



August 28, 2000

Mr. John Marschewski
President
Southwest Power Pool, Inc.
415 North McKinley
700 Plaza West
Little Rock, Arkansas 72205-3020

Re: East Texas Cooperatives

Dear John:

We have received a copy of a letter to you dated August 24, 2000, written on behalf of certain electric cooperatives (East Texas Coops). In that letter, the East Texas Coops requested that, at its August 30, 2000 meeting, the Southwest Power Pool (SPP) Board of Directors adopt a policy that "all transmission owners that transfer facilities to the proposed SPP Regional Transmission Organization (RTO) are entitled to be treated equitably and to share in the revenues received by the SPP." East Texas Coops Letter at p. 3. As I will explain in this letter, such a policy would be anything but equitable. American Electric Power Company, Inc. (AEP) will not object to the East Texas Coops' being given one more opportunity to argue for their position. However, there exists no basis in fact, law or the regulatory policies of the Federal Energy Regulatory Commission (FERC) for requiring Public Service Company of Oklahoma (PSO) and Southwestern Electric Power Company (SWEPCO) to share transmission revenues collected under the SPP regional transmission tariff with the East Texas Coops.

On several occasions this summer, the RTOWG and the RTWG have heard the plea of the East Texas Coops that they be given the right, directly or indirectly, to take transmission revenues that otherwise would be paid to PSO and SWEPCO. The East Texas Coops assert that such a taking would be fair because otherwise the East Texas Coops would unfairly be required to pay for a portion of the transmission service costs of the PSO/SWEPCO system and also to pay the entire costs of the East Texas Coops' investment in "transmission" facilities. The East Texas Coops would effect this taking directly by requiring an "allocation" to them of the transmission service revenues paid to the AEP zone for service rendered under the SPP tariff or indirectly by establishing a separate East Texas Coop zone, which would mean that the East Texas Coops would pay only themselves for network transmission service when and if

they become customers under the SPP tariff¹, and pay nothing for use of the PSO/SWEPCO transmission system. All East Texas Coop loads served in the SPP are connected to the PSO/SWEPCO system and because there is no source of power connected directly to the East Texas Coops' facilities, the use of the PSO/SWEPCO system is indispensable to obtaining power supply for such loads. The East Texas Coop proposals would also divert revenues from all existing SPP transmission zones derived from point-to-point transmission services, half of which are distributed on the basis of relative revenue requirements ratios.²

The East Texas Coops assert that the diversion of transmission service revenues under their proposals would be a "relatively small revenue loss" to AEP that "is outweighed by the benefits to the region from the formation of an RTO." East Texas Coops Letter at 2. AEP does not agree. The East Texas Coops' proposals could potentially mean a revenue shift from AEP to the Coops approaching \$9 million per annum. Furthermore, the region will have the benefit of an RTO whether or not the East Texas Coops are permitted to take revenues from PSO and SWEPCO. In our view, it is not necessary to enrich the East Texas Coops unjustly to gain RTO approval. Last year, an administrative law judge of the FERC soundly rejected the arguments the East Texas Coops have made to various SPP bodies this summer:

ETEC [one of the East Texas Coops whose loads are served from connections to the SWEPCO transmission system] suggests that it is not being afforded comparable treatment because it must pay the entire cost of its own facilities and a portion of the CSW rates as well. If ETEC is granted credits [the functional equivalent of the revenue allocation the East Texas Coops seek here], the cost of the ETEC facilities would have to be borne by the CSW ratepayers ***who receive no benefit from the ETEC facilities***. The fact that CSW would include the ETEC facilities in its rate base if the

¹None of the East Texas Coops is currently a network service customer under the SPP tariff.

²However, no other member of the SPP, or other user of the SPP Transmission System, would derive any additional benefit from the establishment of an East Texas Coop Zone. Because no point-to-point transaction will begin in, go through or end in the East Texas Coop zone, other than transactions for the benefit of the loads that the East Texas Coops serve as monopoly providers, the establishment of an East Texas Coop zone will not result in additional point-to-point revenue to other SPP members.

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facilities were owned by CSW is simply irrelevant to the issue of customer credits.

East Texas Electric Cooperative, Inc. v. Central and South West Services, Inc., Initial Decision, 89 FERC ¶ 63,005 (1999)(emphasis added).

While the ALJ's decision is still pending review by the FERC, we have been advised that the ALJ's decision is absolutely consistent with earlier FERC decisions addressing the same issues and we expect that the FERC will sustain the Initial Decision. Moreover, we understand that no other RTO would permit the diversion of RTO transmission revenues to entities that own facilities that only perform a local delivery function.³ In Order 2000, the FERC encouraged public power entities and cooperatives to participate in a collaborative process to arrive at solutions to problems that would permit them to participate in an RTO. However, there is nothing in Order 2000 or any other Commission order or policy that mandates that RTO rules permit transmission users to receive transmission service at no charge or to subsidize the costs of delivery facilities that do not perform a transmission function.

To their credit the East Texas Coops candidly admit that: "The real issue raised by the East Texas Cooperatives' request is one of cost shifting." East Texas Coops Letter at p. 2. As you know, the original purpose of establishing pricing zones within the SPP was to mitigate cost shifting. The specification of zones was addressed at many previous meetings of the RTWG, which represented months of negotiations and work by the SPP participants. As a general matter, the existing zones under the SPP OATT consist of historic control areas that had previously offered single-system pricing of transmission service, integrated operations and contiguous interconnected transmission facilities. In previous meetings of the RTWG, in which the East Texas Coops participated, various criteria for the establishment of new zones were considered, but ultimately rejected as no consensus could be found. The current working rule is that the

³The East Texas Coops persist in claiming that their facilities are transmission facilities by virtue of the voltage at which they operate and without regard to the function they perform. In contrast, AEP believes that the delivery facilities that the East Texas Coops would have the SPP recognize as "transmission" facilities do not perform a transmission function, but instead perform the limited function of delivering power taken from the SWEPCO transmission system to scattered loads served by the East Texas Coops. Such loads are served in multiple, non-contiguous service areas and, as a matter of physics, the only connection between the East Texas Coops' various facilities is that they all receive power and energy from the SWEPCO transmission system, which the East Texas Coops and their distribution cooperative members then deliver to end-use consumers.

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establishment of a new zone must be approved by the SPP Board of Directors. This is the process by which a new zone was recently approved for Southwestern Public Service Company.

The East Texas Coops' arguments were most recently considered in an August 16 meeting of the RTWG. The East Texas Coops' letter accurately reports that the RTWG rejected a motion by the East Texas Coops to establish a new East Texas Coop zone under the SPP tariff by a vote of 8 to 6. Instead, the RTWG voted to recommend that the SPP tariff be amended to provide that, if Transmission Owners in a zone cannot agree on a sharing of revenues, any Owner may take the matter to dispute resolution procedures under Appendix D to the SPP Membership Agreement or seek resolution from the FERC. This resolution was adopted by a vote of 11 to 2 with AEP abstaining.

The East Texas Coops argue that: "An RTO's goal should be to include as many facilities, and open as many markets to competition, as possible." East Texas Coops Letter at p. 2 Yet, the East Texas Coop proposals would not advance this goal. The East Texas Coops' facilities would do nothing to enhance the reliability of the SPP transmission system and their inclusion in the SPP Transmission System would have no value except to the East Texas Coops. The East Texas Coops' facilities serve only the function of delivering power taken from points of connection to the SWEPCO transmission system to East Texas Coop loads that are not otherwise connected to sources of generation. As such, the East Texas Coops facilities are not used to provide transmission service under the SPP OATT.

Furthermore, the establishment of an East Texas Coop zone or allocation of AEP zone revenues to the East Texas Coops would do nothing to enhance competition. Under the Texas restructuring law, S.B. 7, neither the East Texas Coops, nor their distribution cooperative members, are required to open their service areas to competition. In fact, the East Texas Coops recently informed PSO and SWEPCO that the East Texas Coops have not yet decided to open their service areas to competition, although the matter is the subject of continuing deliberation.

We understand that the East Texas Coops' have threatened the SPP that if their request for the establishment of their own zone is denied, they will protest the SPP's amended RTO filing, claiming that they have been unfairly denied the opportunity to participate in the RTO. However, the SPP's rejection of the East Texas Coops' proposals, and the concomitant revenue shifts they would engender, can be readily and rationally defended. As you know, in an earlier order concerning the SPP OATT, *Southwest Power Pool, Inc.*, 89 FERC ¶ 61284 (1999), the FERC responded to ETEC's claim to a revenue allocation by stating:

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The issue of whether and to what extent the East Texas Cooperatives' transmission facilities are integrated with CSW is currently being litigated. Consequently, acceptance here of the East Texas Cooperatives' position would prejudice the outcome of that hearing. Therefore, we will accept for filing SPP's treatment of revenues, subject to the outcome of the ongoing litigation.

The litigation referred to is the East Texas Electric Cooperative case discussed above in which the ALJ rejected all claims for contribution by CSW to ETEC's transmission facility carrying costs.

As a member of the SPP Board, I believe that all participants in the SPP electric markets deserve to have their concerns about the SPP's RTO design fully heard and considered. As I think you know, the East Texas Cooperatives have had several opportunities already this summer to air their concerns. I do not object to their being granted one more hearing, but I urge the Board to adopt the proposal of the RTWG that the dispute between AEP and the East Texas Coops be left for resolution by the FERC or, if the parties can agree, to alternate dispute resolution procedures.

Very truly yours,



Richard P. Verret
Senior Vice-President, Transmission

RPV/af

cc: SPP Board of Directors
Pat Wood, III, Chairman, PUCT
Judy Walsh, Commissioner, PUCT
Brett A. Perlman, Commissioner, PUCT
Jess Totten, PUCT
Christine Ryan, Brickfield, Burchette & Ritts, P.C.