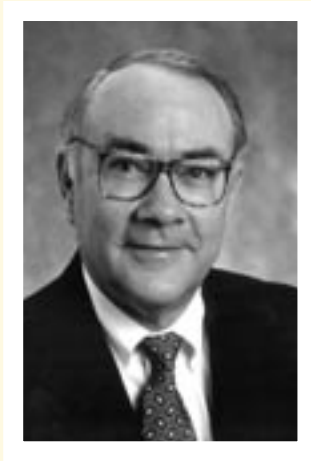


Building Trust

LEADING CEOs SPEAK OUT:
HOW THEY CREATE IT,
STRENGTHEN IT, AND SUSTAIN IT.



Dr. E. Linn Draper, Jr.

CHAIRMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER
AMERICAN ELECTRIC POWER COMPANY, INC.

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stayed on in AEP’s service territory.”*

– Dr. E. Linn Draper, Jr.

RESPONDING TO THE WORST U.S. BLACKOUT

Months after the August 14th blackout which affected 50 million Americans and Canadians, it continues to be a prime topic for both legislators and regulators. It was the worst blackout in U.S. history.

The investigation and research to reconstruct the events of that day are continuing, and the public policy debate to determine ways to minimize the likelihood of a similar event in the future has only just begun.

Because the August 14th outage has wide-ranging implications for the future of the electric utility industry, I want to share our company's perspective on these events with you.

As you will see, we believe the actions of our employees contribute significantly to building a good business reputation. Inasmuch as AEP has \$5 billion invested in its 39,000-mile transmission grid, ours is certainly a unique perspective.

From the outset, let me be clear—we did it right. The AEP System held together—a point of pride for us. Our protective systems performed as they were designed to perform, our operators performed and communicated as they should, and our load and generation remained in balance before and after the blackout. Our grid is large, robust and integrated, and can therefore withstand the power swings we experienced that day. In short, our people responded correctly and we were able to avoid serious problems caused by the blackout. In fact, Michehl Gent, the president and chief executive officer of the North American Electric Reliability Council (NERC), said on August 15 that AEP’s 765,000-volt transmission system is “often heralded as the world’s finest transmission system.”

From an operational standpoint, the 14th was a fairly typical August day until our operators first detected transmission line problems at an interconnection point with our neighboring utility to the north, FirstEnergy. When that took place, we contacted FirstEnergy’s operators. Throughout this event, we maintained extensive communications with our reliability coordinator, the PJM (Pennsylvania-New Jersey-Maryland) Interconnection, and with FirstEnergy.

Power flows on the AEP System before the event, especially into Michigan and northern Ohio, were high but not unusual, given typical summer loads. It’s important to note that Michigan is often a significant importer of power. Power flows on our lines continued to increase

because of increased demand outside our system. We still do not know the cause of the increased demand.

As the flows of power exceeded safe operating levels across our lines, our equipment in northern Ohio operated automatically to isolate the problem. This is exactly what the equipment is designed to do. To quote the U.S. Department of Energy's National Transmission Grid Study, released in May of last year, "Electricity flows according to the laws of physics and not in response to human controls—what happens in one part of the grid can affect users throughout the grid."

The opening of the lines prevented damage to our equipment. More importantly, it avoided cascading outages across the AEP System and probably far beyond, given the central role of AEP's transmission grid in the eastern and midwestern United States. The AEP System was not the only one to respond this way. The transmission system serving Consumers Power's load in Michigan, among others, also isolated it from the problem during the event, and their system held. I do not know why all systems failed to perform in a similar manner.

Automatic tripping of lines is not simply a matter of protecting our equipment. There are serious reliability and safety implications if the automated protection mechanisms do not activate.

First, if the equipment is damaged, it can be out of service for an extended time, further burdening other lines that are already stressed. In short, the system holds for as long as it can, but at some point equipment must "trip off" to prevent further cascading outages. In this instance, tripping off stopped the cascade to the south, enabling AEP's personnel to assist others in their restoration efforts, because we did not have to deal with restorations of our own.

Tripping off also has safety implications. If current runs as high as it was during the event, it could actually cause the lines to literally melt or to sag beyond design criteria, which can result in safety hazards to the public.

I do not wish to speculate on the root causes of this event, so I can't say it wouldn't have occurred a year ago, or it will never occur in the future. The interconnected nature of our grid, and the fact that we are now using it in ways that were not originally intended, mean that these kinds of events can occur in the future, although lessons learned can help prevent a recurrence of the same magnitude.

I take great exception to the characterization of the U. S. transmission system as “a Third World grid,” as some have said. The American transmission grid is the strongest in the world, although it is being pushed to its limits.

The electrical grid in this country was designed, in large part, to move a local utility's generation to its customers—not to carry thousands of cross-country and regional transactions, as the grid is now doing. In the five-year period during which wholesale electric competition first gained momentum, the number of wholesale transactions in the United States climbed from 25,000 to 2 million—an 80-fold increase. And many stakeholders are striving for continued growth. Transmission infrastructure expansion—which is an expensive and time-consuming prospect at best—did not increase 80-fold in that time frame. In fact, very little expansion has taken place.

Clearly, there is a need to strengthen the grid through greater investments—new equipment, new power lines and new technologies—to support today's use of the grid.

Several factors will hasten grid improvement. First and foremost, we need regulatory certainty. If we need to build new transmission facilities today, we must often navigate through multiple state and federal regulators to get that done. Processes vary in every state. For permits and siting, for instance, we must get approvals from multiple state regulators, and probably multiple federal regulators, as well. We proposed a 765,000-volt line in West Virginia and Virginia in 1990. After an expenditure of more than \$50 million, we received final clearance to build the line during the last week of 2002. While we respect the interests of all jurisdictions in siting decisions, we'll never get where we need to be if it takes nearly 13 years to get permission to build a power line.

And for every dollar we spend—and the National Transmission Grid Study quoted a price of \$1.8 million per mile for a new 765,000-volt line—we must go back to those multiple state and federal regulators to receive full recovery. In this context, it is difficult to understand recent actions by the Federal Energy Regulatory Commission (FERC) to eliminate transmission revenues from third-party or wholesale customers. If FERC's proposal comes to pass, power will be able to move from St. Louis to New Jersey for the same fee as moving power from Pennsylvania to New Jersey. Such scenarios not only jeopardize existing investments, but they also create a disincentive for future investments since full and fair cost recovery is even more difficult.

Second, and also critically important, we must improve coordination and communication among the various entities that oversee the grid. The reality is that we don't have one single transmission grid owner and operator throughout the country, nor would it be feasible or wise to do so. It's a given that there will always be seams—or boundaries—between various grid operators.

What's required is continuous improvements in the coordination among the various grid operators to ensure coordinated planning and operations, and quick response in emergency situations. On August 14, our operators did coordinate and communicate with other operators, which helped to prevent this outage from spreading even further across the country. However, we can all strive to improve. Those who are using this event to promote their desire for a single Regional Transmission Organization (RTO) administering a spot market are not only missing the boat, but misleading some people into thinking that simply installing such an RTO would answer the reliability issues that have been raised by this event.

I fear the current controversy and seemingly endless debate over the role of RTOs are hindering our ability to make progress and create an environment conducive to investment in needed transmission assets. Although AEP has committed \$50 million to RTO development, many states now are opposing an expansive role for RTOs (including a number of the 11 states where AEP's transmission and distribution lines are located), while others fully support a broad role for RTOs and more federal control over the grid and the wholesale market.

While the debate about RTOs rages on, let's not forget some key points:

- AEP is in the center of the current debate largely because of the scope and the high quality of our system, which is at the crossroads of many markets. That's one big reason why we're coveted by electricity market stakeholders in their attempts to expand RTOs.

- Policies should balance both generation and transmission. Transmission owners must receive sufficient revenues to assure adequate investment.
- Parties that benefit from competitive markets should bear the costs. Those that use the transmission system to receive those benefits should pay for it.
- While some have suggested splitting up the AEP System, the idea is unacceptable and counterproductive. The AEP System has been touted as the backbone of the Eastern Interconnection. Splitting it apart amidst efforts to increase the nation's electric reliability flies in the face of reason.

We need consensus on an appropriate use of the grid. If we focus solely on competitive markets and economics, serious implications for reliability and security arise. We need a balance, but that balance must be tipped toward reliability—the fundamental foundation of the transmission grid. Without reliability, we have no market to structure.

The benefits of competitive markets should not only flow to generation owners or electricity users, as seems to be the present policy, but also to the transmission owners. They need to receive a sufficient share of benefits to assure investment in the transmission infrastructure necessary to support competitive markets.

Additionally, we must approve NERC as the enforcement entity for mandatory reliability standards. Our grid is interconnected. We must all play by the same rules, and we must have a knowledgeable independent entity—such as NERC—empowered to enforce such standards.

We will continue to work with the U.S. Department of Energy, NERC and all of the entities that are working on investigations of the events of August 14, 2003. As part of that process, I testified before the U. S. House of Representatives' Committee on Energy and Commerce on September 4, 2003. We look forward to a complete analysis and answer to exactly what happened that day, and we hope to have a voice in determining appropriate solutions or improvements. In the meantime, we can take a measure of satisfaction in knowing our protective systems worked well and the lights stayed on in AEP's service territory.

My apologies for running on a bit on this technical subject, but I believe that greater understanding of this issue will increase shareholder and consumer faith in AEP.

Dr. E. Linn Draper, Jr.

**CHAIRMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER
AMERICAN ELECTRIC POWER CO., INC.**

Dr. E. Linn Draper, Jr. became chairman, president and chief executive officer of AEP in May 1993. He served as president of AEP and the Service Corporation starting in March 1992, following 13 years with Gulf States Utilities Company, where he served as chairman, president and chief executive officer. Draper is also president of Ohio Valley Electric Corporation and its subsidiary, Indiana-Kentucky Electric Corporation.

Before joining Gulf States Utilities, Draper served on the faculty and administration at the University of Texas in Austin. He holds a bachelor of arts degree and a bachelor of science degree from Rice University, and a doctorate in nuclear science and engineering from Cornell University.

In 1992, Draper was elected a member of the National Academy of Engineering. He was elected to the Cornell University Council Board in 1998, appointed to the University of Chicago Board of Governors for Argonne National Laboratory in 1999, and serves on the University of Texas Engineering Foundation Council. He is a member of the boards of directors and past chairman of the Nuclear Energy Institute, the Institute of Nuclear Power Operations, the National Coal Council and the Edison Electric Institute. He is a past president and former member of the board of directors of the American Nuclear Society.

He is chairman of the Environment, Technology & the Economy Task Force of The Business Roundtable-WDC, and chairman of the Ohio Business Roundtable. Draper is also on the board of the U.S. Chamber of Commerce and the National Association of Manufacturers. He is the chairman of the Columbus Downtown Development Council and is a member of the board of directors of Borden Chemicals and Plastics.

AMERICAN ELECTRIC POWER COMPANY, INC.

American Electric Power is one of the largest electric utilities in the United States. Approximately 5 million customers in the Midwest, Middle Atlantic and Southwest regions are linked to the company's 11-state grid.

AEP operates 39,000 miles of transmission lines and more than 180,000 miles of distribution lines. The company has more than 2,000 miles of 765,000-volt transmission lines—more than the rest of the nation's electric utilities combined. AEP is also one of the largest generators of electricity in the United States, owning and operating more than 38,000 megawatts of generating capacity.

The company has become one of the nation's largest producers of wind energy. AEP owns two wind farms in Texas with a combined generating capacity of 310 megawatts. AEP also produces electricity from coal, natural gas, nuclear and hydroelectric plants.

AEP has a tradition of environmental stewardship. The company has planted more than 62 million trees since the 1940s, some as a part of its award-winning surface-mine reclamation activities and some as a part of its carbon sequestration projects. Eleven of AEP's power plants have been designated as certified wildlife habitats by the Wildlife Habitat Council, a non-profit organization. The company sponsors summer workshops for teachers, as well as its E-LAB program, which allows teachers and students to visit and study in the forests of Bolivia or Belize.

Since 1951, AEP has been a pioneer in coal ash utilization and research. Today, fly ash produced from coal combustion is used as a partial replacement for cement in concrete and is also used in the production of paints, coatings and plastics.

Founded in 1906, AEP is headquartered in Columbus, Ohio.

For more information, visit: www.aep.com.

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