jr.
Virginia President
540 985 2900

Dear Bill:

During one of the meetings of the Stranded Cost Working Group, Virginia Power Company representatives presented an analysis which supported their Company's estimate of the net plant investment which could be expected to be rendered uneconomic in a competitive environment. You subsequently asked during the meeting if AEP had performed a similar analysis or if it would perform such an analysis.

In this regard, I am enclosing for your review a recently completed paper concerning AEP's/APCO's Projected Stranded Commitments assignable to Virginia. Rich Munczinski had the primary responsibility for preparing this analysis, and he and I would welcome the opportunity to meet with you to discuss it at your earliest convenience.

Sincerely,

R. Daniel Carson, Jr.

dml

Enclosure

Copy: Mr. R. E. Munczinski (w/o enclosure)
Mr. B. L. Thomas (w/enclosure)
Mr. M. S. Lawrence (w/enclosure)

Appalachian Power Company d/b/a/ American Electric Power
Projected Stranded Commitments - Virginia

As part of its ongoing efforts regarding restructuring and competition in the electric utility industry, Appalachian Power Company, d/b/a/ American Electric Power (APCo or the Company), has endeavored to quantify its projected stranded commitments. The term "stranded commitments" refers to (1) net stranded costs for generation assets, and (2) generation-related regulatory assets.

The Company's quantification of projected stranded commitments was conducted in two parts: Generation-related net stranded costs were first quantified by subtracting the present value of future cash flows associated with generating assets from the net investment (net book value) of the generation assets as of December 31, 1996, and then allocated to the Virginia retail jurisdiction. Regulatory assets were taken from the books of account as of that date, and allocated or specifically assigned to the Virginia retail jurisdiction.

While the determination of generation-related regulatory assets is relatively straight forward, projecting a utility's generation-related net stranded costs is a difficult matter that is dependent upon a myriad of variables. Changing assumptions about any of these variables will likely lead to widely differing results. In addition, the industry debate on stranded cost calculations is in its infancy. The assumptions and variables underlying the projections contained herein are based upon the best available information at this time and AEP reserves the right to advance the use of other assumptions, variables and methodologies at some future date.

Given that the AEP System was developed and is operated as a single, integrated and coordinated unit to serve the combined load of all customers within the service areas of its operating utility companies, it is appropriate to evaluate any projected generation-related stranded costs on an AEP System basis. In order to minimize controversy, we have also quantified this information for APCo on a stand-alone basis.

Attachment 1, consisting of one page, is a summary of projected generation-related net stranded costs for the AEP System, for APCo's Virginia retail jurisdictional share of the AEP System, and for APCo (both total company and Virginia retail jurisdiction) on a stand-alone basis including the capacity settlement under the AEP Interconnection Agreement. The calculations were performed assuming levelized market prices of 2.50 ¢/kWh, 2.75 ¢/kWh and 3.00 ¢/kWh over the 20-year study period. Also shown on this page are the results of a further sensitivity analysis that depicts the effect on projected generation-related net stranded costs assuming each generating asset's capacity factor is increased by 5 percentage points throughout the study period. Attachment 2, consisting of two pages, is a description of the major assumptions used to project generation-related net stranded costs.

A quantification of APCo's generation-related regulatory assets, as of December 31, 1996, was previously filed with the Virginia State Corporation Commission, in Case No. PUE960301, as part of APCo's request for approval of an alternative regulatory plan and for a general increase in electric rates. For convenience, a copy of that quantification is enclosed as Attachment 3.

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Appalachian Power Company d/b/a American Electric Power
Virginia Retail Jurisdiction
Projected Generation Related Net Stranded Costs

	Net Book Value	Projected Generation Related Net Stranded Costs at: 2.5 cents	2.75 cents	3 cents
AEP System	$4,686.7 M	$3,938.9 M (84%)	$1,966.7 M (42%)	$(5.4) M
APCo -VA Retail (Rate Case Allocators)		$527.8 M	$263.5 M	$(0.7) M
AEP System w/ Incr Cap Fact	$4,686.7 M	$3,397.3 M (72%)	$1,280.0 M (27%)	$(837.3) M
APCo -VA Retail (Rate Case Allocators)		$455.2 M	$171.5 M	$(112.2) M
APCo (with Capacity settlement)	$885.1 M	$885.1 M (entire)	$680.8 M	$240.2 M
APCo -VA Retail (Rate Case Allocators)		$394.8 M	$303.6 M	$107.1 M
APCo with Incr Cap Factor	$885.1 M	$885.1 M (entire)	$512.5 M	$36.7 M
APCo -VA Retail (Rate Case Allocators)		$394.8 M	$228.6 M	$16.4 M

ATTACHMENT 1

Major Assumptions for Projected Generation-Related Net Stranded Costs Quantification

1. Generation from the AEP System's generating plants was assumed to escalate at 1.3% per year through the year 2008 and then decline at a constant rate of 1.6% per year through 2015 to reflect retirement of units. For APCo, generation was assumed to escalate at 2.5% per year through the year 2010 and then decline at a constant rate of 3.2% through the year 2015 to reflect retirement of APCo generating units.

2. Total Revenue projections were calculated for AEP and APCo generating plants using levelized market prices of 2.5 cents per kWh, 2.75 cents per kWh and 3.00 cents per kWh.

3. Fuel costs for the AEP System's generating plants were assumed to increase at 3.1% per year through 2008, which reflects load growth and cost escalation. Thereafter, fuel costs were assumed to increase at 0.5% per year through 2015 which reflects cost escalation and a decline in generation.

4. Fuel costs for APCo's generating plants were assumed to increase at 3.5% per year through 2010 which reflects load growth and cost escalation. Thereafter, fuel costs were assumed to increase at 0.7% per year through 2015, which reflects cost escalation and a decline in generation.

5. Other O&M expenses, Depreciation and Taxes Other Than Income Taxes were based on Corporate Planning and Budgeting projections for the years 1996 through 2015 and/or were specifically calculated for those years using composite depreciation or revenue tax rates. Projected amounts only reflect generation-related expenses for these items of expense.

6. APCo's projected stranded cost calculations include AEP System Pool capacity equalization payments of $127 million per year escalated at 1% per year through 2015.

7. Current Federal/State income taxes were calculated for the AEP System and APCo based on the study's projections of pre-tax book income from the generation assets and estimates of Schedule M tax adjustments. A composite federal/state income tax rate of 37% was used for AEP and 38.05% for APCo. Deferred federal income taxes and deferred investment tax credits were calculated based on the tax normalization treatment of timing differences for the AEP System and APCo.

8. Net Investment (net book value) includes production plant, generation-related transmission and general plant, fuel inventory, a portion of materials & supplies inventory and prepayments less accumulated deferred federal income taxes, based on projections obtained from Corporate Planning & Budgeting for the years 1996-2015.

9. A net-of-tax discount rate of 8.9% (13.69% on a before-tax-basis) was used to discount future cash flows for AEP's and APCo's generating assets back to December 31, 1996. The sum of the present value of future cash flows as of December 31, 1996 was subtracted from the net book value of the generation assets as of that date to obtain the quantification of generation-related net stranded cost, if any.

10. The capacity factors for the AEP System's and APCo's generating plants were increased by 5 percentage points to determine the sensitivity that an increase in capacity utilization would have on projected stranded costs. For the AEP System, the capacity factor was increased from a projected 20-year average of approximately 69% to approximately 74%, while for APCo's generating plants, the capacity factor was increased from approximately 65% to approximately 70%.

[H:\mjl\apco\attach2.w51]

APCO Exhibit No. ___
Witness: REM
Schedule 1

Appalachian Power Company
Generation Related Recorded Net Regulatory Assets Subject To Potential Accelerated Recovery
Under The Company's Proposed Alternative Regulatory Plan
As of December 31, 1996
($000)

Description	Total Company	Generation Total Company	Generation Virginia Retail
Regulatory Assets			
SFAS 109 Net Deferred Federal Income Taxes	350,534	159,296	36,599
SFAS 109 Deferred State Income Taxes	81,523	28,112	7,994
Unamortized Loss on Reacquired Debt	25,567	10,902	4,877
Deferred Storm Damages	10,990	0	0
Deferred Fuel Costs Underrecovery	9,374	9,374	9,374
Postemployment Benefit Deferrals	12,889	5,975	2,000
Carrying Costs of Purchased Allowances	80	80	34
Deferred Preferred Stock Reacquisition Costs	6,788	2,894	1,295
Total Regulatory Assets Subject to Accelerated Recovery (See Note 1)	497,745	216,633	62,173
Regulatory Liabilities			
Deferred Fuel Costs Overrecovery	2,961	2,961	0
Unamortized Gain on Reacquired Debt	12	5	2
Total Regulatory Liabilities Subject to Accelerated Recovery (See Notes 1 and 2)	2,973	2,966	2
Net Regulatory Assets and Liabilities Subject to Accelerated Recovery (See Notes 1 and 2)	494,772	213,667	62,171

Note 1

Deferred Investment Tax Credit (ITC) of $72.677 million (Account 255) and the related regulatory liability recorded pursuant to SFAS 109 of $39.134 million (Account 254) are excluded from this analysis since they cannot be amortized more rapidly than ratably at this time. APCo remains a regulated utility and as such, like other utilities, its public utility property is subject to the provision in IRC Sections 46(f)(1) and (2). These IRC sections do not permit offset of ADITC against recovery of a deferred regulatory asset.

Note 2

Deferred gains and related carrying charges on Ohio Power Company's 1994 sale of SO2 emission allowances and deferred EPA auction proceeds totaling $5.592 million (Account 254) are excluded from this analysis because the Company proposes under its alternative regulatory plan to not include these deferred gains as a credit to the cost of service, but rather to amortize them during the moratorium period.