UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Regional Transmission Organizations) Docket No. RM99-2-000

STATEMENT OF THE
DISTRICT OF COLUMBIA PUBLIC SERVICE COMMISSION
February 17, 1999

Good morning, Chairman Hoecker and members of the Federal Energy Regulatory Commission ("FERC"). My name is Marlene L. Johnson and I serve as Chairperson of the District of Columbia Public Service Commission. I am joined this morning by my fellow Commissioners Agnes M. Alexander and Edward M. Meyers, and we are pleased to have this opportunity to discuss with the FERC the propriety of dividing the United States into specific districts for the purpose of developing regional transmission organizations ("RTOs"). We appear this morning in response to the FERC's Notice of November 24, 1998 to provide our views on the four (4) specific questions propounded in the Notice, as well as to respond to several of the issues raised by Commissioners Bailey and Breathitt in their separate statements issued concurrently with the Notice.

I. INTRODUCTION

As you are aware, the District of Columbia's electricity service is provided by Potomac Electric Power Company ("PEPCO"), a company that participates in the Pennsylvania- New Jersey-Maryland ("PJM") power pool, which is a voluntary organization of investor-owned utilities operating in six mid-Atlantic States that has been in existence since 1927. Just one year ago, on January 1, 1998, that regional power pool became the first FERC-approved operational

Independent System Operator ("ISO") in the United States. In our view, the PJM ISO meets the needs of the mid-Atlantic States and already serves as an effective and efficient RTO. Therefore, at least as to the District of Columbia, we do not believe that it is necessary for FERC to mandate regional boundaries or to consider requiring any different form of an RTO for us. However, should the FERC take a different view, our Commission recommends that FERC: (1) establish minimum criteria that all RTOs must meet; (3) encourage voluntary formation of RTOs; (4) preserve existing boundaries for approved ISOs; and (5) work closely with the States to assure reliability and cost-effectiveness, if existing boundaries are to change or if a certain form of RTO is to be required.

II. ESTABLISHING BOUNDARIES FOR RTOs

A. Boundaries Should Not Be Established by FERC

The first question that the Notice poses to State Commissions is what criteria and policy considerations should be used to establish boundaries for RTOs, should the FERC decide to do so. However, our Commission shares the view expressed by both Commissioner Bailey and Commissioner Breathitt that the threshold question is whether there is, in fact, a need for FERC to establish specific regional boundaries. Commissioner Bailey queries whether establishment of boundaries is necessary to encourage RTO formation or whether the FERC could take other less aggressive actions; Commissioner Breathitt questions whether there are less intrusive methods for achieving full competition and non-discriminatory access.

In response to their requests for comments from the States on this initial issue, our Commission believes that formation of RTOs should remain voluntary among electric utility companies, notwithstanding the fact that five (5) ISOs conditionally approved by FERC to date,

and the ISO ordered by the Texas Commission, all vary as to "operational responsibilities, geographic scope, governance and structure." In order to minimize variances as between the ISOs, or to assure that variances have no adverse impact on the transmission grid, our Commission would recommend that FERC issue either a policy statement or rulemaking that specifies certain minimum criteria for RTOs, much the same way as it established the eleven (11) ISO principles in Order No. 888. In this way, FERC could address the several critical RTO requirements that the Notice references, that is, adequate operational authority, comparable treatment for all transmission users, proper resolution of loop flow issues, elimination of pancaked transmission rates, long and short term transmission reliability, congestion management, transmission expansion planning, as well as minimum geographical size.

B. Existing PJM Boundaries Should Remain Unchanged

Our Commission sees no need for FERC to either redraw the PJM's boundaries or to require that the PJM be transformed into any other type of RTO. In short, we would encourage FERC to resist the temptation to fix something that isn't broken. As we have noted, the PJM is a well-functioning ISO, formed voluntarily, with boundaries that we believe are appropriate. It is the fourth largest centrally dispatched entity in the world, trailing only similar organizations in France, Tokyo and England. Its peak load is estimated at over 49,000 MW and it manages 540 units, which is larger than any other centrally dispatched electric control area in North America. It successfully operates a bid-based energy market, and monitors, evaluates and coordinates over 8,000 miles of high voltage transmission lines. It performs critical ISO functions including: serving as transmission provider and central area operator; forecasting, scheduling and coordinating the operation of generation units; administering an active and liquid energy market;

serving as a regional transmission planner; and, performing as security coordinator. In addition, it maintains system reliability by complying with the Mid-Atlantic Area Council ("MAAC") reliability standards.

C. Specific Considerations In Changing PJM Boundaries

As to the question of whether the boundaries the PJM should be changed, there are two (2) practical issues that we would like to note. First consideration is reliability, must be maintained through any transitional period of boundary change. The formation of a new RTO or ISO, or the merging of two or more ISOs, is not a simple task. Tremendous resources, coordination, and reorganization are required. Initial resistance from power pool participants, infrastructure adjustments, and computer equipment reconfiguration are all factors which impact upon system reliability.

Second, we believe that cost-benefit issues should be analyzed before redrawing the boundaries of an approved ISO. FERC should weigh the potential incremental gains achieved through economies of scale, efficiency, and additional savings against the potential incremental costs of reorganization, computer reprogramming, infrastructure changes, and changes required to achieve effective communication and coordination. If cost-effectiveness cannot be justified, it is our position that FERC should decline to redraw existing boundaries.

D. Policy Considerations For Setting Boundaries, Generally

In addition to those two (2) operational issues, we believe there are five (5) basic policy issues, four (4) of which have been suggested by Commissioner Massey, that FERC should consider when moving to change or establish boundaries to assure effective RTOs. The first, and perhaps most obvious, is operational authority, since an RTO without adequate authority to

manage participant activities and operate an efficient energy marketplace cannot bring any wholesale benefits to the region. The second is reliability, which we have discussed above. The third is the combined criteria of independence and comparability, which can only be achieved if transmission providers do not offer to their own wholesale generation operation, or their company affiliate(s), preferential access to transmission and transmission information. Fourth is economic efficiency, since RTOs that include several control centers will reap the benefits of economies of scale. The creation of numerous and/or small RTOs is likely to be costly, inefficient, and may worsen reliability. The fifth, full participation, would require that no electric company be discriminated against when an RTO is formed, and that an "inclusive" rather than "exclusive" approach be adopted, as Commissioner Massey has noted.

In addition to these 5 considerations, there are other factors -- such as historical commercial relationships, technical constraints involved in coordination and central dispatch, transmission congestion, electric system development, natural geographic separation, and State or other jurisdictional boundaries -- that will affect the decisions on boundaries of an RTO. Finally, though not directly related to boundary determinations but related to achieving effective RTOs, is the issue of incentives, for both non-profit ISOs and for-profit transcos, which can be tied to managerial performance so that successful management of RTOs is encouraged.

III. Placement of Utilities In A Specific Region

The second question the States have been asked to comment upon is whether there are factors that make it appropriate for the utilities in each State to belong in a specific region. For PEPCO, a major company in our region, the answer is "yes." The factors that prompt our answer involve the long history of the PJM and PEPCO's involvement in it; the fact that the PJM's

present boundaries mirror those of the MAAC; PJM's successful operating history; the relationships among the mid-Atlantic States themselves; and the present relationship of those States to the PJM ISO.

As noted above, the PJM power pool had been in operation for more than seventy (70) years before the formation of the PJM ISO, with PEPCO having become a member of the PJM in 1960. The PJM's boundaries are identical to those of the MAAC, which to us presents a compelling argument for leaving the PJM's boundaries in tact and for placing PEPCO within that ISO. The PJM ISO has maintained system reliability, eliminated barriers to a competitive wholesale market, and is fully operational. It has been organized in accordance with the FERC's 11 principles governing ISO formation and, after several years of efforts to restructure the power pool, the PJM ISO has addressed the very issues that the Notice references as perhaps being problematic elsewhere in the country. Specifically, the PJM has: (1) established a region-wide transmission expansion planning process; (2) implemented a poolwide open access transmission tariff; (3) retained an obligatory capacity market and reserve sharing; (4) implemented locational marginal pricing for transmission congestion; (5) managed short-term transmission reliability; and (6) eliminated pancaked transmission rates.

In achieving the successes that PJM now enjoys, the 6 mid-Atlantic States and their utility companies have had a long-standing cooperative relationship that continues today. The affected State Commissions have worked together to resolve numerous issues involving both the PJM power pool and the new ISO. The full participation of those State Commissions has facilitated prompt resolution of a number of issues, including transmission pricing, congestion pricing, reliability assurance, and the independence of PJM's Board of Directors.

The close relationship between the States and the PJM ISO has been formalized into a Memorandum of Understanding ("MOU"), executed this past October, through which Commissioners within the PJM control area and their staffs have formed a liaison committee ("Committee") to the PJM Board, under the auspices of the Mid-Atlantic Conference of Regulatory Utility Commissioners ("MACRUC"). The responsibilities of the MACRUC Committee are to "collect information, monitor events, and to consider proposals related to the operations and functions of PJM which affect those member Commissions' responsibilities for reliability, safety, siting and reasonably priced electric services." In turn, the PJM Board, through the MOU, has pledged to cooperate with the MACRUC Committee, to meet with the Committee not less than once a year and to have its staff meet with MACRUC State Commission staff on a more frequent basis to discuss issues of mutual concern and to plan agendas for the joint meetings between the Committee and the Board.

IV. States' Role in RTO Formation and Governance

Our observations in this regard bring us to FERC's fourth and fifth questions, which are what is the appropriate role for State Commissions in the formation and governance of RTOs. We have been fortunate within the mid-Atlantic States to have developed an excellent working relationship with the PJM ISO. In our view, it is imperative that lines of communication between States and the RTOs within which their utilities participate be successfully developed, because in the absence of such a relationship, the goal of achieving competitive markets without compromising system reliability cannot be met. In the case of the formation of the PJM ISO, our several States have held regional meetings, as well as individual meetings, with PJM principals and managers at all steps along the way. Yet, our Commission has also maintained an independent

voice before the FERC by filling comments on the autonomy of the PJM ISO and the ISO's governance structure, PJM's capacity benefit margin, PJM's market monitoring plan, and PJM's Reliability Assurance Agreement and its ISO policies.

Our Commission believes that the role that States play in the formation and governance of RTOs is a critical one, since State Commissions must regulate the utilities belonging to an RTO and must assure that electric service is provided in an adequate and reliable manner. Further, State Commissions have a role in the establishment of State energy policy, including policy respecting the bulk energy system, and also may have responsibility to review the need, siting and environmental effects of new transmission construction. In addition, as States move towards adopting retail competition within their jurisdictional boundaries, the role, function and geographical boundaries of any RTO becomes critical.

It is clear from the November Notice and from the comments of all of the FERC Commissioners at the regional consultation held last week in St. Louis that each of you agree that the States' input into the question of RTO formation is key. It is equally clear from the comments of State Commissioners attending that consultation that there is a divergence of opinion among the States as to that question. Our Commission therefore suggests, given the concomitant federal and State interest in this issue, that FERC consider forming a joint board comprised of federal and State Commissioners, or a similar entity, much in the same way that the Federal Communications Commission ("FCC") has done for telecommunications issues where there is a community of interest. Such a board could be charged with reviewing all, or only some, of the issues involving RTO policy and with making recommendations for FERC to consider. In our view, a joint board could not only coalesce the best thinking of the States but could also help in establishing an

effective communications mechanism between the States and the federal government on the issue of RTOs, and could assist both in finding common ground.

Again, and on behalf of my fellow Commissioners and myself, thank you for allowing us the opportunity to appear before you this morning.