

**UNITED STATES OF AMERICA  
BEFORE THE  
DEPARTMENT OF ENERGY**

**Interstate Electric Transmission System                    )           Notice of Inquiry**  
**Electric Reliability Issues    )**

**COMMENTS OF THE  
COMPANIES OF THE AMERICAN ELECTRIC POWER SYSTEM**

The companies of the American Electric Power System (collectively “AEP”) submit these comments in response to the Notice of Inquiry issued by the Department of Energy (“Department” or “DOE”) on November 20, 2000.

The AEP system is a multistate electric utility holding company system which provides electric service to more than 4.8 million households and businesses in portions of eleven states - Arkansas, Indiana, Kentucky, Louisiana, Michigan, Ohio, Oklahoma, Tennessee, Texas, Virginia and West Virginia. AEP owns more than 38,000 MW of electric generating facilities and owns and operates extensive electric transmission networks, which it uses to serve its customers and to provide non-discriminatory open-access transmission service. AEP’s generation and transmission facilities are located in three regional reliability councils - the East Central Area Reliability Council (“ECAR”), the Southwest Power Pool (“SPP”) and the Electric Reliability Council of Texas (“ERCOT”). AEP also participates extensively in the highly competitive wholesale trading market. AEP is fully committed to the development of a more competitive electricity industry in the United States, and is fully committed to transferring operational control of its transmission facilities to independent Regional Transmission Organizations (“RTOs”).

AEP appreciates the Department’s initiative in focusing attention on a crucial issue - the maintenance of reliability of the electric power system in the face of profound changes to the

industry. AEP believes that the increasingly competitive nature of electric markets has presented and will continue to present challenges to the maintenance of reliability. AEP also notes that there is near unanimous consent among industry stakeholders, as well as government officials and regulators, that the present system of reliability controls, which was well suited to the historically vertically-integrated monopoly structure of the electric industry, requires fundamental changes in order to adapt to the more competitive environment. We believe that such consensus is reflected in the reliability legislation introduced in the 106<sup>th</sup> Congress in the form of reliability provisions of the Comprehensive Electricity Competition Act (“CECA”) referred to in the Notice of Inquiry, as well as stand-alone reliability legislation (S. 2071 and H.R. 4941) which would have refined and improved upon the reliability provisions of CECA. The essence of these legislative proposals is the creation of a self-regulating reliability organization with an inclusive governance structure, which would develop and enforce mandatory reliability standards, subject to FERC’s oversight.

However, as the Notice of Inquiry indicates, the 106<sup>th</sup> Congress has not enacted reliability legislation. Consequently, the Department states that it is considering using its authority under Section 403 of the DOE Reorganization Act to initiate an electric reliability rulemaking at the Federal Energy Regulatory Commission (FERC).

AEP urges the Commission not to institute an electric reliability rulemaking at FERC. FERC’s statutory authority to take the steps proposed in the pending reliability legislation is uncertain. Further, FERC reliability rules could not govern non FERC-jurisdictional entities, which comprise a significant sector of the electric industry. AEP urges the Department to join AEP and other stakeholders in pursuing the enactment of reliability legislation in the next Congress, either as part of comprehensive electric restructuring legislation, or as part of a more

limited legislative effort. Regardless of the pace of retail competition, or the progress of federal legislation implementing retail competition on a national basis, wholesale competition is a reality, and the resultant challenges to reliability already exist. Widely-supported measures to address this situation in a comprehensive and legally sound manner should be pursued. In this regard, and prior to the enactment of such legislation, AEP supports the contractually-based enforcement of reliability measures under development by the North American Electric Reliability Council (NERC).

With the above general recommendations in mind, AEP will address each of the questions set forth in the notice, as follows:

**1. Is the existing arrangement of voluntary compliance with industry reliability rules sufficient to ensure reliability of the bulk power transmission system? If not, why not, and has reliability been jeopardized by violations of the existing bulk power reliability standards?**

The existing arrangement of voluntary compliance with industry reliability rules is no longer sufficient to ensure reliability of the bulk power transmission system, for a number of reasons including, but not limited to, the following:

**a. Increased Transactions.** Increased competition in the wholesale market has led to a large increase in the number of power transfers that must be coordinated (scheduled) by transmission providers, RTOs and/or control area operators. As a result of these changes, competition has been greatly enhanced, but problems such as implementation of commercial practices and system congestion (localized transmission capacity shortages) are being encountered with increasing frequency. These problems can be expected to increase as retail competition increases. The

new competitive environment has created new responsibilities for system operators including providing nondiscriminatory service to all transmission users. These new customers, including many new market entrants, have increased the power flow across transmission systems. The resulting increase in utilization of existing transmission facilities, in turn, results in significant increases in system operational complexity.

- b. Industry Restructuring.** The existing system of reliability controls has relied heavily upon cooperation among vertically-integrated monopolies. As the industry becomes more competitive, vertically-integrated utilities are corporately or functionally disaggregating production and competitive sales functions from energy delivery functions. Further, monopoly franchises are being eliminated. Non-traditional market entrants are playing a much larger role in the new industry structure. The degree of cooperation relied upon under the old regime is not achievable, and indeed, may be inconsistent in many respects with the continued development of competition.
- c. Competitive Pressures.** Competitive pressures to decrease the cost of transactions or avoid common responsibilities necessary for reliability necessitate a system of mandatory enforceable standards, developed in a non-discriminatory manner with input from all stakeholders.

**2. What can FERC do under existing authorities to address reliability concerns?**

FERC can take and has taken a number of steps to address reliability concerns. Probably the most important step FERC has taken is to issue Order No. 2000, encouraging the voluntary formation of RTOs. The very existence of such regional organizations should enhance reliability by consolidating on a regional basis numerous reliability-related functions such as transmission tariff administration, energy scheduling and available transmission capability determination, that were previously administered by numerous individual utility systems.

Another step FERC can take is transmission rate reform. At present, transmission providers plan, build, and operate transmission facilities and maintain reliability on a regulated cost-of-service basis. There are no clear incentives available under the current rate making mechanisms to encourage transmission providers to take necessary actions associated with maintaining and/or enhancing transmission-related reliability in the deregulated generation environment. Rate freezes enacted in connection with retail restructuring provide further disincentives for transmission providers to add new facilities or enhance reliability. As the industry changes, there is a need to assure recovery of investment and provide an opportunity to earn adequate returns on equity by way of, for example, explicit increments of basis points or other performance based ratemaking. FERC appropriately addressed these issues in Order 2000, by making available to RTOs price incentives so that needed new facilities will be constructed pursuant to a regional planning process that ensures that all public interests and the interests of investors are addressed. Regardless of economic incentives, it must be recognized that a disincentive may exist where protracted approval processes encumber the process to certify and construct needed transmission facilities to remove constraints.

In addition, FERC can address another crucial aspect of electric reliability - adequacy of generation supply - by refraining from re-regulation in response to increases in market prices. Such activities are sure to discourage the investment in new generation necessary to avoid power shortages.

Despite all of the above, it must be recognized that FERC's existing legal authority over reliability matters is limited. In particular, FERC's present authority to create and oversee a self-regulating reliability organization is uncertain. FERC has not historically regulated reliability, and FERC has no express statutory authority to do so. Moreover, even if it had such authority, it could not exercise it over non-jurisdictional entities, such as public power systems, which comprise a significant portion of the electric industry. Federal reliability legislation could provide FERC with explicit authority to create and oversee effective reliability institutions governing all industry sectors.

**3. If FERC has the authority to establish and enforce reliability standards, may FERC delegate such authority to a self-regulating reliability organization? Should it do so?**

As indicated above, FERC's present authority to establish and enforce reliability standards is uncertain, and therefore its authority to delegate such functions is similarly uncertain. If Congress grants FERC the authority to establish reliability standards, it should also establish a mechanism for FERC to delegate such authority to an independent entity. That entity would develop the reliability standards with input from a broad base of stakeholders, including regional reliability organizations, and would enforce those standards in cooperation with the regional reliability organizations. DOE should report to the Congress the need for federal

reliability legislation that will provide the FERC with the necessary enforcement powers and authority to establish a North American self-regulating reliability organization.

**4. Are there elements in CECA, or other electric reliability legislative language, which can, with or without modification, be used in a rulemaking?**

As indicated above, AEP believes that it would be inappropriate for FERC to implement the provisions of the existing reliability bills through rulemaking.

**5. What should the relationship be between Regional Transmission Organizations, as advanced in FERC Order No. 2000, 65 FR 809 (January 6, 2000), FERC Stats. & Regs. Para. 31,089 2000), and an Electric Reliability Organization as proposed in CECA?**

As indicated above, RTOs should, by their very nature, enhance reliability. Further, under Order No. 2000, RTOs will be responsible for maintaining short-term reliability in their regions, and will address longer-term reliability by implementing regional transmission planning and by coordinating the regional planning process with the adjacent contiguous RTOs/TOs. Further, there may be instances in which RTOs can and should develop and implement localized reliability standards, and the RTOs, as stakeholders, should be actively involved in the development and modification of reliability standards. However, AEP believes that RTOs should not be given the ultimate responsibility for developing or enforcing reliability standards. AEP sees independent transmission companies (“Transcos”) as the preferred form of RTO, and has been instrumental in the formation of the Alliance RTO - a pioneer Transco. Transcos will, through business incentives, insure the robust development and efficient operation of interstate transmission systems. However, Transcos will be private businesses and will be participants in one sector of the newly -restructured electric industry. They will not, directly or indirectly, be

participants in generation markets. Therefore, it would be inappropriate for Transcos, or other forms of RTOs for that matter, to establish the reliability standards under which they and other market participants must operate.

**6. How should the responsibilities and roles of FERC and the States be addressed in a rulemaking?**

State regulators involved in retail competition and restructuring efforts are taking an active role to ensure that those efforts do not compromise quality of service to consumers. Performance standards and incentives/penalties are under consideration in a number of states. Quality of service to end-use customers is affected by both distribution system and transmission system reliability. AEP believes that states should recognize the regional and national scope of transmission reliability issues, which requires that such issues be addressed at the federal level. There ought to be a coordination of state and federal activities to avoid overlapping, conflicting or duplicative regulation, while recognizing the interdependence of the transmission and distribution systems. Reliability legislation would be helpful in outlining the respective spheres of federal and state regulation.

**7. Recognizing the international nature of the interconnected transmission grid, how could implementation of mandatory reliability standards be coordinated with Canada and Mexico?**

