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

American Electric Power Service Corporation	)	
Consumers Energy Company,	)	Docket No. ER99-3144-000
The Detroit Edison Company	)	
FirstEnergy Corp.	)	
Virginia Electric and Power Company	)	
	)	
Application under Section 205 of the Federal	)	
Power Act for Approval of Transaction	)	

**NOTICE OF INTERVENTION, REQUEST FOR HEARING,  
MOTION TO CONSOLIDATE AND COMMENTS  
OF THE  
VIRGINIA STATE CORPORATION COMMISSION**

Pursuant to Rules 212 and 214(a)(2) of the Federal Energy Regulatory Commission's ("Commission's") Rules of Practice and Procedures, 18 C.F.R. §§ 385.211 and 385.214(a)(2), the Virginia State Corporation Commission ("VSCC") hereby notices its intervention, requests a hearing, comments on the filing and moves to consolidate this docket with Docket No. EC99-80-000. The VSCC is filing an identical notice in each docket.

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**I. The Alliance Filing Raises Factual And Policy Issues Warranting A Hearing**

Efforts to form regional transmission entities can facilitate the development of competitive electricity markets within Virginia and the surrounding region. To do so, they must meet certain criteria, including those identified by the Commission in Order Nos. 888 and 889 and the Notice of Proposed Rulemaking in Docket No. RM99-2-000 (hereinafter, "RTO NOPR"). The Alliance filing has many features warranting close comparison with those criteria at hearing. These features fall into five broad categories:

- A. Geographic Scope**
- B. Structure and Governance**
- C. RTO Activities**
- D. Pricing**
- E. Authorization of Future Dispositions**

The VSCC will discuss each in turn.

At the outset, the VSCC emphasizes that it is not taking a position on any particular feature of the Alliance proposal. As explained in more detail in Part II below, the VSCC under state law will have to determine whether the transfer of control or ownership of any transmission asset satisfies certain state law requirements. The VSCC believes that a full hearing under the Federal Power Act is necessary to carry out the Commission's statutory obligations. It is to facilitate the conduct of that full hearing that the VSCC offers the comments and raises the questions below.

**A. Geographic Scope and Regional Configuration**

With respect to geographic scope and regional configuration, the Commission's RTO NOPR states three important principles:

"[R]egions should be configured so as to recognize trading patterns, and be capable of supporting trade over a large area, and not perpetuate unnecessary barriers between energy buyers and sellers." RTO NOPR at p.134.

"Transmission owners could seek to gain strategic advantage by the way an RTO is formed. For example, an RTO could be placed to act as a toll collector on a critical corridor. Alternatively, an RTO could propose configurations that interfere with the formation of a larger, more appropriately configured RTO." RTO NOPR p.129 (footnote omitted).

An RTO should "take into account existing regional boundaries" and "not disrupt existing useful institutions." RTO NOPR at p.136.

The members of Alliance are associated by virtue of their agreement to the terms and conditions of the Alliance documents, not necessarily because their corporate boundaries satisfy the Commission's aforementioned principles. This fact raises a number of questions for the Commission.

1. The corporate boundaries of these joining entities create an entity critically positioned between Midwestern and Northeastern power markets.

- a. Will the proposal deter more effective means of providing competitively priced electricity, by forestalling consideration of alternative configurations or by limiting the scope of transmission facilities under single RTO control?
- b. If the proposal may have this deterrent effect, should any Commission approval be conditioned upon provisions which ensure future relationships with other transmission organizations' transmission owners that are consistent with the fullest feasible development of competitive generation markets?

2. The proposed Alliance configuration would include only portions of the East Central Area Reliability Coordination Agreement (ECAR) and Southeastern Electric Reliability Council (SERC) reliability regions, effectively bisecting each one.

- a. Was the Alliance's decision to bisect ECAR and SERC the product of a careful reliability and economic analysis that identified all positive and negative effects of the bisection?

- b. Will the bisection cause conflicts with respect to the differing operating requirements and agreements within the two reliability regions?
- c. Will the effect of the bisection be to further the Alliance's stated goal of integrating all participants in the proposed RTO into one NERC reliability region, or will it instead be disruptive of existing reliability institutions?

The Commission should seek full information regarding the possible effects of any disruptions.

## **B. Structure and Governance**

The Alliance consists of a complex structure accompanied by similarly complex governance rules. Questions arise in at least seven areas:

- 1. Hybrid ISO-Transco Entity
- 2. Five Percent Ownership Limit
- 3. Requirement of Majority Vote for New Members
- 4. Transmission Owner Vetoes
- 5. The Alliance's Fiduciary Obligation
- 6. "Put Right"
- 7. Standards of Conduct

We discuss each in turn.

### **1. Hybrid ISO-Transco Entity**

Under the Alliance proposal, there will be either an ISO or a Transco. The "baseline" structure is an ISO. As the Section 205 Application explains (at pp.8-9), the Transco structure would be triggered if (a) one or more transmission owners indicates a willingness to divest to an Alliance Transco transmission facilities with a gross book valuation of at least \$1 billion and (b) at least 50 percent of Non-Divesting Transmission Owners concur with the establishment of a Transco. Divesting transmission owners may transfer ownership of their transmission facilities to the Alliance in exchange for shares of stock in the Alliance Publico, a membership interest in the Alliance Transco, or some combination of these two options.

Under this approach, it is possible that the Transco could be formed even if fewer than all of the Transmission Owners decide to divest their transmission assets to the Transco. In this

situation, the Transco would own and operate its own transmission facilities, while also operating transmission facilities owned by others.

In determining whether this structure is consistent with the goal of independence, the Commission should ask:

- a. Will the Alliance be completely independent when its ultimate structure will be determined solely by the individual divestiture and stock ownership decisions of transmission owners?
- b. Will the Alliance Transco have conflicting goals in that it must protect its own financial interests, the interests of divesting owners with membership entitlements, and the interests of nondivesting transmission owners, and will the resolution of any such conflicts impair the Transco's independence?
- c. Might a residual financial interest by the Divesting Transmission Owners manifest itself in superior access to information and influence?

## **2. Five Percent Ownership Limit**

The Commission has stated:

Market participants must be assured that the RTO will provide transmission access to all market participants on a fair and nondiscriminatory basis. An RTO needs to be independent in both reality and perception. It is the Commission's view that independence can be achieved if the RTO satisfies three conditions. First, the RTO, its nonstakeholder governing board members and its employees must have no financial interests in market participants. Second, the RTO's decision making must not be controlled by any market participants. Third, the RTO must have independent authority to file changes to its transmission tariff.

RTO NOPR p.119-20. The RTO NOPR notes that the second condition "would be satisfied, for example, by an RTO with a prohibition on market participants having more than a de minimis (one percent) ownership interest in the RTO." Id. at 122 (emphasis added).

The Commission's concern about ownership interest should be explored in the context of the Alliance filing. Questions for Commission consideration include:

- a. Is the Alliance proposal's feature enabling a transmission user to exercise voting rights of up to five percent of the stock of the Alliance Publico

inconsistent with the Commission's goals of independent governance? See Appendix 2, page 1.

- b. How readily might five transmission owners aggregate their interests so as to achieve a voting block of 25%?
- c. Would such a 25% interest be more likely to be inconsistent with the goal of independence than a five-utility aggregation of one percent interests to equal five percent ownership?
- d. Would the five percent authorization create a conflict between the goals of geographic broadening and independence, in that the more transmission owners which are brought into the Alliance, the more rapidly the percentage ownership held by utilities grows? (For example, a growth from five transmission owners to ten transmission owners would, under a five percent per owner regime, bring transmission ownership to 50%, whereas a one percent ownership regime would bring transmission ownership to 10%.)
- e. Is this concern compounded by the possibility that divesting owners may also have membership rights in addition to shareholder rights?
- f. The 5% limitation applies to "Transmission Users." That phrase is defined to include "all entities which are any one or more of the following: (a) Transmission Customer, (b) Delivering Party, (c) Power Purchaser, (d) Receiving Party, (e) Transmission Owner which utilizes the Transmission System to effectuate a Transmission Transaction, or (f) broker or marketer or any other intermediary that is a party to a Transmission Transaction." Ex. A to Appendix 2. It appears that the term does not include all entities that could have an interest in restricting access to the transmission facilities controlled by the Alliance. Such entities could include market participants in adjoining regions. The Commission will need to consider whether the absence of ownership limits for such entities is consistent with the goal of independence.

### **3. Requirement of Majority Vote for New Members**

Additional transmission owners may not join the Alliance unless approved by majority of initial transmission owners. Alliance Agreement Section 8; ISO Bylaws Section 2.3.1(b). The majority's ability to exclude new participants exists even if the transmission owner seeking membership had the same qualifications as the existing owners; e.g., a transmission tariff, contiguity with existing Alliance boundaries, and agreeing to execute the Operation Agreement

(unless a Divesting Transmission Owner). With the initial group numbering five, only three negative votes would be necessary to prevent participation by a new transmission owner.

The Commission's present policy is to leave to transmission owners (as distinct from a neutral entity) the discretion to determine, at least initially, the various geographic territories to be served by RTOs. The apparent premise for the Commission's present approach is that economic self-interest will be aligned with the goal of effectively competitive generation markets.

The Alliance filing presents a test of that proposition, raising several questions. For example:

- a. Is the right of existing transmission members to deny participation by newcomers inconsistent with the independence sought by the Commission?
- b. More specifically, under the Alliance's rules, could the initial transmission owners use their rejection power over new transmission-owning members to limit or preclude physical or contractual transmission linkages that, if they existed, could increase market size and therefore increase trading among heretofore separate markets?
- c. Where one or more veto-armed transmission owners is vertically integrated and has generation serving markets affected by the Alliance's transmission decisions, does this vertical integration provide an economic incentive and opportunity to such owners to use the power to deny new membership to advance the owners' generation business?
- d. A reason sometimes given for the Alliance's proposed approach is that the transmission owners need to protect the stock value from dilution that might result from the entry of new transmission owners.
  - i. Should the concern about diluting a particular transmission owner's stock value always take precedence over potentially larger public benefits from the joining of a new member?
  - ii. If not, how should these two concerns be balanced and who should do the balancing?
  - iii. Are there alternative means of protecting against dilution, besides authorizing transmission owners to exclude others from membership, which are consistent with the Commission's goal of

effective competition and independent operation of transmission facilities?

#### **4. Transmission Owner Vetoes**

In a number of situations, the Alliance documents grant to an individual transmission owner a veto over certain actions which otherwise could be undertaken unilaterally by the ISO or Transco. We discuss two such vetoes below: (a) the veto over the acquisition of transmission assets and issuance of securities; and (b) the veto over changes to the transmission tariff.

##### **a. Acquisition of Transmission Assets and Issuance of Securities**

A Divesting Transmission Owner can prevent the RTO's acquisition of additional transmission facilities, or the RTO's issuance of securities, if such actions would dilute the value of the Owner's stock. Appendix 3, Page 2-3. It appears that there is no minimum ownership interest which a divesting transmission owner must have as a condition of asserting this right. Appendix 3, page 2. The Commission will want to explore whether this approach is consistent with the goal of independence. For example:

- i. Assuming there is a legitimate concern about dilution, can this concern be addressed reliably by statutory means, such as just and reasonable ratemaking, rather than by extending to a transmission owner a veto over expansion activities which can facilitate effective competition?
- ii. In balancing the dilution concern with the public's interest in independent operation of the transmission grid, should the Commission take into consideration whether the transmission owner is vertically integrated and has a generation business in the market affected by the transmission expansion decision?
- iii. Will this provision complicate, or bias, future transmission ratemaking? Suppose a potential seller seeks a price exceeding the book value of the transmission facilities offered for sale, thereby creating an acquisition premium. The existing Divesting Transmission Owners may refuse to allow the purchase unless the Commission allows the acquisition premium in rates; otherwise their stock value would be diluted (all other elements of the revenue requirement remaining the same). In this situation, the Commission would be in a position of having to act contrary to its precedent, which limits recovery of an acquisition premium, so as to fulfill its other goal of increasing the geographic area covered by the RTO by facilitating the RTO's acquisition of new transmission facilities.

## **b. Changes to the Transmission Tariff**

A Non-Divesting Transmission Owner has the right to veto the RTO's decision to seek changes in the Alliance Open Access Transmission Tariff (OATT) or other agreements, where the concern is rate design or revenue allocation. Appendix 3, p.3. Concerning this provision, the Commission will need to ask several questions:

- i. Is this veto consistent with the Commission's view that the RTO must have independent authority to file changes to its transmission tariff?
- ii. Could this veto be used to forestall participation by additional transmission owners, since such participation, while possibly increasing regional efficiency by bringing more transmission assets within a regional regime, may also result in changes in revenue allocation? As with questions previously framed, the Commission will want to ask whether the transmission owners' concerns underlying these provisions are statutorily protected concerns, and whether there are alternative means of protecting those concerns which are consistent with the Commission's goal of independent governance.
- iii. Some assert that the veto over rate changes is necessary to protect the Transmission Owners' ability to recover their revenue requirement and to avoid the potential for cost shifts among customers. The Commission must ask whether these assertions are accurate. For example, is it sufficient protection against inability to recover the revenue requirement to have access to the Commission through normal Federal Power Act procedures, or is it necessary to grant to the Owners the additional ability to prevent those procedures from ever being triggered? Put another way, is the Commission's legal obligation to address a transmission owner's concern about revenue requirement any less when the RTO brings forth a proposal not endorsed by the transmission owner, as compared to a proposal which the transmission owner has endorsed?

## **5. The Alliance's Fiduciary Obligation**

Alliance would have a general fiduciary duty to the transmission owners. This duty includes a specific obligation to maximize transmission service revenues. Appendix 8, Section 3.3.4.

The Commission will need to determine whether the fiduciary obligation concept is consistent with its goal of ensuring that the RTO can act consistently with the public interest in

an efficient regional transmission system. For example, assuming the Commission ultimately approves a role for the Alliance in defining inappropriate transmission owner behaviors, detecting such behavior and penalizing it, the same entity then will have a fiduciary duty to maximize profits for transmission owners while also having an obligation to reduce the profits of those owners by such enforcement activities. The Commission will need to examine whether this tension between Alliance duties can be resolved consistently with the public interest.

## **6. "Put Right"**

A Divesting Transmission Owner has a right to require the Alliance Transco to purchase its membership interest for cash at an appraised fair market value (based upon an independent appraisal) on the fifth anniversary of the date of the divestiture of such transmission facilities and on each subsequent anniversary thereafter. Appendix 3, p.6. Several questions arise:

- a. This "Put Right" provision appears to obligate the Alliance to purchase membership rights regardless of the Alliance's view of the value of those membership rights to the RTO. The Commission should assess the effects on the other Alliance members, Alliance customers, and the public interest of an allocation of decisionmaking power wherein the RTO must make an investment based on the value calculation of the member, rather than the value calculation of the RTO.
- b. The Commission will need to consider the future effects on rates of an arrangement under which the cash price paid by the Transco for membership rights is determined by an independent appraiser. Absent clear guidance as to the Commission's ratemaking intentions concerning any acquisition premium (excess of acquisition price over book value), there is a risk of financial uncertainty that will affect the public. Clarity also is necessary concerning the methodology the independent appraiser would use to value membership rights, whether the Commission is bound to accept that methodology, and what effect any resulting uncertainty would have on the goal of efficient regional transmission policy.

## **7. Standards of Conduct**

Essential to independence is a clean separation between the Transco and the Non-Divesting Transmission Owners. The device proposed by the Alliance is "Standards of Conduct" governing communications between the Transco and employees of the Non-Divesting

Transmission Owners. See Appendix 3-A to the Alliance Transco Term Sheet. The Commission will want to explore whether the proposed Standards of Conduct are primarily hortatory, or whether in practice they will contain sufficient elasticity and strength to preclude improper influence.

### **C. RTO Activities**

The Commission has noted that to assure the independent provision of transmission service, an RTO should have control of certain minimum functions. RTO NOPR at p.115. These minimum functions should include establishing requirements for operational control, market monitoring, and congestion management. On these subjects, the Alliance proposal presents issues in at least eight areas:

1. Allocation of Responsibility for Operations
2. Congestion Management
3. Provision of Ancillary Services
4. Construction of New Transmission Facilities
5. Efficiency Incentives
6. Planning and Assessment of Adequacy
7. Transco Generation Activities
8. Market Monitoring

#### **1. Allocation of Responsibility for Operations**

The RTO NOPR (at p.141) states:

Operational control raises two basic questions: What functions should be performed by an RTO? How should an RTO perform the functions that it has reserved for itself? With respect to the first question, there is a concern that some splits of functions between an RTO that is an ISO and existing control area operators could compromise reliability and allow the control area operators to continue to favor their own power marketing efforts.

On this subject, the Alliance proposal states:

The Transmission Owners who are Control Area operators shall continue to operate their Control Areas for local generation control and economic dispatch in addition to meeting Alliance RTO and NERC requirements. The Transmission Owners who are Control Area operators will continue to be responsible for operation of their Control Areas until they are relieved of that responsibility by the Alliance RTO.

Appendix 5, Section 1.4.2. Section 1.4.1 also makes clear that the Transmission Owners will perform all physical functions, subject to the RTO's directions.

These provisions leave existing transmission owners significant operating authority. There is no definitive schedule by which the transmission owners will consolidate control area functions and transfer them to the RTO. The Commission should consider the following questions:

- a. Is the transmission owners' continuing role in control area operations appropriate?
- b. Should the RTO have authority to determine whether and when the presently proposed split should change?
- c. Should there be a definitive schedule for transferring physical control of these functions to the RTO?

## **2. Congestion Management**

Concerning congestion management, the Alliance proposal presents issues in three areas:

- a. Market Mechanisms
- b. Cost of Congestion Management Services
- c. Availability of Redispatch to Accommodate New Transactions

### **a. Market Mechanisms**

The RTO NOPR (at p.162) states that "the RTO must ensure the development and operation of market mechanisms to manage transmission congestion." Proposed Rule Section 35.34(j)(2) states that the "Regional Transmission Organization must either operate such markets itself or ensure that the task is performed by another entity that is not affiliated with any market participant." The RTO "must satisfy this requirement no later than one year after it commences initial operation." Id.

The Alliance proposal notes that it will "seek" to develop a congestion management structure that "allows" an energy market to develop prices on a locational basis. Appendix 5

p.22. The Commission must ask whether this approach, which imposes no deadlines and which appears to leave such efforts optional with the Alliance, "ensure[s] the development and operation of market mechanisms to manage transmission congestion."

**b. Cost of Congestion Management Services**

Section 2.5.2 of the Pricing Protocol (Appendix 7) states that the Alliance RTO will pay the "contract price" to providers of congestion management services. The RTO will "endeavor to prudently procure these services." The provision does not commit the RTO to a price cap for these services.

The Commission should consider what forms of protection against excessive prices for these services is appropriate. In considering this issue, the Commission will want to take account the competitiveness, or lack thereof, of the market for congestion management services, particularly given the lack of a commitment by the Alliance RTO to create a power exchange.

**c. Availability of Redispatch to Accommodate New Transactions**

The Alliance proposal appears to limit the RTO's authority to use redispatch to create transmission capacity required by new transmission transactions. The Commission should examine whether this feature of the proposal will unnecessarily disadvantage new firm service transactions.

The Alliance's Section 205 Application (at 47) provides the following overview:

The Alliance RTO will not undertake redispatch procedures to accommodate requests for new firm transmission service when there is insufficient ATC ["available transmission capacity"] to otherwise provide the service. The Alliance RTO will, however, facilitate generation redispatch arrangements between generation owners and those requesting firm service. The Alliance RTO will solicit bids for providing generation redispatch and firm transmission reassignment, and will post the bids on the OASIS.

More specifically, the Operating Protocol (Appendix 5) contains the following provisions:

Section 3.2.4:

When there is not adequate transmission capability to satisfy a firm transmission request, the Alliance RTO shall facilitate the identification of redispatch that will, or might, relieve, to the extent possible, the transmission constraint consistent with the terms of the OATT and communicate the redispatch possibilities via OASIS. The impact of the redispatch will be handled in a manner consistent with Article X.

Section 10.4.1:

The Alliance RTO will accommodate new firm transmission service requests as long as sufficient ATC exists. However, the Alliance RTO will not consider redispatch to accommodate new firm transmission requests if it determines that there is not sufficient ATC. To assist customers seeking transmission service in the absence of sufficient firm ATC, the Alliance RTO will develop a service to facilitate bilateral redispatch contracts between a Transmission Customer and a Generation Owner. This service will allow Transmission Customers an option to make non- firm service more firm through use of generation redispatch. The Alliance RTO will post the identity of Generation Owners that will redispatch their generation facilities to offset power flows on the congested path, unless this service is being provided elsewhere in the market. The Alliance RTO will solicit bids for providing the redispatch of the generation facilities and post the bids for Transmission Customers to view. The Alliance RTO will coordinate schedule changes as necessary to implement the generation redispatch that has been contracted. Bids will also be sought for reassignment of firm transmission on the secondary market.

These provisions leave some uncertainty concerning the availability of redispatch to accommodate new firm transmission requests. For example:

- i. Will redispatch be as available to new transmission load as it is available to existing transmission load?
- ii. If the answer to the preceding question is no, will that difference be consistent with the goals of Order 888 and the RTO NOPR?
- iii. Will generators connected to the RTO's facilities be obligated to offer redispatch service, and what should be the consequences for generators who agree to or decline to offer redispatch service on request of the RTO?
- iv. Will an existing generator have sufficient incentive to participate in a redispatch transaction, where the effect of the redispatch would be to open up new transmission capacity for the benefit of a competing generator?

In short, the Commission should examine whether the Alliance proposal, by leaving the possibility of redispatch in the hands of interested existing generators rather than the disinterested RTO, will create a bias toward existing trading patterns rather than new generation entrants.

### **3. Provision of Ancillary Services**

The Commission proposes to require RTOs to act as the "supplier of last resort" of ancillary services, and to "promote the development of competitive markets for ancillary services whenever feasible." RTO NOPR at pp. 169-71.

On this subject, the Alliance's proposed Operating Protocol (Section 6.1.3) states:

The Alliance RTO expects that a market for the provision of Ancillary Services will develop within the region. The Alliance RTO will cooperate with other entities to facilitate the development of one or more Regional Power Exchanges as may be proposed by market participants. If a Regional Power Exchange is formed, it could become a reliable and economic source for Ancillary Services for Transmission Customers and the Alliance RTO.

This provision neither commits the Alliance RTO to any particular activity, nor makes it accountable for any particular outcome. The Commission will need to consider whether allowing transmission owners to form the Alliance, which will advance their generation objectives, while not requiring the creation of a market for ancillary services, is consistent with the Commission's goal of effectively competitive generation markets.

### **4. Construction of New Transmission Facilities**

#### **a. Overview**

The Commission has observed that the level of planned transmission additions is significantly lower than five years ago, despite increased load growth and unbundled transmission service. The Commission noted that this situation may reflect an incompatibility between existing planning institutions with new market realities. RTO NOPR at p.53.

The transmission planning and construction process must align the incentive to construct transmission with the public interest. The power to construct, or to decline to construct, should

rest with neutral entities. The power should not rest exclusively with vertically integrated transmission owners or others having an incentive to advance their own generation interests, either by building in areas which will facilitate access to their own generation, or declining to build in areas which would benefit their generation competitors.

The Alliance proposal raises questions in this area, in two categories: (1) new facilities ordered by the RTO; and (2) new facilities added by Transmission Owners.

**b. New Facilities Ordered by the RTO**

According to Section 3.8 of the Planning Protocol, transmission owners will be obligated to construct facilities as required by the RTO. Where the new facility is to be directly interconnected to a facility owned by the Alliance Transco (e.g., previously acquired from a Divesting Transmission Owner), the construction responsibility is with the Transco. Where, however, the new transmission facility is to be interconnected with an existing facility still owned by a Non-Divesting Transmission Owner, the construction responsibility would be with that Transmission Owner.

It appears that in this second context (new facility is to be interconnected with a facility owned by a Non-Divesting Transmission Owner), the RTO would lack the authority to construct the new facility. The Commission will need to consider whether the Alliance RTO should be empowered and obligated to construct the needed transmission facilities in the event that the transmission owner which has received the RTO's order to construct is unwilling to do so or otherwise fails to take the necessary steps.

**c. Facilities Not Controlled by the Alliance**

If the Alliance RTO determines that certain transmission facilities controlled by a Transmission Owner are "necessary to provide reliable transmission services contemplated under the Alliance Agreement and the OATT" and should be transferred to the RTO's control, the RTO can only "recommend" to the Transmission Owners to undertake such projects. Operating Protocol Section 2.1.2. Moreover, if a Transmission Owner acquires transmission facilities not

identified in the Operation Agreement, the RTO cannot gain functional control of those facilities unless the Transmission Owner consents. See Operation Agreement 4.1.4.

These provisions correctly contemplate that the Alliance's reach will require periodic adjustment to ensure reliable nondiscriminatory transmission service. But they also appear to mean that it is the Transmission Owners, not the RTO, that ultimately determine the set of facilities to be managed and operated as a single regional system. The Commission will need to consider whether this retention of control is consistent with its goal of RTO independence.

Specifically, the Commission should ask:

- i. By allowing the generation-owning Transmission Owners, rather than the neutral RTO, to determine which of their facilities are to be added to those facilities subject to the RTO's control, will the arrangement result, eventually, in a geographic scope consistent with efficient, unbiased generation markets?
- ii. Will the RTO have the necessary ability to ensure reliability if some portions of the regional transmission system are subject to its control but other parts are subject to the Transmission Owners' control?
- iii. Will prospective builders of new generation face difficulties determining the most economical site for their plants if they wish to sell to loads located throughout the region, but face operational uncertainty because not all facilities in the region are or will be subject to the RTO's functional control?

## **5. Efficiency Incentives**

Whether non-profit or for-profit, an RTO must operate the transmission system efficiently, making existing facilities available for all economic transactions and expanding or adding facilities to allow for additional economic transactions. To achieve these goals, the RTO must have appropriate financial and regulatory incentives.

The Transco Term Sheet (Appendix 3 at 4) contains a provision that may affect the RTO's efficiency incentives:

[T]he Alliance RTO shall develop provisions for sharing with the Non-Divesting Transmission Owners those profits directly attributable to the operation of their transmission facilities resulting in transactional efficiencies or increased

throughput. However, that comparison shall not be duplicative with the revenue allocation, and those profits resulting from the direct actions of the Alliance Transco associated with its own transmission facilities would not be subject to such sharing.

From this provision, several questions arise:

- a. When will the "provisions for sharing" be available for public review and what regulatory review will apply to these provisions?
- b. Does "sharing" mean that 100% of the "profits directly attributable to the operation of [the Non-Divesting Transmission Owners'] transmission facilities" go to the Owners, or does the provision anticipate some splitting of the profits?
- c. Will the fact that the Transco may keep 100% of the profits "associated with its own transmission facilities," while it must "share" the profits associated with the Non-Divesting Transmission Owners' facilities, mean that the provision creates for the Transco an inherent bias toward accommodating transactions that make use of its own facilities and against transactions that make use of the Owners' facilities? In effect, does the provision place the two types of facilities in competition with each other, with the judge of the competition having a bias?

## **6. Planning and Assessment of Adequacy**

### **a. Planning**

The Commission's proposed minimum functions for RTOs includes obligations regarding planning and expansion. Specifically, the Commission (RTO NOPR at 189) proposes the following function:

Function 7: Planning and Expansion. The RTO must be responsible for planning necessary transmission additions and upgrades that will enable it to provide efficient, reliable and nondiscriminatory transmission service and coordinate such with the appropriate state authorities. (Proposed Section 35.34(j)(7)).

The Alliance proposal notes that the Alliance will be responsible for "coordinating" the development of a regional plan and indicates that the RTO will have an oversight role regarding the planning process. See Appendix 6 of the filing. As such, it is not clear how active and independent a role the Alliance will have. The Commission should evaluate whether the Alliance's review and approval authority over planned facilities will be independent of the

transmission owners' reviews and, if not, whether the Alliance's role should be expanded to provide for more direct planning activities.

**b. Assessment of Adequacy**

Section 3.2 of the Planning Protocol (Appendix 6) states in part:

Responsibilities of the Alliance RTO. The Alliance RTO will assess the adequacy of the overall regional Transmission System for anticipated uses while maintaining adequate reliability margins. This assessment will include consideration of transmission and generation outage/addition scenarios, load growth, and potential power transfer patterns. Where deficiencies are found, the Alliance RTO will coordinate necessary studies with affected parties for alternate plan development and recommendations. The Alliance RTO will have responsibility for selecting the preferred system expansion alternative, subject to the nondiscriminatory provision of Section 1.3(d) of this Planning Protocol. The Alliance RTO may also perform its own alternative system expansion studies, commission studies to be performed by a third party, and consider the input of studies from other interested parties in choosing a preferred plan.

This passage does not indicate how the consideration of "potential power transfer patterns" will translate into actions to construct necessary transmission facilities. More generally, the Commission needs to address what obligations the Alliance should have to identify and create those institutions and processes, and the necessary physical infrastructure accompanying them, that will ensure that transmission expansion and trading mechanisms are put into place so as to maximize the potential for economical generation to be built and operated in the market.

**7. Transco Generation Activities**

The Alliance proposal appears to allow the Transco to engage in generation-related activities that do not involve asset ownership (including, for example, trading in futures markets for generation and brokering arrangements, but not including owning generation that would make the Transco a transmission user). The Commission will need to explore what risks to the goal of reliable, nondiscriminatory and efficiently priced transmission service might flow from the unrelated activities. For example, some of the generation-related activity might require transmission service from the Transco, or from transmission owners with which the Transco does

business. There also are the risks traditionally associated with the mixing of noncompetitive and competitive businesses in the same corporate family. Such risks include cross subsidies due to common costs, increases in the cost of capital associated with these higher risk activities, and confusion in the market as to the role being played by this new entity.

## **8. Market Monitoring**

According to the RTO NOPR, the RTO must monitor markets for transmission services, ancillary services and bulk power to identify design flaws and market power and appropriate remedial actions. RTO NOPR p.181. At the same time, the Commission asks whether this role is appropriate for a for-profit Transco (id. at 182-83):

The proposed requirements are arguably based on the presumption that an RTO will be a non-profit, system operator that does not own any facilities. The requirements may not be appropriate for a for-profit transco that owns the facilities that it operates. [footnote omitted] Therefore, a threshold question is: what should be the market monitoring role, if any, of an independent, for-profit transco? Is it reasonable to expect that such an RTO could be objective in its assessments? If the RTO is an ISO, do its monitoring activities need to be further insulated to ensure independence and objectivity? For example, should monitoring be performed by one or more individuals or organizations that are funded by the RTO but that have the right to issue reports without the RTO's approval?

The Alliance market monitoring proposal (Appendix 5, Article VIII, p.21) provides in part:

The Alliance RTO shall monitor and record such information regarding the reservation of transmission as scheduling of reserved transmission, provision of Ancillary Services and other transmission-related activities of the Transmission Owners as necessary to enable the FERC to exercise its statutory authority over transmission and power sales transactions subject to its jurisdiction.

As written, the Alliance market monitoring proposal does not specifically obligate the RTO to "identify design flaws and market power and appropriate remedial actions." The Commission must determine whether this approach, whose details apparently have not been worked out, is adequate to allow the Alliance to carry out the minimum RTO functions identified in the NOPR as necessary to assure RTO success. Given the potential that the Alliance will, in

part, be a for profit Transco, the Commission must also consider whether there should be specific requirements assuring that the Alliance's market monitoring function is performed independently of the Transco's self-interest.

#### **D. Pricing**

##### **1. Pancaking in General**

The Commission's RTO NOPR (at pp. 56-57) identified transmission rate pancaking as an obstacle to efficient power supply markets:

In most of the United States, a transmission customer pays separate, additive access charges every time its contract path crosses the boundary of a transmission owner. By raising the cost of transmission, pancaking reduces the size of geographic power markets. This, in turn, can result in concentrated electricity markets. Balkanization of electricity markets hurts electricity consumers, in general, by forcing them to pay higher prices than they would in a larger, more competitive, bulk power market.

The Alliance's transitional pricing structure contains pancaking. For those transactions involving two or more zones, the transmission customer would pay a zonal rate, plus a regional access charge. There is no dispute that these two separate charges constitute pancaking. This transitional pricing structure would exist for six years, unless (a) "[a]ll of the Transmission Owners agree by unanimous vote to move to the Uniform Pricing Structure; or (b) [a]ll of the Transmission Owners elect to become Divesting Transmission Owners." Appendix 7, Section 2.1.1. Zones can be combined (thereby reducing pancaking frequency), only if Transmission Owners in contiguous zones agree. Appendix 7, Section 2.1.2(b)(iii). There is no guarantee that pancaking will end after six years; either, the proposal does not legally preclude the signatories from seeking, or the Commission from granting, approval for a continuation of the initial pricing method.

The Commission should consider carefully the appropriateness of the regional access charge, including its consistency with Commission precedent. In particular, the Commission

needs to ask whether an RTO is truly independent of transmission owners if one of its central features -- the regional price -- conflicts with the Commission's nonpancaking policy only because of the insistence of transmission owners.

## **2. State Non-Recovery Pricing Exception**

The "State Non-Recovery Pricing Exception" (Appendix 7, Section 2.2.4(b) allows a transmission Owner to avoid full application of the Uniform Pricing Structure. The avoidance option would be available where the move to the Uniform Pricing Structure renders the Owner unable to recover a material part of its revenue requirement because (a) the move caused the owner to incur a higher transmission charge for its service to bundled load and (b) the state regulatory authority did not permit recovery of the higher charge in retail rates. In this situation, "the Transmission Owner may choose to retain its Pricing Zone while the remainder of the Alliance Pricing Zones move to the Uniform Pricing Structure." Id. Section 2.2.4(b)(ii).

It appears that were a Transmission Owner makes this choice, it will remain the beneficiary of pancaking. Thus Section 2.2.4(b)(iii) of Appendix 7 states:

If a Pricing Zone is retained, the Zonal Rate shall be applied to all Transmission Transactions utilizing the Pricing Zone. In addition, the charge under the Uniform Pricing Structure shall be applied to all Transmission Transactions which utilize any other part of the Transmission System (i.e. Drive-within, Drive-in, Drive-out, and Drive-through).

This provision appears to state that transmission customers would be subject to transmission rate pancaking within any zone where a transmission owner has invoked the "State Non-Recovery Pricing Exception."

Although Section 2.2.4(b) is not completely clear on this subject, we will assume for purposes of this discussion that with respect to transmission transactions using such Transmission Owner's facilities, the transmission customer would pay the Owner's zonal charge

plus the regional access charge, i.e., that the pancaking feature of the Transition Period Pricing Structure would remain.

The Commission should consider carefully whether to authorize a retention of pancaking in this (or any other) context. In doing so, the Commission should keep in mind two principles it has previously articulated, explicitly or implicitly: (a) pancaking undermines progress toward an efficient regional market that will benefit all; and (b) a transmission owner should not suffer underrecovery due to actions it takes to eliminate pancaking. Section 2.2.4 therefore presents the difficult question whether a state retail rate policy inconsistent with these two principles can properly be incorporated within an RTO filing, as it apparently has been here.

Specifically, the Commission will need to ask whether the outcome anticipated by Section 2.2.4(b), i.e., an individual state precluding passthrough of a transmission cost increase arising from the elimination of pancaking, can lawfully occur. It appears that where the actions of a particular state precludes such passthrough, the only way to make the transmission owner whole would be to recover the disallowed costs from others. The Commission will need to determine whether this type of cost-shifting, arising from a single state's establishment of retail rates in a manner not consistent with the Commission's goal of eliminating pancaking, is lawful and appropriate. Section 2.2.4(b) assumes that it is; but if it is not, then the Commission will need to determine whether Section 2.2.4(b) is necessary.

#### **E. Authorization of Future Dispositions**

The Alliance signatories request approval en masse, in advance, of disposition decisions each signatory would make individually in the future. See Section 203 Application at 14 ("The Alliance Companies request that the Commission approve the entire Alliance RTO proposal at this time and permit the Alliance Companies to implement the appropriate components of the

proposal at the appropriate times without being required to receive further approvals from the Commission." ). While the signatories may argue for this treatment based on their own interests, the Commission must consider whether such treatment is, as required by Section 203, consistent with the public interest.

The Applicants assert their desire to take advantage of market timing. The Application does not explain how this argument connects to the public interest, as opposed to the sellers' and buyer's interest. In any event, the same argument could be made about any transaction under Section 203. It is not customary for the Commission to accept an Applicant's desire to benefit from market timing as a reason not to require information specific to how a disposition will affect the public at the time of that disposition.

The public interest effects of an individual transmission owner's decision to transfer facilities, under the terms and conditions set forth in the proposed Alliance documents, will depend on the identity of the transferor and the time of the transfer. At the present time, the Commission does not know about future voting patterns, the smoothness of the operational relationships between the ISO and the individual utilities handling control area functions, the competitiveness of the markets for ancillary services and redispatch services, or other factors which will affect the public interest. The Commission thus should consider whether, lacking this information, it has a sufficient basis today to determine whether Section 203 will be satisfied by dispositions made in the future.

It also appears that future prospective signatories to the Alliance will have to make their own Section 203 application before disposing of their transmission facilities. Thus benefits of market timing sought by the initial signatories would not be available to future signatories. The

Commission should examine whether this differential in treatment is consistent with the public interest.

## **II. The FERC and VSCC Review of Transactions Associated with RTO Creation Should be Complementary**

The VSCC supports the goal of efficient regional transmission access. In 1999, the Virginia General Assembly enacted legislation, discussed below, mandating that Virginia utilities take actions to establish or join regional entities, and also requiring the VSCC to review such actions. Applicable also are longstanding Virginia statutes requiring Commission review of certain transfers of utility assets.

In the context of the Alliance, it appears that these state requirements will apply to Virginia Power and Appalachian Power. The public interest will be best served if both regulatory bodies -- the VSCC and the FERC -- understand fully each others' authority and obligations, and determine how they can be used together to create efficient regional transmission access.

Below we summarize the main Virginia statutory provisions, and then raise some questions concerning the possibility of coordination.

### **Utility Transfers Act**

The Code of Virginia, Section 56-88 et seq. (the "Utility Transfers Act") provides:

It shall be unlawful for any public utility, directly or indirectly, to acquire or dispose of any utility assets situated within the Commonwealth or any utility securities of any other company unless such acquisition or disposition shall have been authorized by the [VSCC].

Section 56-90, in turn, provides that the Commission shall issue an order that a proposed acquisition or disposition of utility assets or securities is lawful if it has been "satisfied that adequate service to the public at just and reasonable rates will not be impaired or jeopardized" by

the granting of the petition. Further, the Commission "shall make such order in the premises as it may deem proper and the circumstances require."

### **Virginia Electric Utility Restructuring Act of 1999**

The Virginia Electric Utility Restructuring Act of 1999 ("1999 Act"), Section 56-576 et seq., provides for the introduction of retail choice in the purchase of electric energy within the Commonwealth. On the subject of regional transmission policy, the 1999 Act has several provisions.

Section 56-577 A.1 provides:

On or before January 1, 2001, each incumbent electric utility owning, operating, controlling, or having an entitlement to transmission capacity shall join or establish a regional transmission entity, which entity may be an independent system operator, to which such utility shall transfer the management and control of its transmission system, subject to the provisions of 56-579.

The statute does not define "regional transmission entity" (RTE), but Section 56-576 defines "independent system operator" to mean "a person that may receive or has received, by transfer pursuant to this chapter, any ownership or control of, or any responsibility to operate, all or part of the transmission systems in the Commonwealth."

Section 56-579 A.1 states:

No such incumbent electric utility shall transfer to any person any ownership or control of, or any responsibility to operate, any portion of any transmission system located in the Commonwealth without obtaining the prior approval of the [VSCC], as hereinafter provided.

Two provisions require the VSCC to establish rules governing the transfer of transmission facilities to an RTE. Section 56-579 B provides that the VSCC shall:

adopt rules and regulations, with appropriate public input, establishing elements of regional transmission entity structures essential to the public interest, which elements shall be applied by the [VSCC] in determining whether to authorize transfer of ownership or control from an incumbent electric utility to a regional transmission entity.

56-579 A.2 provides that the VSCC shall:

develop rules and regulations under which any such incumbent electric utility owning, operating, controlling, or having an entitlement to transmission capacity within the Commonwealth, may transfer all or part of such control, ownership or responsibility to an RTE, upon such terms and conditions that the [VSCC] determines will:

- a. Promote:
  - (1) Practices for the reliable planning, operating, maintaining, and upgrading of the transmission systems and any necessary additions thereto; and
  - (2) Policies for the pricing and access for service over such systems, which are safe, reliable, efficient, not unduly discriminatory and consistent with the orderly development of competition in the Commonwealth;
- b. Be consistent with lawful requirements of the Federal Energy Regulatory Commission;
- c. Be effectuated on terms that fairly compensate the transferor; [and]
- d. Generally promote the public interest, and are consistent with (i)ensuring the successful development of interstate regional transmission entities and (ii)meeting the transmission needs of electric generation suppliers both within and without this Commonwealth.

Pursuant to the General Assembly's directive to develop rules and regulations concerning the transfer of utility assets to an RTE, the VSCC recently entered an order soliciting comments. Order Establishing Investigation and Inviting Comments, Case No. PUE990349, Document Control No. 990530033, issued May 26, 1999.

The VSCC views the state statute, and the VSCC's obligations thereunder, as consistent with the Federal Power Act, in several ways.

First, while the Commission has not yet interpreted the Federal Power Act to authorize it to require transmission owners to join or establish regional entities, the Commission has encouraged these actions. The state statute, consistently with that goal and not inconsistently with the Federal Power Act, requires transmission owners to take those actions.

Second, FERC has set forth, in Order No. 888, its orders approving or conditioning various ISOs, and in the RTO NOPR, its thoughts on the governance, structure, activities and

pricing for regional transmission entities. We see no conflict between these Commission statements and the criteria which VSCC must apply under Section 56-579 in reviewing our jurisdictional utilities' actions to comply with their obligation to join or establish an RTE.

Third, the Commission has, on many occasions, explicitly referenced the role states must play in transmission policy, particularly in areas where the Commission's authority is absent or unclear. For example:

1. The Commission has recognized the intersection between retail competition policy and regional transmission access. See, e.g. RTO NOPR at 13 ("RTOs can play a critical role in the realization of full competition at the retail level as well as at the wholesale level"); PJM Interconnection, 85 F.E.R.C. para. 61,383; 1998 FERC LEXIS 2515, \*8 (recognizing need to adjust PJM regional tariff to take into account unique attributes of the Pennsylvania retail competition pilot program).
2. The Commission has recognized the unique and historic state role, undiminished by passage of the Federal Power Act, concerning siting and reliability. See RTO NOPR at 13 ("the existence of RTOs has not, and will not in the future, interfere with traditional state and local regulatory responsibilities such as transmission siting, local reliability matters, and regulation of retail sales of generation and local distribution").

This clear consistency between the Commission's jurisdiction and goals, and the VSCC's jurisdiction and goals, creates the legal and policy foundation for a strong regulatory partnership. Central to the success of this partnership is a recognition that both the state commission and FERC must proceed with knowledge of each other's actions and goals. Both agencies have recognized this point. See, e.g., RTO NOPR at 13 (RTOs "provide a vehicle for amicably resolving state and Federal jurisdictional issues"); Order Establishing Investigation and Inviting Comments, supra, slip op. at 5 ("in specifying the criteria by which we will evaluate our utilities' compliance with their state law obligations, we will need to address the intersection between those criteria and FERC's eleven ISO principles."); id. at 22 ("the Commission and its jurisdictional utilities must carry out the Act's RTE mandates in a legal context that includes activities of other states, and of FERC acting under the Federal Power Act. This multijurisdictional context raises both legal and practical issues.").

Based on the foregoing, the VSCC sees little or no potential for conflict between the state statute and the federal statute, or between its actions and the Commission's actions. The real potential for conflict is the traditional one: between the goals of the regulator and those of the regulatee. If such a conflict develops (and with so many discretionary judgments made by the Alliance signatories such conflicts seem a virtual certainty), the VSCC and the Commission should take care to attribute that conflict to its source -- the natural differences between private endeavor and public interest -- and not to the oft-repeated but rarely defined concept of "federal-state tensions." Similarly, although regional transmission efficiency certainly depends on consistency among state and federal regulatory actions, consistency does not require identical decisions from every regulator and it does not require uniform regulatory agreement with the initial proposals of the transmission owners. While regulators must achieve consistency among themselves, above all they must achieve consistency between private proposals and the public interest. We are confident that the VSCC and FERC, guided by their compatible policy goals and their compatible statutory mandates, can achieve these consistencies.

As an example of the potential for cooperation, we note that the Alliance proposal in many situations grants discretion to the Transmission Owners to take certain actions. This intervention has asked the Commission to examine, in each instance, whether that discretion is consistent with the Commission's goals. In those situations where the Commission decides to allow Transmission Owner discretion, it is possible that a state commission will have (a) certain preferences as to how that discretion should be exercised, and (b) the authority or obligation to act on those preferences, conditioning its approval of the utility's transfer of transmission control on utility actions consistent with those preferences. The Commission, in any order approving the Alliance proposal, should make clear that in such situations, a state which acts in this manner is not acting inconsistently with the Commission's goals or with the Federal Power Act. One suggestion for making this result legally secure (which we offer for consideration and not necessarily as our position at this time), is for the Commission to require inclusion in the Alliance documents of a statement to the effect that where a utility is granted in those documents

the discretion to take certain actions, it is not inconsistent with such documents (or the Commission's approval thereof) for the state commission to guide or mandate that discretion. With this addition, the state commission action would be secure from the argument (with which we do not necessarily agree), that such state commission action otherwise would be preempted by the Federal Power Act, as interpreted by the Court of Appeals in Commonwealth of Massachusetts v. FERC, 729 F.2d 886 (D.C. Cir. 1984).

### **III. Motion for Consolidation**

While the Alliance's applications in Docket Nos. ER99-3341-000 and EC99-80-000 contain a number of distinct agreements and other transactions, the two applications seek approval of what is in essence a single, comprehensive transaction that should be considered as a whole. The section 203 and section 205 filings raise a number of related and interwoven issues, which analysis involves substantially the same material facts. Given the interrelated nature of the two applications and the commonality of the issues raised therein, the two applications can be most efficiently and effectively addressed in a single proceeding. Therefore, the VSCC respectfully requests that the Commission consolidate the two proceedings.

### **Conclusion**

WHEREFORE, for the foregoing reasons, the VSCC respectfully requests that the Commission consolidate the proceedings in Docket Nos. ER99-3341-000 and EC99-80-000 and establish a hearing on the issues identified herein.

Respectfully submitted,

James C. Dimitri, General Counsel  
Scott Hempling

Attorneys for  
Virginia State Corporation Commission

## **CERTIFICATE OF SERVICE**

I, James C. Dimitri, hereby certify that I have served, or caused to be served, the foregoing document on the Secretary and on the official service list in this proceeding.

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