

**STATE OF ALABAMA
ALABAMA PUBLIC SERVICE COMMISSION
ADVISORY STAFF
P.O. BOX 304260
MONTGOMERY, ALABAMA 36130**

**Judy G. McLean
Director**

March 22, 2002

BY ELECTRONIC FILING

Hon. Magalie R. Salas, Secretary
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

Dear Secretary Salas:

We are in receipt of Chairman Woods letter dated January 2, 2002 soliciting the views of the Alabama Public Service Commission (APSC) regarding a number of specific questions pertaining to the development of Regional Transmission Organizations (RTOs) in the Southeast. This request is consistent with our strong belief that state commissions must be regarded by the Federal Energy Regulatory Commission (FERC) as full partners in identifying and addressing the important issues associated with the formation of RTOs. The APSC therefore commends the FERC for this effort and appreciates the opportunity to express our views. It should be emphasized, however, that these responses should not mark the end of state commission involvement and input, but rather the beginning of an ongoing dialogue in that regard.

Before addressing specific questions, the APSC would like to offer a few threshold comments and observations. The letter begins by mentioning that the FERC "is now conducting a cost/benefit analysis on having one or more RTOs in the Southeast." The APSC has been (and continues to be) concerned that the RTO concept (if implemented) could raise costs to consumers in Alabama and/or jeopardize the excellent service reliability that they have historically enjoyed. While we are pleased that the FERC initiated a cost/benefit analysis, at this time the resulting information does not resolve our concerns. Additional analyses are required to explore the cost/benefit issues in more detail, as well as the issues related to reliability impacts. By undertaking to respond to your questions, the APSC does not mean to suggest that we have concluded that an RTO (or multiple RTOs) should be formed in the Southeast or that our jurisdictional utility (Alabama Power Company) should participate in any such entity. To reach those conclusions, the APSC will have to be convinced that the proposed RTO would be in the public interest of the citizens of this State. As of now, information we have seen from the cost/benefit study does not allow the APSC to make an affirmative determination. In fact, the information to date in the analysis suggests the opposite may be true for our region. The APSC will file the appropriate comments in the cost/benefit analysis, but as a prelude, the APSC is convinced that the FERC needs to slow, if not stop their efforts to implement the formation of RTOs in the Southeast. These concerns will be more fully developed by the Southeastern Association of Regulatory Utility Commissioners (SEARUC), which the APSC fully supports.

In conjunction with any discussion regarding the formation of RTOs in the Southeast, it is also important that the FERC have a clear understanding of the current conditions in this area. Contrary to some assertions that have been attributed to the FERC, the Southeast has a very vibrant wholesale market today. Most states (including Alabama) rely on competitive bidding to select new generation to serve retail consumers. Substantial amounts of new generation are both planned and under construction. Retail rates are among the lowest in the country and reliability in the region is extremely high. In order to change the existing framework (which

certainly seems to be working), the APSC must be convinced that there is something that needs fixing. Our concerns regarding the responsiveness of any RTO to local issues must be adequately addressed.

For purposes of the questions posed, the foregoing discussion should be considered to be incorporated by reference in all of our responses. Moreover, these responses reflect our tentative views on these particular issues based on our understanding of the relevant facts and circumstances. These tentative views do not reflect our regulatory decision on any such issue, and we specifically reserve the right to revisit any or all such matters in the future.

1. What RTO structure -- a single RTO, multiple RTOs with seams agreements, or other -- would most efficiently administer the transmission system and facilitate wholesale electric power sales to meet the needs of the Southeast?

Before deciding whether the Southeast needs one or several RTOs, it should first be determined whether any RTO should be put in place. As discussed above, the answer to this fundamental question hinges largely on a convincing showing that the benefits of an RTO in this region would outweigh the associated costs. To date we have seen no such evidence.

If RTOs are ultimately found to be beneficial to Alabama consumers, then several scope issues need to be addressed. First, what is the maximum size of an RTO that can handle both regional and local reliability needs? We are very concerned that a large RTO would not be able to pay as much attention to local problems and issues as Alabama Power does today. We are also concerned over a direct correlation between the size of an RTO and its cost. It may be more difficult for a large RTO to withstand a cost/benefit analysis unless the demonstrated benefit increases in the same manner.

Another important issue related to a larger RTO involves proper transmission pricing. If the RTO uses traditional postage stamp pricing, generators would have no real incentive to locate in proximity to the load being served. Based on current economics, they would simply choose to locate in this region (close to sources of natural gas) and transmit power to other areas within (or adjacent to) the RTO. We do not believe our retail customers should in any way subsidize the cost of new transmission investment that would be required to accommodate such transactions. Any move towards large RTOs must therefore be coupled with the development of distance sensitive transmission pricing.

2. If you think more than one RTO is appropriate in the Southeast, (a) how should market interface and reliability issues at the seams be resolved and (b) what should be the scope of the RTO that would include the electric utilities in your state?

If there is ultimately more than one RTO in the Southeast, coordination and reliability issues among adjacent RTOs can be resolved through "seams agreements" that address market rules and mechanisms. These arrangements will be, and are necessary under any scenario, due to the large footprint of the Tennessee Valley Authority in the Southeast. In our view, the minimum scope for an RTO should be the Southern Company control area, together with the municipal and cooperative utilities within that area if they choose to participate.

3. Order No. 2000 permits hybrid RTO organizations.

a. If the functions in Order No. 2000 are shared or coordinated between an ISO and an independent transmission company (ITC), how would you suggest that those functions be apportioned? For example, which organization should perform planning and expansion, tariff administration, OASIS administration, market monitoring, security coordination, and interregional coordination? What role do you believe an ITC could or should play in the Southeast?

If the functions in Order No. 2000 are shared or coordinated, we believe that planning, security and interregional coordination could be at the RTO level (which would include the Independent System Administrator concept currently reflected in the SeTrans RTO). We understand that the SeTrans RTO is working to incorporate a proper role for ITCs. When that role is determined, the APSC will at that time assess the resulting division of responsibilities.

b. If an ITC is appropriate for your region, is it necessary for an umbrella independent board to have ultimate responsibility for RTO functions?

At the present time, we do not perceive a need for an umbrella independent board. Whether the RTO is an ISO, an ISA or even a Transco, control should be vested in the Board of the RTO for reasons related to direct accountability. The APSC favors an organization that is subject to proper penalties for poor performance and incentives for good performance.

c. Does an ITC need to provide RTO functions to be a viable business, or can it own and invest in transmission with agreements on revenue requirements with the ISO or RTO umbrella organization?

In order to attract investment and satisfy the needs of its owners, an ITC would need some degree of autonomy, which would include the ability to perform some RTO functions.

4. Order No. 2000 recognizes that wholesale electricity markets are becoming increasingly regional in nature and that new trading patterns are putting additional stress on the interstate transmission system. However, many of the functions that RTOs will be called upon to perform clearly have both regional and local implications (e.g., planning and expansion decisions which ultimately require the siting approval of one or more states). Do you have suggestions regarding how states can work with one another, with the RTO, and with the FERC to ensure that needed infrastructure is sited and built in a timely manner? With regard to other RTO functions, are additional processes needed to ensure that states have the ability to fulfill their regulatory responsibilities or to adequately protect retail electric consumers?

In the Southeast, states are continually working together and coordinating on issues such as the ones you have described. In our experience, infrastructure that is shown to be needed can and will be built provided it does not financially harm local consumers or adversely affect reliability. To date, Alabama Power has not had significant problems building needed infrastructure other than typical local landowner concerns that arise everywhere. This should continue to hold true so long as RTOs and utilities within the state demonstrate that new transmission facilities are needed and that local consumers will benefit. If the phrase "additional processes" means FERC certification of transmission lines and an associated power of eminent domain, we see no such need. Instead, we suggest that FERC respect the existing regulatory processes and jurisdiction of state commissions, which serve to protect the welfare of local citizens.

5. What processes do you believe would be the most efficient for obtaining the input of state commissioners in the Southeast on the issue of RTO formation?

In order for state commissions to have meaningful input in this process, substantial time needs to be spent in face-to-face discussions with members of the FERC and its Staff so that both sets of regulators can fully understand the other's concerns and explore mutually agreeable solutions. Written comments and conference calls alone are not sufficient to establish and maintain the requisite levels of understanding, respect and cooperation. In the end, there should be a formal role for the state commissions, possibly in a State/Federal Joint (Regional) Board setting.

6. Please provide your ideas on ways in which state commissions can have input to RTO decisions.

The APSC's jurisdiction includes transmission used to serve retail consumers and the siting of certain facilities within the state. Our approval is also required in conjunction with any transfer by Alabama Power of utility property that is used to serve the public. For these and other reasons, we will eventually have to review and approve whatever RTO is proposed. Assuming such approval, the APSC will thereafter be involved in many aspects of the RTO's decisions. Indeed, the RTO might prove to be a public utility under state law and thus subject to the APSC's jurisdiction. Even if the RTO does not fall under our direct jurisdiction, it would (as a practical matter) have to take state concerns and issues into account. To this end, the RTO might choose to establish a state advisory board. By getting state input up front, we believe conflict between the RTO and regulatory authorities can be minimized.

7. What actions -- either procedural or substantive -- do you believe the Commission could take to encourage the participation of public power entities in RTO formation in the Southeast?

First and foremost, the FERC must be flexible in entertaining RTO applications that, while perhaps varying from its "ideal" model, provide the necessary protections that public power utilities believe they need. For example, municipal and cooperative utilities will be especially sensitive to ensuring that their transmission systems can be used first to serve their own customers. Their willingness (or perhaps even their ability) to participate will therefore be diminished if the FERC insists that utilities cannot favor native load customers' use of transmission facilities or service. Indeed, that same issue lessens the APSC's interest in having Alabama Power participate in an RTO.

8. With regard to the two models proposed in the Commission's mediation hearings, the Collaborative Governance Model (CGM) and Independent System Administrator (ISA) model, which features of each model do you support or not support? In what way might your interests and objectives be preserved under each model?

Our understanding is that the major difference between the two models is in governance -- the CGM has a "Transco" on top and the ISA model has a for-profit experienced operator on top. While we believe either model could ultimately be made to work, we think the ISA model is more suitable to the Southeast. This is due to a significant presence of public power and our perception that most regional utilities do not currently plan to divest their transmission assets. The APSC's interests and objectives can best be met by ensuring that the RTO produces net benefits for the retail consumers in our state and that existing high levels of service reliability are maintained.

9. Do you think the Collaborative Governance Model or "Transco at the top" RTO structure could favor transmission solutions relative to generation or demand-side solutions to congestion on the grid, and could favor investment in Transco-owned facilities relative to transmission operated but not owned?

There are probably opportunities for a Transco to exercise such favoritism. If a Transco model is adopted, proper regulatory oversight and monitoring will have to be in place to protect consumers by guarding against that possibility.

10. Do you think that under the ISA model transmission owners' preservation of some control over RTO functions through the System Administrator selection and removal process would affect independence?

Given the magnitude of the investment that would be turned over to third party control, it seems reasonable that the owners want the right to choose the ISA from a list of qualified candidates. The manner in which the list of qualified candidates is selected will be of the

utmost importance. This process should not detract from the independence of the ISA once it is chosen, nor should it give the owners any ability to control its functions. The ISA could only be removed pursuant to the provisions of the governing agreement that set forth its duties and responsibilities, and any effort to do so would presumably require regulatory confirmation that it has failed to properly discharge its obligations.

11. Do you have any other suggestions or advice as to how the FERC should proceed in its efforts to complete RTO formation in the Southeast?

Everything we've seen and heard suggests that utilities in the Southeast are making reasonable progress in developing an RTO for this region. We do not believe that any action by FERC is necessary until a filing is made for approval by the FERC and by state commissions. Indeed, direct or indirect efforts by the FERC to force this developmental process could prove to be counterproductive because they tend to divert the focus of management and/or could lead to a hastily conceived RTO that does not adequately address the potential issues and concerns of the affected parties.

Again, the APSC appreciates this opportunity to provide input on an issue that is of critical importance to our citizens. We sincerely hope that this marks the beginning of an ongoing dialogue whereby federal and state regulators can understand, appreciate and accommodate their respective issues and concerns.

Respectfully submitted,

-S-

Eugene G. Hanes
Federal Affairs Advisor
Advisory Staff
Alabama Public Service Commission

March 22, 2002