

COMMENTS BY THOMAS M. DORMAN BEFORE THE
ELECTRIC RESTRUCTURING TASK FORCE
MAY 21, 2001

TRANSMISSION ISSUES OVERVIEW

As recent events in California have brought to public attention, federal oversight of the bulk-power transmission grid has become increasingly less regulated in an effort to allow market forces to work.

We in Kentucky are not immune to that. In November 1999, Cinergy advised the Kentucky Public Service Commission that it no longer wished to sell power to Union, Light, Heat, & Power its Kentucky subsidiary at cost-of-service rates when its contract expires in January 2002. Though a wholesale contract is a matter to be filed at FERC, Union Light Heat and Power did enter into discussions with the Commission and we were able to negotiate a contract that would fix the rates of the new contract and insulate customers from wholesale market increases through the end of

2006. We are also examining the reasonableness of relying extensively on wholesale market purchases as opposed to a utility constructing and owning its own generating capacity.

We are also fortunate that Kentucky appears to have adequate generating capacity with more planned in the near future. While reserve margins are much tighter than they have been for the last decade or so, Kentucky has been steadily adding generating capacity as needed. Recent projections made by the East Central Area Reliability Council (“ECAR”), the regional reliability council serving our region, indicate that load and capacity projections for this summer are slightly better than the past two years. The projected summer capacity margin in the ECAR region is expected to be 11.5% during the peak demand this summer, slightly higher than the forecast for last summer.

There has also been significant interest by Independent Power Producers in building new merchant power plants in Kentucky. It has been reported that approximately 6400 MW generating capacity is being considered for construction in

Kentucky over the next few years, compared to a total installed operating capacity of approximately 17,000 MW – a 35% increase.

It is not certain that all this generating capacity will be built, but if a large portion of it does come to fruition, the energy generated will likely be exported out-of-state. This does raise concerns about whether the transmission system can handle this increase in power flows and to what extent Kentucky citizens might have to bear the negative consequences of it. Possible negative consequences are:

- potential failures due to overloads,
- curtailment of native load to relieve overload conditions,
- siting issues related to transmission line construction,
- higher costs for transmission.

Expanding on these issues, when curtailment is required to relieve overload conditions, FERC requires that this be applied to all users equally, even native load. However, utilities have been

reluctant to take this step, and FERC equally reluctant to enforce it, for obvious reasons.

It is highly likely that we will soon be faced with the prospect of having to add transmission capacity or new routes not to accommodate the needs of Kentuckians, but so that some of our excess energy can be exported out. Clearly, this will raise some very difficult issues that we will need to address at some point.

While arguably new generation connected to the system should bear the costs of being connected, it's perhaps unavoidable that ultimately, transmission costs will increase. This is so because the transmission system was not built or designed to handle large, continuous power flows across great distances, which is what is contemplated now. Instead, the transmission system was designed to transport power locally, over much shorter distances, with interconnections with neighboring systems primarily for emergency back-up reasons. In regions with high generation costs, it is projected that lower generation costs as a

result of restructuring will more than offset the increase in transmission costs. Obviously, that does not apply in Kentucky.

The Commission has been concerned with these issues for quite some time and consequently, has participated actively in the development of the Midwest ISO, along with other states in the region. It is important to stress that many of these issues go beyond the scope of what any one can state address. In fact, transmission itself, to the extent used for wholesale transactions, is not under the Kentucky Commission's jurisdiction at all, but is instead regulated by the Federal Energy Regulatory Commission.

While FERC is the federal regulatory agency, reliability standards and coordination are performed by the North American Electric Reliability Council. NERC is a voluntary organization formed by the electric utilities with a relatively open rule development process, but no legislative authority to enforce its rules. However, after an incident that occurred in 1998 that could have had an adverse impact on reliability, ECAR, one of the regional reliability councils under NERC, was able to obtain FERC

approval on a tariff designed to prevent recurrences. So until legislation is enacted to clarify authority for reliability, FERC has shown a willingness to use its authority to enforce the reliability standards established by NERC and the regional councils.

In an effort to encourage non-discriminatory open access to the transmission system, FERC has also required utilities to form Regional Transmission Groups, whose purpose is to control and operate transmission grids on a regional basis, including regional planning and development. Kentucky has the potential of being split among at least three different RTO's – the Midwest ISO, the Alliance RTO, and possibly another public power RTO led by TVA. This raises some concern over interconnection issues, often referred to as “seams issues.” Fortunately, the Midwest ISO and Alliance RTO have recently achieved a settlement over some interconnection issues.

In summary, responsibility for, and ultimate resolution of, transmission issues is divided among several state, regional, and national organizations. Ultimately, issues related to transmission

adequacy and planning will be handled on a regional basis by the RTO's. As noted earlier, the Commission has been actively monitoring the efforts of these other organizations, primarily related to RTO's. As a result, we have made dramatic changes in our formerly rather insular approach to regulation, one which rarely involved coordination with out-of-state organizations. We have now established an excellent working relationship with other state commissions in our region and hope to maintain that so that we may coordinate and mutually arrive at solutions that are in the best interests of all customers in the region.