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BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION
- - - - -x
IN THE MATTER OF: : Docket Number:
MARKET-BASED RATES FOR : RM04-7-000
PUBLIC UTILITIES :
- - - - -x
Commission Meeting Room
Federal Energy Regulatory
Commission
888 First Street, N.E.
Washington, D.C.
Tuesday, December 7, 2004
The above-entitled matter came on for technical
conference, pursuant to notice, at 10:47 a.m., Steve
Rodgers, presiding.
APPEARANCES:
MARN CAIN, OMTR
RICHARD O'NEILL, OMTR
KELLY PERL, OMTR

1 APPEARANCES CONTINUED:
2 CHAIRMAN PAT WOOD, III
3 COMMISSIONER NORA MEAD BROWNELL
4 COMMISSIONER JOSEPH T. KELLIHER
5 COMMISSIONER SUEDEEN G. KELLY
6 JERRY PEDERSON, OMTR
7 MICHAEL BARDEE, OGC
8 DEBORAH LEAHY, OGC
9 MARY BETH TIGHE, OMTR
10 SEBASTIAN TIGER, OMOI
11 JOHN HIKE, FTC
12 ANNE KIMBER, Iowa Assoc. of Municipal
13 Utility
14 RICKY BITTLE, VP of Planning
15 CRAIG ROACH, Principal, Boston Pacific
16 Co, Inc.
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1 PROCEEDINGS

2 (10:47 a.m.)

3 MR. RODGERS: Why don't we go ahead and get
4 started this morning. I would like to invite our panelists
5 for the first panel to come forward to the table.

6 While they are doing that, let me announce the
7 purpose of today's meeting, which is to discuss vertical
8 market power issues, sometimes called "Transmission Market
9 Power Issues," as well as Barriers To Entry, which comprises
10 two of the four prongs of FERC's current four-part Market
11 Power Test in deciding whether to grant applicants
12 Market-Based Rate Authority.

13 The Commission's Four-Prong Market-Based Rate
14 Test was developed nearly 15 years ago in the context of
15 specific Market-Based Rate proposals filed with the
16 Commission.

17 Much has changed in the industry since the
18 Commission began using the Four-Prong Test in the 1980s, and
19 the Commission believes it is important to ensure that its
20 test is sufficient to support Market-Based Rates in today's
21 energy markets.

22 The generic proceeding that has been convened to
23 discuss these matters, and on which this conference is a
24 part of the record, is not going to be limited to but will
25 address whether the Commission should retain or modify its

1 existing Four-Prong Test.

2 The focus of today's conference will be to hear
3 evidence on two of the prongs of the current four-part test,
4 as I mentioned, transmission or vertical market power, and
5 barriers to entry.

6 In late January, the Commission is planning to
7 have a two-day technical conference to address the other two
8 prongs of that Four-Prong Test, and there will be more
9 information forthcoming soon about the exact topics, as well
10 as the exact dates of that conference in late January.

11 Each of the panelists that are here today I've
12 asked to speak for five to seven minutes in opening prepared
13 remarks. I strongly encourage them to engage in commentary
14 on each other's presentations at the appropriate time.

15 So, in other words, we are not just interested in
16 your prepared remarks, not just interested in your answering
17 questions from staff or Commissioners, but also very
18 interested in hearing your responses and your commentary on
19 what others have had to say on the panel.

20 Today we will proceed by having each of the
21 prepared remarks given, and then after the last of those has
22 been given we will be open for questions and answers from
23 staff and Commissioners.

24 At the end of each of the three panels, we will
25 have an open-microphone opportunity for members of the

1 audience to come forward to either of the microphones near
2 the front of the room and ask questions that they may have.

3 We have three panels scheduled for today. The
4 opening panel will deal with scoping out what are the
5 problems, if any, associated with vertical market power?

6 The second panel, the early-afternoon panel, will
7 deal with proposed solutions to the problems that are
8 identified for vertical or Transmission Market Power.

9 And then the late-afternoon panel will deal with
10 barriers to entry into electric markets that should be
11 considered in the grant of market-based rate authority.

12 The conference today is going to be transcribed,
13 and a copy of those transcripts will be available about 10
14 days after today, in about 10 days' time.

15 With that, let me go ahead and introduce our
16 first panelist who is John Hilke, who is an economist with
17 the Federal Trade Commission.

18 Welcome, Mr. Hilke.

19 MR. HILKE: Thank you, very much.

20 The views I express today are my personal views
21 and do not purport to be the views of the Federal Trade
22 Commission or any individual Commissioner, other than in the
23 instances in which I'm quoting from a Commission statement.

24 The basic premise of regulatory reform in the
25 United States, and in many areas of the world, is that

1 competitive markets lead to an efficient allocation of
2 resources.

3 Competitive markets also provide consumers with
4 choices between combinations of price and quality, including
5 innovative products and services.

6 FERC's goal in its Market-Based Rate process is
7 to utilize competition to achieve Just and Reasonable Rates
8 in wholesale electricity markets.

9 One of the obstacles FERC faces is that during
10 the decades, while nearly all aspects of electric markets
11 were subject to traditional Cost-of-Service Regulation, and
12 while utilities were organized largely as local vertically
13 integrated monopolies, utility mergers took place and
14 industry practices developed that can allow vertically
15 integrated utilities to profitably raise wholesale electric
16 power prices above competitive levels by reducing their own
17 generation output or the output of other suppliers. That
18 is, they have the incentive and ability to exercise market
19 power in generation through their control of transmission,
20 transmission that is essential to their generation rivals.

21 FERC's stated intent has been to grant Market-
22 Based Rates only to a firm that is able to satisfy FERC that
23 it does not have market power that would prevent competitive
24 rates in wholesale electric power markets where the
25 applicant operates.

1 As is appropriate and inevitable after an
2 incident like the California energy crisis of 2000 and 2001,
3 FERC is in the process of revising that criteria that it
4 uses in granting Market-Based Rates.

5 Like other sector regulators, FERC applies
6 initial screens for horizontal or vertical market power.
7 This is a sensible and efficient technique because it can
8 quickly and often at relatively low cost separate
9 applications from Market-Based Rates that can be readily
10 approved from those that require further study, remediation,
11 or denial.

12 The four prongs that FERC employs--namely,
13 Transmission Market Power, ability to create entry barriers,
14 horizontal market power, and affiliate abuse--are all
15 reasonable because they potentially cover the most important
16 market power concerns in the electric power industry.

17 In keeping with the focus of this Technical
18 Conference, my remarks today deal primarily with the
19 Transmission Market Power prong of FERC's Market-Based Rate
20 Assessment; and secondarily with the Barriers To Entry
21 Prong.

22 I would be remiss, however, if I did not mention
23 that the FTC has expressed views in its July 16th, 2004,
24 comment regarding appropriate screens for use in each of the
25 four prongs.

1 In my view, the best paths forward for the two
2 prongs being considered today are relatively clearcut, as I
3 will discuss in a moment.

4 Regarding the two prongs not on today's agenda, I
5 would say first that while the EDGR policies address many
6 concerns that are covered on the Affiliate Abuse Prong,
7 there are several significant issues remaining in updating
8 the Horizontal Market Prong, particularly those associated
9 with geographic market delineation, coordinated interaction,
10 and the temporal nature of wholesale electric power product
11 markets.

12 With respect to Transmission Market Power, I want
13 to start by quoting from the FTC's July 16th, 2004, comment
14 to FERC on Market-Based Rates:

15 "In Order 2000, FERC encouraged public utilities
16 to join Regional Transmission Organizations and
17 thereby reduce the ability of a vertically
18 integrated public utility to discriminate in
19 favor of its own generation services. Some
20 public utilities have not joined a FERC-approved
21 RTO, and not all approved RTOs are fully
22 operational. Public utilities in these areas may
23 have the incentive and ability to engage in
24 transmission discrimination that favors their own
25 generation assets. A supplier that owns

1 transmission assets but is not part of an
2 approved RTO or Independent System Operator may
3 be in a position to exercise Transmission Market
4 Power. Moreover, the applicant may be able to
5 engage in improper information sharing and cross-
6 subsidization."

7 Vertical discrimination in transmission is a
8 serious concern because transmission technology continues to
9 exhibit major economies of scale that often preclude
10 effective competition in providing alternative transmission
11 service between generation and loads. That is, there is not
12 likely to be competition between networks in transmission.

13 FERC should take advantage of all it has learned
14 over the past 15 years about transmission service
15 discrimination as it updates its Market-Based Rate
16 Assessments.

17 One of the most important lessons is the
18 inadequacy of behavior rules to curtail less transparent
19 forms of transmission discrimination. Behavior rules are
20 often inadequate because they leave intact the incentives to
21 discriminate, and because discrimination in transmission
22 operations can be very difficult to detect and document due
23 to the time sensitivity and subtlety of negotiations for
24 transmission access.

25 Electricity transmission negotiations and

1 transactions are inherently time-sensitive because it is not
2 practical to store electricity in large quantities with
3 existing technology.

4 Transmission discrimination issues are often
5 serious, most serious, during peak demand periods. As Paul
6 Josko observed: Unfortunately, it is also under these tight
7 supply conditions that market power problems are most
8 serious, and when system operator discretion is most
9 important. Thus, tight supply conditions aggravate
10 transmission discrimination detection and documentation
11 problems.

12 The NOPR leading to FERC Order 2000 has an
13 extensive section regarding experience and concerns leading
14 to the conclusion that structural unbundling is necessary to
15 prevent transmission discrimination.

16 The FTC staff raised this point itself in 1995
17 when it first was commenting on Orders 888 and 889. The
18 OECD Secretariat's assessment across many countries and
19 across many regulated sectors is very similar.

20 On this basis, the FTC recommends that FERC use
21 membership in an approved and fully operating RTO or ISO as
22 its initial transmission market power screen in evaluating
23 applications for Market-Based Rates, as well as full
24 compliance with Orders 888 and 889.

25 RTOs and ISOs with independent governance, even

1 if the membership of the transmission assets remain the same
2 provides structural separation that substantially diminishes
3 the ability of transmission owners to discriminate in favor
4 of their own generation assets and removes incentives for
5 transmission operators to discriminate.

6 Divestiture of transmission assets to an approved
7 and fully operating TransCo is another form of structural
8 remedy. As the FTC stated in its July 16th, 2004, comment
9 to FERC: A utility that has joined an approved and
10 operating RTO or ISO, or a firm that has divested its
11 generation in that area, should pass the transmission market
12 power screen.

13 Firms operating in the areas without an approved
14 or fully operating RTO or ISO, or a close substitute,
15 should fail the initial transmission market power screen if
16 they also own generation or conduct a wholesale marketing
17 business in the same area. Such firms should have the
18 burden of proof that they do not have transmission market
19 power, or that violations of FERC Orders 888 and 889 can be
20 detected and documented in these markets where they operate.

21 This burden, in my view, is likely to be
22 substantial for those utilities outside an approved and
23 fully operating RTO and ISO.

24 I note that FERC has a limited number of carrots
25 and sticks available to try to reshape electric power

1 markets into structurally competitive markets that will be
2 efficient and provide benefits to consumers.

3 In my view, granting Market-Based Rates to firms
4 with the incentive and ability to discriminate in
5 transmission services is inconsistent with FERC's goal of
6 using competition to achieve Just and Reasonable Rates in
7 wholesale electric power markets.

8 Finally, I would like to add that membership in
9 an approved and fully operating RTO or ISO should be a part
10 of the initial screen regarding entry barriers, along with
11 compliance with generation connection standards.

12 One of the most important challenges for FERC and
13 the States is to ensure that the evolution of RTOs includes
14 effective approaches to assure that market participants or
15 other investors have incentives to make economically
16 efficient transmission investments in a timely manner,
17 including transmission investments with substantial public
18 goods' aspects.

19 This evolution will help alleviate existing
20 barriers to entry and broaden geographic markets, thereby
21 enhancing competition in wholesale electric power markets.

22 Connection and transmission discrimination
23 against independent generators, new or established, is one
24 of the most effective barriers to entry that an incumbent
25 generator can impose because it simultaneously increases

1 present cost, and increases the perceived uncertainty of
2 future costs and earnings. Both are likely to reduce entry
3 incentives.

4 Thank you, very much.

5 MR. RODGERS: Thank you, very much, Mr. Hilke.
6 We appreciate that.

7 Before we go to our next panelist, I had one
8 other housekeeping matter I omitted to mention earlier.
9 That is, because we got a little bit of a late start this
10 morning, we are not going to have a full hour and fifteen
11 minute scheduled lunch break. We will probably only have
12 about 20 minutes of a break that we will take between the
13 two panels. So I apologize for that, but I did want to make
14 you all aware of that as soon as possible.

15 Next why don't we turn to Ann Kimber, who is a
16 technical and environmental systems engineer with the Iowa
17 Association of Municipal Utilities, and she is here today
18 representing the Midwest Municipal Transmissions Group, as
19 well as the Transmission Access Policy Study Group, also
20 known as TAPS. Welcome.

21 MR. KIMBER: Thanks very much for the opportunity
22 to participate in today's conference. I represent the
23 Midwest Municipal Transmission Group, MMPG, which consists
24 of 120 municipal utilities, about 1300 megawatts of load;
25 many of these are small systems, less than 10 megawatts.

1 MMPG exists to strengthen municipal access to
2 market by obtaining rights to invest in transmission and
3 thereby alleviate the constraints that block access to
4 competitive alternatives for power supply. We are ready,
5 willing, and able to invest in new transmission.

6 I am also speaking for TAPS, which represents
7 transmission-dependent utilities in more than 30 states.
8 And I am going to summarize what has a lot more detail in my
9 written statement.

10 The question has been asked: Does the OATT
11 mitigate market power? For my region, we have to say: No.
12 Under the Open Access Transmission Tariff, the grid has
13 become increasingly weak and it has foreclosed power supply
14 choices.

15 The municipal utilities depend on access to the
16 markets. There has not been joint planning between the
17 transmission owner and its network customers. There aren't
18 any useful rollover rights that enable access to new power
19 supply sources.

20 The result is that there are very few suppliers
21 that are able to serve municipal-seeking new power supply
22 contracts. Who benefits from the weak transmission grid as
23 it is? The transmission owners. They have no incentive to
24 fix the problems where the improvement is going to benefit
25 competitors to those loads.

1 The staff has asked the question: How can you
2 distinguish between transmission market power versus
3 legitimate reliability based denials?

4 But you have to consider that in today's context.
5 Today's reliability based denials may well be the product of
6 years of inadequate investment in the transmission grid,
7 whether it's intentional or not.

8 So in spite of the existence of the OATT,
9 transmission providers are using their control over
10 transmission to limit access. I am going to give a couple
11 of horror stories here.

12 The first is Indianola, Iowa. It's a 30 megawatt
13 load on the Mid-American System. Indianola had a contract
14 with Mid-American that expired in January of this year, and
15 they wanted to join with a Joint Action Group called the
16 Resale Power Group of Iowa, which is about 120 megawatts of
17 load, 33 municipal utilities.

18 They wanted to join with RPGI because they wanted
19 to participate in a new contract with Ameron. But when
20 Ameron tried to get a transmission path to deliver that
21 resource into Indianola, they couldn't get firm transmission
22 from any path that they tried. And they tried all that were
23 available.

24 They ended up, a month before their contract
25 expired with Mid-American, getting a new three-year contract

1 but with Market-Based Rates, and Indianola's costs increased
2 by 67 percent for their delivered energy.

3 Another example is the City of Hudson. This is a
4 small city, a 3.5 megawatt load, also in Mid-American's
5 control area. They have no local generation. Hudson had
6 always been served by Mid-America either as a full-
7 requirements customer or, since 1999, through RPGI. And the
8 rest of the RPGI systems are on the Alliant control system.

9 Just like Indianola, Hudson couldn't get
10 transmission to deliver to Ameron Power. It ended up with a
11 one-year Mid-American contract, and a 79 percent increase in
12 delivered costs.

13 Why did it just get a one-year contract? Because
14 RPGI and Ameron called the FERC Hotline and hoped to get a
15 resolution of this issue so that Hudson could buy power from
16 Ameron. But the time ran out, and they have now had to get
17 a new contract with Mid-American for even higher-priced
18 costs for 2005.

19 The conclusions from these two horror stories are
20 that all the interfaces into Mid-American's system were
21 blocked. Neither of these cities had effective rollover
22 rights that they could use to reach a new supplier. And in
23 the meantime, Mid-American could charge Market-Based Rates
24 even in this constrained area.

25 My statement also has more details about the

1 plight of three other cities: Sergeant Bluff, Callender,
2 and Buffalo.

3 These are all located in Mid-American's control
4 area, and the historical supplier was Mid-American. The
5 cities are small. They decided to go out jointly for power
6 supply. The Municipal Energy Agency of Nebraska was the low
7 bidder, and they submitted 10-year transmission requests to
8 Mid-American and MISO.

9 Were they successful?

10 Yes. For Sergeant Bluff, which is on the very
11 western edge of Iowa right next to Nebraska, they were able
12 to get delivery from Means, Nebraska's resource into Iowa.

13 But the other two--Callender is a .6 megawatt
14 load; Buffalo is a 1.5 megawatt load--but these are both
15 much more centrally located in the Mid-American System, they
16 could not get a transmission path to deliver the Nebraska
17 resources.

18 The outcome was that Callender turned to the
19 local distribution Rural Electric Cooperative. They were
20 able to get a contract. The price is a little bit higher
21 than what Means would have been.

22 Means has been able to find another power
23 supplier for Buffalo from the east, and they're temporarily
24 using MAPP Schedule F to be able to secure that long-term
25 service.

1 But the reality here is that very few suppliers
2 would go to such lengths to secure a new power source to a
3 small municipal utility that is mired in transmission
4 constraints.

5 What do these examples--plus I have more--what do
6 they show? They are showing that for these cities that are
7 trying to get to market, inadequate transmission is driving
8 away their choices.

9 For these systems, the RFP process is costly and
10 challenging, and when transmission becomes unavailable it is
11 frightening. In the examples that I described, the cities
12 resorted to makeshift solutions, and they in reality had no
13 choices.

14 It is also costly for power suppliers, too, who
15 want to serve these systems. The consultant for Pocahontas,
16 Iowa, was recently told by one supplier who had initially
17 expressed interest in responding to its RFP, it would not
18 bid because it didn't wish to invest the time and money it
19 would take to attempt to secure a clear transmission path.

20 What are some solutions?

21 Well I am going to give some things I don't think
22 will work. Several years ago I would have said that
23 Regional Transmission Organizations are the solution. But
24 my recent up-close and personal experience with MISO
25 convinces me that the cure is worse than the disease.

1 MISO is extremely inflexible. With respect to
2 Callender, even a 50-kilowatt adverse impact on the flowgate
3 foreclosed the transaction. Callender was getting delivery
4 from a supplier outside of MISO into a system that's also
5 outside of MISO.

6 The other problem that we face in MISO is the
7 problem of load pockets. The municipals are subject to high
8 nodal LMPs that reflect congestion charges paid to the
9 generators as a reward for maintaining a weak grid, without
10 even the cushion of being able to have our nodal LMPs
11 averaged with the zonal LMP of the transmission owner.

12 The second thing, the staff has raised the
13 question suggesting that cutting existing long-term firm
14 transmission rights might be the answer, but we disagree.
15 The Commission should not undermine the transmission rights
16 that the transmission-dependent utilities relied on in
17 financing generation, and upon which they depend to serve
18 their load.

19 We need long-term rights to support long-term
20 contracts that provide the revenue streams for merchant
21 generators.

22 What we fundamentally need is a more robust grid
23 that reduces congestion and supports real access to the
24 competitive market, and reduces the opportunity for the
25 exercise of market power.

1 The TAPS White Paper, which I have copies of
2 here, outlines two models. The first one is an inclusive,
3 stand-alone transmission company. The second one is a
4 shared transmission system. And examples of that includes
5 systems in Georgia, Indiana, and in the upper Midwest. An
6 example of the first one, the stand-alone transmission
7 company, is the American Transmission Company.

8 Either way, these companies, or these systems,
9 are open to all load-serving entities in the area. And so
10 you can work together.

11 MMTG has experience with the first model in our
12 participation in TransLink. We worked very hard and were a
13 full participant because we could see that it was going to
14 benefit our municipal utilities greatly to be able to have
15 ownership of transmission.

16 Even if you talked to the smallest city council
17 about what MMTG was and what TransLink was, everybody
18 understood that it is always better to own than to rent.

19 There is something needed to induce the
20 transmission owner to fulfill its OATT planning and
21 expansion obligations. Where the TO system is weak, and
22 especially where a TO has rebuffed municipal requests to
23 jointly plan and participate in ownership, the TO must be
24 held accountable.

25 The Commission should find that the maintenance

1 and transmission insufficient to support a competitive
2 market is an exercise of transmission market power. It
3 should deny Market-Based Rates to TOs that have not remedied
4 congestion but maintains and enhances their generation
5 market power.

6 In fact, the Commission could tie Market-Based
7 Rates to a vertically integrated TO's willingness to allow
8 municipals to jointly plan and invest on a comparable basis.

9 Thank you, very much.

10 MR. RODGERS: Thank you very much, Ms. Kimber.
11 We appreciate that.

12 Why don't we next turn to Mr. Ricky Bittle, our
13 next panelist. Mr. Bittle is the Vice President of
14 Planning, Rates and Dispatching with the Arkansas Electric
15 Cooperative, and he was asked to speak today on behalf of
16 the National Rural Electric Cooperative Association.

17 I would also note that Mr. Bittle had to miss an
18 annual Board meeting of the Cooperative to be here with us
19 today. So we particularly appreciate your making the extra
20 effort to be here and talk about these important matters.

21 MR. BITTLE: Well let me clarify it, first. My
22 views do not represent all of the members of NRECA. They
23 really represent mine.

24 I do appreciate the opportunity to be here, and I
25 think as we move through this you will see why some of my

1 views do not represent all of the members. But basically
2 when you start looking at the transmission system, you're
3 looking at a monopoly. I think if you start from that
4 premise, then the idea of how do you measure market power is
5 just a matter of basically you start with the presence of
6 market power and then look to see how it has been mitigated,
7 or whether it is being exercised in a way that would be
8 harmful to the other participants.

9 I think it was interesting, if you read
10 yesterday's Wall Street Journal, the article that was in the
11 editorial on the New York Stock Exchange. One of the things
12 that The Wall Street Journal was complaining about was that
13 the New York Stock Exchange is a monopoly, and as a monopoly
14 has no incentive to make any major changes. And I think
15 that's true.

16 Basically when you look at the transmission
17 system for the last 10 to 15 years, I'm not sure that you
18 see major changes in the amount of transmission that has
19 been added. Basically what you see is the loads have
20 continued to grow, and that there is basically a continuing
21 scramble to share a limited resource.

22 It is in that that when you start looking at who
23 owns the transmission, they really have to do nothing in
24 order to benefit from the fact that this is occurring. And
25 I think that is one of the problems.

1 The transmission owners do have major advantages.
2 They own the transmission system and, as such, they can
3 argue for all of their ownership rights which, you know, has
4 some logic to it. But the inherent system design is one
5 that gives them an advantage.

6 The transmission system, major transmission
7 system improvements have been driven primarily by the
8 addition of new generation resources. And as that is true,
9 that means that the existing generation is what has the
10 major advantage of being able to serve existing loads.

11 So as you have these contracts that basically run
12 out and they start looking for new types of resources, what
13 that does when you start asking for transmission that goes
14 to different places, what happens is you expose the existing
15 weaknesses of the transmission system, which should be of no
16 surprise to anyone, but it does place the existing
17 transmission owner in an advantageous position.

18 Now the transmission owner can make a lot of
19 different arguments, all of which contain facts, but they
20 really argue to maintain the status quo and then, in my
21 opinion, therefore contribute to barriers to entry.

22 The idea that, you know, the proposed
23 transmission really doesn't benefit my customers; I really
24 don't see how you add much transmission to the system that
25 does not benefit everyone.

1 The idea that, you know, to protect their
2 existing consumers you've got to charge an incremental price
3 to this new entity. Well, the new transmission is going to
4 benefit everyone. And so I really just have a real distaste
5 for incremental pricing, especially of transmission system
6 which it's such a shared commodity.

7 The existing company has several other arguments
8 it can raise, and that is basically being that if you force
9 them to pay for it they're paying an outsized share of it
10 just because the load ratio share is always going to place
11 more costs on them.

12 And then the idea that there is no guaranteed
13 cost recovery. There is no perfect world. All of this
14 raises risk. But if we continue basically the way we're
15 going, there will be no change in the dominant position.
16 The transmission owners will continue to dominate.

17 Is it reliability, or is it market power? That's
18 an extremely difficult question to answer because, as the
19 transmission gets more fully subscribed--which we're
20 approaching--it is easier to justify denials of service
21 based on reliability. The impact of them is such that they
22 could continue to serve them.

23 But it is always easier to require major upgrades
24 at the expense of others, as this transmission is fully
25 subscribed, and so it is a real problem there.

1 But the reliability has to be maintained. But
2 merely adding transmission for reliability only maintains
3 the status quo.

4 So what is the Commission going to do? What are
5 you looking for? One of the things you really ought to be
6 looking for is just what Ann was talking about. Are these
7 existing loads being basically foreclosed from access to
8 transmission basically by pricing?

9 It is one of those questions that just has to be
10 looked at. It is not hard to find those types of examples.
11 Most of them don't ever get built because in one example in
12 the Southwest Power Pool at 9 megawatt request came back
13 with a price tag of \$29.7 million. And those kinds of
14 things just really foreclose any new look at transmission.

15 So the fact is that Market-Based Rates are a
16 privilege. They're not something that is an inherent right.
17 And because of that, I think the Commission can use the
18 granting of Market-Based Rates to do something that will
19 change the status quo.

20 I believe that in changing the status quo there
21 are several things that ought to be required.

22 Number one, that the existing transmission owners
23 must be required to interconnect with transmission owned by
24 others. All reliability arguments can be handled. It's
25 pretty simple to handle those.

1 They should be required, at the same time, to
2 establish some way to recover the cost of those transmission
3 additions. I think that because they provide improvement,
4 they come and basically--you cannot just increase the size
5 of the transmission to cover the exact load that you're
6 trying to serve, and so there's always going to be some
7 benefit. This needs to be shared on a fair basis.

8 If you think about it, it really is the same
9 principle that the existing transmission was built on.
10 Where you have large companies. There are transmission
11 additions in some areas that don't benefit all customers,
12 but all customers get to share. And I think that that is
13 something that is going to have to be part of what's going
14 on.

15 I think that revenue sharing needs to be based on
16 the benefits.

17 The other thing is, I think that there should be
18 a requirement for an open transmission planning model, but I
19 also think that the burden of proof for whether a new
20 transmission addition is useful should, if it's going to be
21 denied at least, should move to the transmission owner. I
22 think the transmission owner should actually have to prove
23 that it is inconsistent with the public interest.

24 And then I think that the required--the idea of
25 cost-based sales to wholesale entities really should have

1 with it the burden of proof to prove that they had other
2 options, other real options. And in doing that, I think
3 with those types of things that you really get to a point
4 that you're starting to force a change.

5 I don't think that we can stay with the existing
6 status quo. We basically are moving to markets with a
7 monopoly in control of the transmission. We're kind of half
8 in and half out, and I think that is really the worst of
9 both worlds.

10 Thank you.

11 MR. RODGERS: Thank you very much, Mr. Bittle.

12 Let's turn next to our fourth panelist this
13 morning who is Craig Roach, who is a principal in the firm
14 of Boston Pacific Company. Welcome, Mr. Roach.

15 MR. ROACH: Thank you, Steve. Good morning,
16 everyone, I appreciate the opportunity to speak today.

17 Let me use my five minutes to provide some
18 context, and then go into more detail during the questions.
19 It is always worth, when you start out, saying why we care
20 about things like transmission market power and barriers to
21 entry.

22 We care about them because they stand in the way
23 of getting the best deal possible for consumers in a
24 competitive market. They stand in the way of getting the
25 best deal possible in terms of price, risk, and reliability.

1 To get consumer benefit out of a competitive
2 market, we need at least two obvious things: One, we need
3 viable competitors. There can be no competition without
4 competitors. And we need a place for those competitors, a
5 forum for those competitors, to compete.

6 In terms of having competitors, we had good luck
7 in having new entrants, new players come into the market.
8 At this point, there is a lot of financial distress. I have
9 concerns about their access to capital in the future. So
10 that is a continuing concern.

11 But in the context of transmission, I think I
12 hear Ann and Ricky making the same point. My concern is
13 that the transmission system has not been built to enable
14 competitors to aggressively compete. We still have a
15 transmission system built, as was appropriate at the time,
16 to accommodate area franchises.

17 Now to move beyond that system, to get a system
18 that accommodates or enables and encourages competition, we
19 have three big questions to answer:

20 First, who decides what gets built?

21 Secondly, how do they decide?

22 And third, who pays for what gets built?

23 Inside RTOs, this Commission has taken the path
24 of ensuring independent decision making, and surely that is
25 a good move. But what can we do outside of RTOs? Is there

1 anything that we can do there to move forward?

2 I think we can do two things. We can borrow two
3 mechanisms that are already out there and being tested. The
4 first is a mechanism of a regional state committee. We
5 might call it something different, but basically I think
6 that the states are not at all opposed to competition, or
7 competitive reform that helps consumers. They just don't
8 want to be told what to do in that regard.

9 I think a regional state committee, or again
10 another name if it's appropriate, represents something of a
11 grassroots effort for states to get together and to
12 determine their own regional destiny.

13 The RSC that I've been involved with most is the
14 one for the Southwest Power Pool, and I'm impressed. It
15 gets the attention of very high level folks from the
16 commissions. It is often the chairperson coming to the
17 meetings and working at those meetings. High level staff.
18 And the RSC and SPP also has the resources both to engage in
19 a collaborative process with all stakeholders, and also to
20 get the analytic help that it needs on very technical
21 issues. These are very difficult issues.

22 The second mechanism I would borrow to help move
23 us along outside RTOs is a mechanism of an independent
24 transmission evaluator. Again, the issues here are very,
25 very technical. You must speak computer model. It's just

1 the way it is. So we need people that really are facile
2 with those models and can answer difficult questions.

3 This Commission has already moved forward on that
4 score. I've read with some interest the use of an
5 independent evaluator in your Tucson Decision.

6 Let me turn then to this notion of having a
7 forum, having a place for competitors to compete in both the
8 long term and the short term.

9 Again, inside RTOs there are really some
10 significant advancements. There's real progress. The
11 competitive solicitations in places like Maryland, the
12 District of Columbia, and New Jersey are very innovative pro
13 consumer solicitations.

14 In those solicitations, not only do suppliers
15 take on operating risks, they now take on market risk. I
16 think these are very beneficial to consumers. It also shows
17 how helpful an RTO is to a state solicitation program.

18 In the short term, the short-term market helps
19 with liquidity to support longer term offers, and the
20 transmission system--any questions about the transmission
21 system are judged prior to bid day. Transmission access is
22 not an evaluation criteria in these.

23 Contrast that with solicitations outside an RTO.
24 In those solicitations, I would say that transmission
25 access, transmission issues are the central concern in those

1 solicitations.

2 Now it doesn't mean that there aren't other
3 concerns. It doesn't mean that there aren't other barriers.
4 Balance sheet penalties are something to be worried about.
5 Failure to appropriately compare offers of different terms--
6 you know, a 20-year deal versus a 5-year deal. Those are
7 other things.

8 But in the solicitations outside RTOs, it is
9 transmission that is a big problem. And among the
10 transmission issues, the most important that I see is an
11 assessment of network resource status.

12 Who decides that a generator can reliably serve
13 local load? In concept, it should be pretty easy, again as
14 long as you speak transmission modeling. But in truth, it's
15 not an easy issue.

16 My experience has been that I find very few pure
17 network resources. There is always some accommodation given
18 to power plants. And what does this Commission have to do
19 to make sure that that's okay?

20 What I think this Commission has to do is to
21 assure comparability in deciding who is a "network
22 resource." If there are actions taken other than system
23 upgrades, actions like de-listing another plant, in effect
24 transferring network resource status, that opportunity has
25 to be given to all suppliers.

1 If redispatch or operating guides are given to
2 accommodate network resource status, that has to be given to
3 the full range of suppliers.

4 So what can we do, again in the hopes of ensuring
5 this forum, assuring this comparable transmission
6 assessment, what can this Commission do?

7 I think the most important thing, the thing
8 that's needed most is that we need a case precedent. We
9 need a case in which this Commission takes on--at the
10 Commission level--takes on the issue of transmission market
11 power, defines the burden of proof, what evidentiary proof
12 must be provided if someone is said not to be a network
13 resource for example.

14 And secondly, in that case precedent we need to
15 be clear on instances of wrong doing. What specific actions
16 are wrong?

17 In sum, then, let me just say that in terms of
18 transmission market power, my concerns lie mostly with what
19 I will call "access to open-access." It's a step before we
20 get to the Open Access Transmission Tariff.

21 To remedy it, we need to build out a transmission
22 system to accommodate competition. We need to assure
23 comparability in things like network resource status. And
24 outside RTOs, what we can do are borrow some mechanisms like
25 the Regional State Committee, a grassroots effort to have

1 regional planning.

2 We can use independent transmission evaluators,
3 and again we need case precedent on transmission market
4 power that defines "burden" and defines "wrong doing."

5 With that, I will just thank you and I will look
6 forward to any questions.

7 MR. RODGERS: Thank you very much, Mr. Roach.

8 Mr. Roach, would you mind just clarifying for the
9 record who are the clients that you typically consult with?

10 MR. ROACH: We--right now, we're heavy into
11 monitoring clients. We are the Independent Market Monitor
12 for the Southwest Power Pool. We are the RFP Monitor for
13 the Maryland Commission and the District of Columbia
14 Commission. We have in the past done a lot of work for all
15 stakeholders. A lot of work for independent power producers
16 on project development, also.

17 MR. RODGERS: Okay. Thank you.

18 Why don't we turn next to our last panelist on
19 this panel, Steve Wheeler, who is the Executive Vice
20 President of Customer Service and Regulation with the
21 Arizona Public Service Corporation.

22 I want to note that Mr. Wheeler--I want to thank
23 him on several regards. First of all, he is the panelist
24 who's traveled the greatest distance to be here today,
25 coming all the way from Arizona, and leaving the wonderful

1 weather of the Southwest for what we have to offer today.
2 So I apologize for that. But thank you very much for coming
3 today.

4 I also want to note that, while Mr. Wheeler is
5 the only IOU representative on this panel, and there's only
6 one IOU representative on the next panel--and that would be
7 Mr. Bonavia speaking on behalf of EEI--I did want to note
8 that there were four or five other IOUs that were invited to
9 be a part of the conference today and that declined our
10 invitations for various reasons. So there were some from
11 the West, and the Southeast, and the Midwest.

12 So I know there were various reasons for why they
13 could not be here, but I do very much appreciate, Mr.
14 Wheeler, your taking the extra effort to be here today, and
15 I look forward to having more IOU representation in future
16 conferences.

17 Mr. Wheeler?

18 MR. WHEELER: Thank you, Mr. Rodgers, and
19 Commissioners, for the opportunity to be here. Actually, I
20 was looking forward to getting out of the cold and rain of
21 Arizona to the better weather here--

22 (Laughter.)

23 MR. WHEELER: --but I see I didn't escape it.
24 But thank you for this opportunity.

25 I suspect some of you may have wanted or

1 anticipated a Jerry Springer Show type of presentation here
2 with flying chairs and fisticuffs, and I'm going to have to
3 disappoint you in the sense that I am not going to be the
4 instigator of that.

5 I share wholeheartedly, I think, the goals of a
6 number--well, all of the speakers here I share some of their
7 goals, that we need a robust, vibrant, abuse-free wholesale
8 marketplace, and we are dedicated to doing our part in doing
9 that.

10 APS is a buyer and a seller of power in the
11 marketplace. We are a buyer and a seller of transmission in
12 the marketplace. So we also want a transparent, vigorous
13 wholesale marketplace free of abuse, and we welcome
14 appropriate regulation that helps ensure that.

15 Where I do disagree with at least some of the
16 comments from the panelists is that you can take the
17 concerns expressed here today and extrapolate them into an
18 industry-wide pervasive problem that is all attributable to
19 the alleged exercise of transmission market power. And,
20 that the only solution to all of that is a fundamental
21 dismantling of a vertically integrated structure that has
22 served the country well.

23 I would hope to show you through my comments and
24 through answers to questions that I may get, that things are
25 a bit different in our neck of the woods, and that we have

1 engaged in a variety of voluntary collaborative efforts that
2 are underway to develop a wholesale marketplace that works
3 under the conditions that we face in the Southwest.

4 And what I thought I might do to do that is,
5 since this is a problem session, I will tell you what I
6 think are the four most significant challenges we face in
7 order to provide adequate and reliable transmission service,
8 and then I'm going to tell you what we are doing about it,
9 or attempting to do about it.

10 Perhaps our most significant challenge is who can
11 and will pay for needed transmission expansion. Right now,
12 congestion on our system is relatively minimal. We use a
13 process called unscheduled flow mitigation under the WECC
14 Protocols and, as I looked at the statistics for the last
15 five years, that was called into play only about two percent
16 of the time annually.

17 That doesn't mean use isn't expanding on our
18 system; it clearly is. But it does suggest that we don't
19 have the degree of congestion that is faced in other parts
20 of the country.

21 To the extent we do have those congestion issues,
22 those are not the result of the exercise of transmission
23 market power. They are most likely the result of either
24 inadequate capacity at the particular time, or siting
25 decisions by generators in locations where there isn't

1 always adequate out-capacity for their throughput.

2 We have to have more transmission capability in
3 Arizona and the Southwest, but the ability to finance that
4 is hampered by probably several things: Market participants
5 who hope that somebody else will do the job so that they
6 don't have to. It is also probably a result of lack of
7 available capital, or competing demands on what capital
8 there is, particularly in our case.

9 We serve one of the two fastest growing areas of
10 the country, and so we have significant demands for
11 infrastructure improvements and for additions and
12 replacements that go to both the distribution and
13 transmission side of the business, and in some cases I
14 suspect there is a lack of incentives, if you will, of the
15 type that I know FERC is contemplating and addressing that
16 probably deter some investment. That is probably our most
17 significant challenge.

18 The second one--and it's a very close second--is
19 that all transmission providers in our area are not required
20 to play by the same rules. This is particularly acute in
21 Arizona where 50 percent of the transmission is owned by
22 non-FERC-jurisdictional entities, and in many cases they are
23 joint owners of the transmission, but they also may operate
24 or control the switchyards and the trading hubs as well. So
25 any time you have a bifurcated regulatory scheme, you are

1 not going to be able to fully achieve all of your
2 objectives.

3 The third challenge I would note is the seeming
4 ambivalence, if not antipathy, toward vertical integration
5 as a business model, despite its proven benefits and
6 economies and efficiencies of scale and scope. If you look
7 at what has happened in the West in the last five or six
8 years, you will see that the utilities that were least
9 vertically integrated--in other words, owned or controlled
10 the least amount of generation in relation to their load--
11 were the ones who faced significant financial difficulties
12 and real-time capacity problems, and had significant
13 increases in their rates.

14 APS, at least during that period, had a fairly
15 good ownership and control of generation and as a result we
16 have been able to reduce rates nine times since 1991 for a
17 total of 16 percent, at a time when inflation went up 40
18 percent, and we were able to deliver that value to our
19 customers with a reliable system in part because we had
20 control of a significant amount, or at least an adequate
21 amount, of generation and were not as dependent at that time
22 on what was a fairly dysfunctional and volatile wholesale
23 market.

24 This issue of vertical integration is of
25 particular concern to us because of the possible tension

1 between what you want to do, perhaps, and what our State
2 regulators want us to do. They have told us we have to
3 retain our generation, after once telling us we had to
4 divest it. They have now said, no, you can't divest it.
5 And we are also told we have to follow least-cost resource
6 procurement plans.

7 So we have a directive from our State to act in a
8 manner that may be contrary to what some of you here would
9 like to see us do.

10 And then the last challenge I would posit is one
11 of siting. Although Arizona has never denied a major
12 transmission project in terms of its siting approval, we are
13 finding it increasingly difficult to get Federal approvals
14 necessary for transmission projects because of both the
15 complexity and the time inherent in going through the
16 Federal review process. But that's a big deal in Arizona
17 because there's only about a quarter of the land in Arizona
18 that's privately owned. The rest is Federally owned. It
19 may be Tribal lands. It may be State owned. So we have a
20 significant amount of non-private ownership of lands in
21 Arizona. So any time a major transmission project is
22 proposed, you have to go through some complicated siting
23 procedures.

24 And this will become particularly intensified as
25 a problem to the extent we start working on the regional-

1 interregional lines that we're studying, because then you
2 will have the issue of why should one state bear the
3 environmental burdens of the siting when the economic
4 benefit goes to another state.

5 So those are the four challenges.

6 What I would like to do, particularly in response
7 to comments from Ann and ricky, is to tell you what we're
8 trying to do in Arizona to address those issues. We are
9 investing over one billion dollars in transmission over the
10 next few years that will more than double our transmission
11 rate base.

12 Those transmission plans are open and
13 transparent. Every year we file a 10-year transmission plan
14 with our State Commission, which is then reviewed by
15 commission staff and a working group of anybody who wants to
16 show up and discuss them.

17 We have to go through siting committee, and then
18 commission review procedures before we can embark on any of
19 those. So we have got a significant investment plan, and we
20 have an open and transparent review plan.

21 We are attempting to expand the footprint of the
22 conditionally approved West Connect RTO and, as you know
23 from those of you who have talked with us about that in the
24 past, we've been hampered in that regard by the hesitation--
25 I'll use that term--of nonjurisdictional entities to join

1 in.

2 We are trying a new approach. We are
3 renegotiating a new MOU that will draw in I think five
4 nonjurisdictional entities to work on a framework of phased
5 cost-beneficial market enhancements that we hope will
6 eventually lead to possibly an RTO with FERC-desired
7 functions in it.

8 But in any event, we briefed your staff on this,
9 and this is something that we're going to be pursuing to see
10 if we can get more folks involved in that process.

11 From a planning perspective, and irrespective of
12 what happens to West Connect as an RTO, we are a leader and
13 a participant in a number of regional planning groups that
14 look at regional transmission needs in the Southwest, in
15 Arizona and New Mexico, in Nevada, in California, and we
16 have invited and encouraged all interested stakeholders to
17 participate in that, including the merchant generation
18 community.

19 We have retail access in our service territory.
20 All customers are able to choose a supplier. All our load
21 is contestable, although at the moment people seem to think
22 our default rates are too low. We'd be glad to remedy that
23 if we could get our State Commission to assist us. But at
24 the moment there isn't much activity, but we do have full
25 contestable load.

1 And we have set aside capacity at the Palo Verde
2 Trading Hub, the best trading hub there is for retail
3 competitors, we've set aside capacity for them rather than
4 doing it pro rata across our system so that scheduling
5 coordinators can use the Palo Verde Hub to serve retail
6 load.

7 And we've set up an Arizona Independent
8 Scheduling Administrator, an independent entity that we and
9 other utilities help fund, to manage that process to make
10 sure the transmission is available to competitive suppliers.

11 We have facilitate new merchant generation
12 through the early use of model interconnection agreements.
13 We've constructed miles of 500 kV lines to help connect one
14 generator to the system.

15 You've congratulated us for an innovative common
16 bus system at the Palo Verde Hub that allowed a lot of the
17 new generators to connect into that new bus and treat it as
18 if it's connected to Palo Verde without any bus wheeling.

19 We and our State are, I think, quite hospitable
20 to merchant generation. Over 25 percent of the generation
21 in our State is now either IPP or merchant, and we've got
22 about 10,000 megawatts of either built or under-construction
23 generation in the State.

24 We have already conducted two RFPs for short-term
25 and long-term power, one with an independent market monitor

1 because we had an affiliate potentially bidding, and one
2 without a market monitor because we had no affiliate
3 participation.

4 Perhaps most significantly, we've just signed an
5 historic rate settlement agreement at the State level with
6 virtually all competing interests, including the Merchant
7 Power Alliance that represents the generators in that State,
8 and individual merchant generators.

9 That settlement calls for another RFP next year
10 for at least 1000 megawatts without any affiliate
11 participation. It has a separate RFP for renewables and
12 DSM. It gives us approval that we sought from our
13 commission to join an RTO because that had been in doubt and
14 we put in a provision in the settlement that makes it clear
15 that by approving the settlement the commission will have
16 given us all requisite authority to join an RTO.

17 Of perhaps even greater interest to this group,
18 the settlement contains a 10-year self-build moratorium with
19 very limited conditions. By that, I mean APS is pledging
20 not to build any new generation for 10 years unless they get
21 explicit approval from the commission after a showing that
22 the market could not provide.

23 That was a very important part of the settlement
24 that garnered merchant support. We have a procurement
25 protocol in place that limits affiliate purchases, and we

1 pushed for state legislation that requires our commission to
2 hold a biennial transmission assessment every two years to
3 judge and critique the adequacy of our transmission system
4 in the State as a whole, and to determine what else may need
5 to be done. That is a process that is open that has all of
6 the merchant community and anyone else who is interested
7 participating and offering comments on that approach.

8 Now I tell you these things not because I
9 expect--not because I want to brag, and not because I want
10 any at-a-boys from you folks, but it is just to point out
11 what voluntarily can be done in a collaborative and
12 transparent method when people work together to try to make
13 sure that markets are working functionally.

14 And as you'll recall, I said we care because we
15 are a buyer and we are a seller in those marketplaces. The
16 points I think I would leave you with by way of conclusion
17 is not to automatically assume that every problem is the
18 result of transmission market power.

19 In our case, we are running out of capacity.
20 That is not a market power situation; that's a lack of
21 having adequate infrastructure.

22 The other thing I would urge you to consider is
23 that just because you see a problem, you cannot extrapolate
24 that to assume that the problem is widespread, universal, as
25 injurious as is claimed, or requires a functional separation

1 or a dramatic dismantling, when your existing tools may be
2 appropriately effective.

3 In our case, I don't believe there have been any
4 complaints filed against APS for alleged market power abuse.
5 We've had our disagreements of course, and one or two of
6 them I think have even reached the commission, but they are
7 not on market power issues.

8 We did not have any protest to our Market-Based
9 Rate Tariff filing. We had a set of comments, but they did
10 not raise market power issues. We serve transmission-
11 dependent entities I think of the type that Ann or John were
12 talking about. We do not have those problems with those
13 entities.

14 So I would tell you that the vertically
15 integrated model has worked. It can continue to work. It
16 is not mutually exclusive with the development of a
17 wholesale competitive market. In fact, I think they're
18 complementary. I think both need each other.

19 We personally, because we're so capacity short,
20 we'll be 25 percent short of our peak load needs in 2010.
21 We need to go to the market for that. We need vertical
22 integration to hedge market risk and to satisfy our State
23 demands, but we need a market that we can go to.

24 And we need vertical integration as a hedge
25 against the market. And I would frankly submit that the

1 market needs vertically integrated utilities that can be
2 solid, stable purchasers of services in that market.

3 So I would ask you to tread carefully, examine
4 the authorities and the tools you already have--there's a
5 vast array of them--and not to act precipitously.

6 Thank you, very much.

7 MR. RODGERS: Thank you very much, Mr. Wheeler.
8 I appreciate your remarks.

9 We will open it up for questions from those at
10 the table here, or Commissioners. I do want to reiterate
11 what I said at the outset, that those of you on the panel
12 today please feel free to comment at this time on what
13 others have said that you agree or disagree with.

14 I would like to open up, Mr. Wheeler, with just a
15 couple of questions on some things you said. You mentioned
16 at one point that a Federal review is causing most of the
17 delays in building transmission in your State, and I wanted
18 to just clarify that that is not FERC-caused delays.

19 (Laughter.)

20 MR. WHEELER: That is absolutely 100 percent
21 true.

22 MR. RODGERS: Thank you, very much.

23 (Laughter.)

24 MR. RODGERS: I appreciate that clarification.
25 So these are like environmental-type reviews or other

1 matters that don't come under FERC's jurisdiction?

2 MR. WHEELER: Absolutely. It is primarily
3 complying with NEPA requirements which now can--even if
4 there is no opposition or objections or people trying to
5 obstruct the line, it can take several years to do it on a
6 smooth-sailing course. If it's not smooth-sailing, it takes
7 longer and you have the threat of appeals that then keep the
8 project in jeopardy even longer. So it just adds a degree
9 of uncertainty and delay into the process that far dwarfs
10 the problem of going through state siting.

11 MR. RODGERS: And one other questions I was going
12 to ask you. You mentioned that, I believe, the second of
13 the big challenges that you all face is that all
14 transmission providers in the Southwest are not required to
15 play by the same rules. You mentioned that about 50 percent
16 of the transmission owned, I think you said in Arizona, is
17 owned by public power entities.

18 Can you tell us what the significant of that is?

19 MR. WHEELER: Well, the significance is that if
20 you require us to operate our system in a certain way, or
21 under certain strictures and protocols, and our co-owners in
22 the particular line, or the operator of the trading hub
23 where our transmission comes in and out of is not required
24 to do that, then at best you have a complicated set of dual
25 protocols; at worst, you are at a competitive disadvantage

1 with that entity that can say "I don't have to comply with
2 any of the FERC rules or requirements," and we say, "but we
3 do, so you need to run your system this way for us to be in
4 compliance," and they say, "no, that's your problem."

5 MR. RODGERS: Isn't the Reciprocity Tariff
6 supposed to take care of that problem?

7 MR. WHEELER: I think in a very high level, and
8 in a limited case, yes, but not to the depth of the type of
9 regulations and requirements that we're talking about here.

10 MR. RODGERS: So your argument is the Reciprocity
11 Tariff isn't doing what it's supposed to be doing?

12 MR. WHEELER: It works as far as it goes. It
13 doesn't go far enough.

14 MR. RODGERS: Should we strengthen it?

15 MR. WHEELER: Who's in the audience?

16 (Laughter.)

17 MR. WHEELER: I think it could undergo some
18 revision.

19 MR. RODGERS: I had a question that I wanted to
20 ask, a couple of questions that I wanted to ask Ann Kimber.
21 Can you tell me about how many retail native load customers
22 your munis serve? You said one of the groups you represent
23 serves, or has about 100 municipals in it?

24 MS. KIMBER: Well in Iowa there are 136 municipal
25 electric utilities that are serving load, and some of those

1 are small joint action groups that might be like 12
2 municipals, or 30 municipals.

3 MR. RODGERS: And about how many retail native
4 load customers are served by these munis, the ones that
5 you're speaking for today?

6 MS. KIMBER: Well I can't answer the numbers, but
7 the municipal load represents about 12 percent of the entire
8 load in the state.

9 MR. RODGERS: Okay. And would having greater
10 transmission access enable you to save money for your retail
11 native load customers?

12 MS. KIMBER: Absolutely. Yes. That's what it's
13 all about.

14 MR. RODGERS: Significantly?

15 MS. KIMBER: Well we'd like to be able to show
16 how significant the savings would be. We haven't been able
17 to get a case where we were able to get a new power supply
18 contract that had lower rates because we were able to get
19 access to the market.

20 MR. RODGERS: Right. But you have seen what you
21 perceived to be opportunities out there that you were not
22 able to take advantage of that would have saved your retail
23 native load customers--

24 MS. KIMBER: Yes.

25 MR. RODGERS: --significant amount of money? Is

1 that correct?

2 MS. KIMBER: Yes.

3 MR. RODGERS: Okay.

4 MS. O'NEILL: Do you see that problem as an
5 under-investment in the transmission infrastructure? Or
6 just the difficulty of getting the transmission?

7 MS. KIMBER: It's under-investment in the
8 transmission in the state.

9 MS. O'NEILL: And have you proposed ways to solve
10 that?

11 MS. KIMBER: Yes, we have. TransLink was really
12 the way we saw to solve those problems. The municipals
13 worked really well with Xcel, Mid-American, and Reliant. We
14 were going to be--in that agreement, we had guaranteed
15 numbers of dollars of investment in transmission, and we had
16 lists of projects that we knew were things that had to get
17 fixed right away, and they were going to be fixed in
18 TransLink.

19 Since then, we have talked to those investor-
20 owned utilities and the door hasn't been shut on municipal
21 participation, but it is a really slow process. And in the
22 meantime, municipals are having power supply contracts turn
23 over. They're trying to get to the market, and they can't
24 do it because the infrastructure is not there.

25 MS. O'NEILL: Was it the dissolution of

1 TransLink? I mean, why couldn't those deals be carried
2 forward?

3 MS. KIMBER: I think it's a question of will.

4 MS. O'NEILL: So you had agreement before, but
5 then now--

6 MS. KIMBER: Trying to get those individual--
7 trying to get the TransLink agreement implemented with the
8 individual investor-owned has been quite a challenge, and
9 we don't have equivalent deals with those individual owners.

10 MS. O'NEILL: And why? Can you sort of elucidate
11 why that problem occurred? I mean what set of events
12 triggered that problem?

13 MS. KIMBER: Do you mean the end of TransLink?
14 Or do you mean where we are now?

15 MS. O'NEILL: Well, I mean, I'm not sure why
16 those deals couldn't have been carried forward and I'm just
17 trying to figure out why not.

18 MS. KIMBER: Well, let's see--

19 MS. O'NEILL: I mean is it a difference between
20 TransLink as an independent transmission operator and the
21 resulting system that doesn't have one?

22 MS. KIMBER: I think that's partly it. I'm
23 trying to think about the right way to answer your question.
24 In TransLink, the, let's see, the advantages of municipal
25 participation in TransLink was that we brought low-cost

1 capital to the table, and we also brought a lot of public
2 support for TransLink.

3 You know, everybody was working together for
4 once, and it was really great. The Cornbelt Power
5 Cooperative, OPPD, NPPD, all these entities. So we
6 represented every sector of the industry working together.
7 When TransLink went down in flames, it burned a lot of
8 people, and there have been a lot of money sunk into
9 TransLink that suddenly just didn't yield anything.

10 And I think everybody sort of took a step back
11 after that point and just tried to deal with the issues at
12 hand. The issues at hand for Reliant, for example, are MISO
13 issues. The same with Xcel. And people are sort of
14 starting now to think that TransLink was really such a good
15 idea and it ought to be revived.

16 The individual companies I think haven't seen--
17 they haven't been eager to just say, yeah, let's just keep
18 going with those agreements and we'll just put our names on
19 them instead of the TransLink name on them, and here they
20 are to sign. They just haven't done it, and we've asked,
21 and asked, and it hasn't gotten done.

22 MR. BITTLE: One thing I would say about that,
23 Dick, is that you asked if the transmission had been under-
24 funded. It depends on what you want to do with the
25 transmission.

1 If you want to serve the existing load from the
2 existing generators, the answer is, no. I mean, it is a
3 good system. The question is: Do we stay with a fully
4 cost-based, regulated system--which I would be perfectly
5 happy to do--or do we move to a market? And in that
6 transition there are problems that are going to be raised,
7 and this is one of them.

8 In the Southwest Power Pool, Craig reminded me
9 that I left something out of what I was going to say about
10 the RSC. The RSC has done something in the Southwest Power
11 Pool that has just been amazing to me.

12 In about a three-month period, they have come
13 together and come up with a funding method for future
14 transmission. Basically they are saying that a third of all
15 future transmission will be shared by everyone, and the rest
16 of it will be allocated to specific zones by benefit.

17 Now there are a lot of details to that, and there
18 are still some questions about network resources, but just
19 the fact that they have been able to agree has been an
20 amazing fact, to me, and that they have come to something
21 like this that will in effect give us a way to move forward.

22 I think that one of the real problems we will
23 face is just being able to get transmission built. Even if
24 everybody wants to do it, there will still be enough
25 opposition that it will be difficult to get done.

1 MS. O'NEILL: Can I take that as an endorsement
2 of SPP?

3 MR. BITTLE: You certainly may.

4 MR. RODGERS: I would like to ask any of our
5 first four panelists to comment on the remark made at the
6 end of Mr. Wheeler's presentation where he talked about how
7 in his view the vertically integrated model can not only
8 coexist with but even support a robust, competitive market,
9 and he identified a number of improvements and enhancements
10 that have been made in the Southwest that he thought
11 promoted that goal.

12 So I would like to hear your comments on that.

13 MR. HILKE: I wasn't clear from his comments
14 whether he thought joining the RTO constituted a breaking up
15 of the vertical system, or whether he felt they are
16 consistent. If he feels that belonging to an RTO is
17 consistent with an integrated model, that's fine, but
18 general economists think about joining an RTO as a form of
19 unbundling.

20 MR. WHEELER: I would be happy to respond to
21 that. We were the leaders of the West Connect Interim
22 Committee that placed the application before the Commission
23 that got conditional approval. We have always indicated our
24 willingness to be part of, and our attempts to become part
25 of a Southwest RTO.

1 And so the answer is, yes, we remain willing to
2 do that. That is why our new initiative is designed to
3 gather more support from the necessary nonjurisdictional
4 entities with a phased approach that will gradually
5 incorporate the functions desired of an RTO to the extent we
6 can get the requisite number of people to agree. And in
7 doing so, I do not believe that would be breaking up the
8 company from a vertical integration standpoint in the way
9 that I was cautioning you not to do.

10 That's a long-winded way of saying, no, we are
11 willing and able to join an RTO if we can bring our friends
12 with us.

13 MR. ROACH: Just to add to that, I think you
14 asked can they? I think they--outside RTOs today, for at
15 least some period of time, they have to. I mean that's the
16 option right now.

17 And I think there are mechanisms to make the
18 continuation of at least the existing part of the vertically
19 integrated system work with new competition, and those
20 mechanisms are some of the things that Steve raised, and
21 some of the things that I've raised.

22 There, as Steve mentioned in Arizona, there is a
23 transmission working group where the commission staff is
24 involved pretty substantially. They have had RFPs. So I
25 think those kinds of efforts, those kinds of mechanisms, can

1 be used to move forward on a competitive market. And if we
2 can't quite get to full-scale competitive reform.

3 MR. WHEELER: Thank you, Craig. The issue that--
4 part of what we were describing is some of the steps that
5 we're talking because we can't get a group together to form
6 a coherent RTO. And I think in many respects we are
7 duplicating some of the functions an RTO would have, albeit
8 not in the same format.

9 And one of the things I neglected to mention is
10 we have also proposed an independent market monitor just for
11 APS in connection with a Section 203 filing we made
12 recently. And our hope is that that also may get some
13 traction among some of the other utilities in the Southwest.
14 I know TEP, Tucson Electric, has proposed one in connection
15 with a 203 filing they've made recently, and our hope is
16 that we can get some of our brethren in the area to also
17 subscribe to that process, not because we think it is
18 required to address market power issues, but because we
19 think it helps people get more comfort with the state of the
20 marketplace to believe that there is some additional
21 independence monitoring activities.

22

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1 MR. RODGERS: The transmission access has hurt
2 your customers, and this has been going on for some time,
3 you both claimed, in terms of problems accessing markets; I
4 am wondering if you have any evidence of or reason to
5 believe that IOUs are interested in taking over serving your
6 costumers?

7 MR. BITTLE: I don't think I said that they
8 have--that there had been a problem with AECC's costumers.
9 AECC has some long-term contracts, so we have not been
10 facing that same kind of thing. Now, some of the
11 cooperatives in the country have had problems arranging new
12 power supplies; now, does that mean someone is interested in
13 taking over their costumers? No, I don't think so.

14 MR. RODGERS: Okay.

15 MR. BITTLE: It just means that, you know, to the
16 extent that you have market power and you have the
17 opportunity to make more money or for somebody, you would do
18 it. I mean it makes economic sense to say that.

19 MR. RODGERS: Okay, Ms. Kimber?

20 MS. KIMBER: Well, I know of one case where there
21 has been interest expressed in by the IOU in taking over the
22 municipal. I think there could be more of those.

23 MR. PEDERSON: And on the issue of transmission
24 planning, I think I heard you express a concern that there
25 needs to be some kind of joint planning. I think Ricky had

1 mentioned some kind of open transmission planning, Steve had
2 mentioned in his comments that one of the ways that Arizona
3 is approaching that situation is being part of a regional
4 planning group and encouraging participants to--all
5 participants to participate in those regional planning
6 groups. My question is, is that what you had in mind or did
7 you have something more specific in mind in terms of joint
8 planning of the transmission system?

9 MS. KIMBER: Well, what I had in mind is that the
10 transmission owner in whose control area all these municipal
11 utilities are embedded with would actually meet with those
12 customers and jointly plan in that way to serve their load
13 growth. And at that time, one of our problems has been
14 getting involved early in the planning process so that when
15 a project becomes available, we would know about it in a
16 timely way and could say, we'd like 10 percent of this or we
17 will bring this much capital for this investment.

18 We don't have that right now, so if we could sort
19 of get that process started earlier together so that we are
20 planning for Cedar Falls load growth or for Cedar Falls new
21 wind generation resource, something like that, it would
22 really help us a lot. There are, you know, in MAPP, IOU is
23 split between MAPP and MAPP region, and with MAPP owners who
24 are in MISO and MAPP owners who are not in MISO. But
25 through the MAPP planning process--for example, the Iowa

1 Association For Municipal Utilities participates in that but
2 that's not the same thing as sitting down between the TO and
3 its customers and coming up with a plan.

4 MR. O'NEILL: Are you saying that MISO isn't
5 going to have a process like that?

6 MS. KIMBER: No, I didn't mean to imply that MISO
7 didn't have a plan like that.

8 MR. O'NEILL: Well, is that--do you have a
9 problem with the MISO planning process?

10 MS. KIMBER: No, I don't have a problem with the
11 MISO planning process. I'm just concerned that by the time
12 the plans have been approved, by that time, it's too late
13 for us to be participating--

14 MR. O'NEILL: But can't you--aren't you a part of
15 the MISO planning process?

16 MS. KIMBER: Part of Iowa is and part of it
17 isn't, in that process. So all the utilities, all the
18 municipals that are in the Alliant control area are
19 more--well, actually MAPP rolls up to MISO now too, so we
20 are part of that through sub-regional planning groups.

21 MR. O'NEILL: What's the reason why you are not
22 involved? I mean is it simply just that they don't alert
23 you to?

24 MS. KIMBER: Well, first of all--yeah, I think
25 it's more than they don't alert to us to when projects are

1 going to become available for us to invest in, and I'll
2 leave it there.

3 MR. O'NEILL: I mean these projects have to go
4 through a state approval process and things of that nature,
5 so I mean, isn't there time to get involved?

6 MS. KIMBER: Well, we don't have any actual
7 history about a recent project that has gone through that
8 process. Part of the problem is that no significant
9 transmission has been built in Iowa since 1983. So there
10 are small upgrades which we're not likely to be able to be
11 part of but, you know, we haven't had that opportunity.

12 MR. BITTLE: In our case, in both the Southwest
13 Power Pool and Entergy, have open access, open planning
14 processes, both of which I think were very good. But the
15 addition that I would make to it is that they be required to
16 include transmission upgrades that we offer, not just
17 suggest but be required to, unless they can show that they
18 are not in the public interest, and that goes a step beyond
19 what is available now. We can suggest, we can meet with
20 them, but there is no way to ensure that the things that we
21 think are necessary are going to be included.

22 MR. O'NEILL: You said something in your
23 testimony about transmission interconnection to act?

24 MR. BITTLE: Yes, it was one of those statements
25 that--in most areas when transmission is proposed, the owner

1 insists on owning it either outright or you give it to them,
2 plus you have to pay them a 40 percent premium to cover
3 their income tax problems. But that really is just another
4 one of those pieces that's a problem now. Most of the
5 reasons that are given for the ownership is that there could
6 be a reliability problem if they don't own it and operate
7 it; I think those can be taken care of through just a lease
8 for the operation of the transmission.

9 MR. O'NEILL: But would you be proposing any kind
10 of rule changes here like interconnection rule for
11 transmission? We have interconnection rules for generation.

12 MR. BITTLE: Well, yes, I think that there needs
13 to be a requirement that if someone proposes to build, that
14 there be interconnection requirements if somebody is going
15 to have market-based rates.

16 MR. RODGERS: Can I just follow up on that?
17 Suppose as some IOUs claim that a generator builds in a
18 really bad location --

19 MR. BITTLE: That can happen, I'm not going to
20 deny it. But there are also situations where you build
21 because that's where you have to build. In Entergy's case
22 in the late '70s, there was a plan for a coal-fire plant
23 that would have four units. That unit, the Public Service
24 Commission said, "No, you can't put four units there, AECC
25 happens to own 35 percent of it." But they moved it to the

1 north, and in doing so they had to build right at 200 miles
2 of 500 KV transmission lines.

3 MR. RODGERS: Did they put it in a bad place?

4 MR. BITTLE: No, they didn't. It was a good
5 addition to the transmission system. It has paid off long
6 term, and you have to look at those kinds of things. Just
7 because, you know, you are having to build some additional
8 transmission doesn't always mean that it's a bad thing.
9 Now, good planning takes care of that, I think that's where
10 good planning has to come in. It's one of those things that
11 if somebody proposes something that's really dumb, if it's
12 an open planning process, it's going to get pointed out very
13 quickly that that is just not a good idea.

14 MR. RODGERS: Suppose the generator thinks it's a
15 good idea though and the IOU does not think it's a good
16 idea?

17 MR. BITTLE: Well, if it's an open planning
18 process, eventually it will get to someone who is regulating
19 that, either in the individual states where it's going to be
20 built or in--you know, if it's an RTO it can be adjudicated
21 there or eventually at the FER City. I mean--but it is just
22 one of those things that--yeah, there are going be
23 differences of opinion, there's no doubt about it.

24 MR. RODGERS: Mr. Hilke, I had a question for
25 you: you raised some significant concerns in your mind about

1 the existence of vertical market power and barriers to
2 entry. Should FERC be more concerned about those in
3 traditional markets or in the so-called organized markets,
4 or is it the same concern about places?

5 MR. HILKE: In my remarks, I was basically
6 suggesting that the concerns are minimal within RTOs and
7 predominantly outside.

8 MR. RODGERS: And can you elaborate why that is?

9 MR. HILKE: Well, assuming that the RTO is in
10 fact independent, it does in fact constitute structural
11 unbundling, in our view, which eliminates the ability of the
12 vertically integrated generation owner to undertake a
13 discrimination, it also eliminates the incentive of the
14 successor, the RTO, to engage in such discrimination. And
15 as I say, that's a finding and a viewpoint which is sort of,
16 I think, have been proven to some degree by the record in
17 the U.S. and there's also a commonly acknowledged experience
18 internationally.

19 MR. BARDEE: Mr. Hilke, when you were testifying
20 earlier, you had mentioned that for utilities not in an RTO
21 or ISO there should be a rebuttable presumption. I just
22 wanted to be clear on what the issue would be at that point,
23 in particular is the issue whether the utility has engaged
24 in some discriminatory behavior or is it just the issue of
25 whether the utility has the ability and incentive to do so?

1 MR. HILKE: I wouldn't base it on a record
2 because as I indicated, I believe that there are really
3 substantial difficulties in finding and documenting cases of
4 discrimination. I'm sorry, I wouldn't base it on that, I
5 would basically--I put that phrase in my testimony in the
6 off chance that there is some other approach which might
7 ultimately work. I suggested transcoase as a possibility or
8 shared grid might be another, so I wouldn't preclude some
9 other sort of solution, but the one that which is at hand is
10 an RTO and that's why I believe that's an appropriate
11 current screen to use.

12 MR. RODGERS: In other words, from understanding
13 what you are saying, you would disagree with what Mr. Roach
14 proposed earlier where he said the Commission should pick a
15 specific case where it takes on the vertical market power
16 issue, I assume based on the factual record of that case,
17 and establishes what are the concerns the Commission has; so
18 you don't agree with that approach?

19 MR. HILKE: My concern is that I'm--I would be
20 afraid that that would then bring the Commission back to a
21 behavioral approach and abandonment of the RTO as the model
22 from which to work. I have no objections to a case in which
23 you actually find it, but I don't think that's going be
24 sufficient. I mean, historically you've got the case, it's
25 Otter Tail power, that was the naked constraint, the Supreme

1 Court's found in your favor; so in some sense the case is
2 already there.

3 But what really is happening is FERC is being
4 forced to sort of fill in what does it mean to be compliant
5 with Otter Tail Power in some way. And I'm not sure that we
6 really need to take the step backward to do that, but it
7 might be very useful to find a case where you could really
8 document it and sort of translate these stories of
9 individual market participants and to, you know, a precedent
10 that you can refer to. I wouldn't say it's useless, but I
11 don't think it's necessary, I think we are--some sense ought
12 to be past that.

13 MR. RODGERS: Thank you.

14 MR. BARDEE: Suppose in a case like that that we
15 went through the whole process and ultimately concluded that
16 the utility still had transmission market power, would you
17 recommend that we approach that as an issue only for the
18 control area, or is there a basis for looking outside that?
19 For example, if the utility could deny access for people on
20 its western border to get across to buyers on the eastern
21 border, would we also want to address the market power not
22 just within its control area but outside its control area?

23 MR. HILKE: I didn't pay you \$0.50 to ask me
24 those questions. One of the substantial problems that I
25 think is often faced is that when you are talking about

1 remedy as well as finding market power, you need to address
2 an appropriately delineated geographic market. And every
3 hour constitutes a separate market. Certainly in some
4 periods of time, the geographic market is not the same as it
5 is at other periods of time. And the problem ought to be
6 addressed for the properly delineated geographic market, and
7 in some instances that may well extend far beyond the
8 control area of a particular company.

9 MR. RODGERS: Mr. Roach?

10 MR. ROACH: Thanks, Steve. Thank you, I would, I
11 understand the theoretical underpinnings of John's
12 statements, but I would urge you not to adopt condemnation
13 by theory on a whole industry based on the potential for
14 things like this happening. When you look at your record, I
15 think you will see a dearth of adjudicated or even alleged
16 complaints that are so pervasive that you have to go to
17 structural remedies. In our case, for example, we haven't
18 had any difficulty interconnecting generators in our state.
19 We always knew how to work out the difficulties and we've
20 had a slew of them connecting there, because the state has a
21 variety of natural and regulatory and other reasons
22 hospitable to new generation.

23 I think if you fall in to the idea that if there
24 is a problem, it must be because of market power, you're
25 overlooking the fact that in many cases, as we have already

1 heard today, the issue is inadequate capacity, not the
2 exercise of market power. So I would urge you strongly not
3 to consider Draconian remedies on the basis that a theory
4 could be applicable in certain cases when you don't have the
5 factual records to back it up and in fact when the factual
6 record would suggest the problem is more capacity related
7 and not behaviorally related.

8 MR. BARDEE: Mr. Wheeler, let me ask you; it's
9 not uncommon for people of our Agency to hear outside the
10 context of a pending matter before anything is come to a
11 pending matter here. I've concerns about transmission
12 access, denials of access, et cetera, and they never result
13 in a filing here. And one explanation is what you've just
14 said, there really wasn't a problem that warranted
15 litigation, but another concern that--I don't know how much
16 weight to put on it--is that the customer really had to
17 maintain a business relationship going forward and was
18 afraid of poisoning that relationship by starting litigation
19 here. How should we balance those two possible explanations
20 for why we don't see more on the record of what we hear
21 stated before the record?

22 COMMISSIONER WHEELER: Well, I can only draw on
23 my personal experience and it runs in two different veins.
24 One is, my experience with sort of hotline calls in
25 connection with other things is that you get an awful lot of

1 very interesting calls, and many times it's impossible to
2 verify the accuracy of them. So you have to take them, as
3 you would any evidentiary presentation under oath, you have
4 to examine them and see how credible they are. So the mere
5 fact that you get hotline complaints on a particular issue
6 doesn't automatically, to me, suggest that that demonstrates
7 conclusively a huge problem.

8 But the second issue is more--the people we deal
9 within the industry, at least out in Arizona, are
10 sophisticated, tough, aggressive players, and somehow the
11 idea that they are intimidated by us, I find that hard to
12 believe. In fact we are intimidated by them. So I would find
13 it real hard to believe that somebody who felt they had a
14 legitimate gripe that we were exercising market power would
15 be afraid to bring it to your attention because of what we
16 might do to them.

17 MR. O'NEILL: Mr. Wheeler, I mean, we do have
18 record evidence on affiliated abuse that where the
19 vertically integrated company gives special treatment to
20 their affiliates. Is that not record evidence of a problem?

21 COMMISSIONER WHEELER: It very well could be, I
22 was talking about the issue--

23 MR. O'NEILL: Should we take that into
24 consideration?

25 COMMISSIONER WHEELER: Oh, I think that is one of

1 your four problems, absolutely you should.

2 MR. O'NEILL: But, I mean there is a lot of
3 record evidence in that area.

4 COMMISSIONER WHEELER: I wasn't suggesting there
5 wasn't, but my concern is that basing your decisions on
6 either theory that it doesn't match observed facts or on
7 not--

8 MR. O'NEILL: Just trying to lay out the fact
9 that it is not just theory.

10 COMMISSIONER WHEELER: Well, and I appreciate
11 that.

12 MR. HILKE: I mean, we did go through this whole
13 exercise of Order 2000, and if you look at basically Noper
14 leading through 2000, there are pages and pages and pages
15 and pages of discussion about why in fact there is an actual
16 problem. So to say that in the instance of--to say that
17 there is no evidence is really, I think, not a good
18 representation of the past record and--national record with
19 concerns about these same issues. So I don't agree that
20 this is sort of a Draconian approach to look at structural
21 remedies and plus, as I understand, RTOs aren't really
22 Draconian unless that's your representation, but you said
23 you're going to join them. So I guess I don't see it as
24 being Draconian on that basis.

25 MR. ROACH: Just quickly, I don't at all disagree

1 that structural remedies are where we want to be. I picked
2 up at least an underlying theme here in this technical
3 conference of--until we get there what can we do under the
4 existing tariff, and that's the context for my remarks. And
5 I think that there are things that can be done. Some of
6 those can be characterized as interim structural remedies,
7 again some sort of regional entity, independent transmission
8 evaluators, but as to the point about precedents, you know,
9 if someone can hand me the precedents I'll stand corrected,
10 but if we truly have to go back to Otter Tail, we don't have
11 a rich set of precedents.

12 And I think we need some--we need some in a
13 modernized world of competitive business, I pick up Dick's
14 point, I think those affiliate cases are fertile ground for
15 that. But it would help a lot to have a definition of
16 burden, what must be shown and a definition of explicit
17 instances that the Commission finds as wrongdoing.

18 MR. BITTLE: It also comes back to the fact that
19 we are trying to make a transition. If you're talking about
20 serving existing load from existing resources, there's no
21 problem. And how do you show that trying to go someplace
22 else is a market power issue and not a reliability issue?
23 Well, it's both. It's one of those things--if it prevents
24 you from being able to reach additional sources of power,
25 then whether it's an overt act of market power or just one

1 that occurs because nothing is done, it is still something
2 that has got to be addressed.

3 MR. O'NEILL: You know, I--just to clarify that,
4 the--not building transmission where it's needed and
5 economic is an exercise of market power; you're withholding
6 that capacity from the market. So it--we're not talking
7 about, you know--

8 MR. BITTLE: Well, no body is obligated to build
9 transmission for somebody else.

10 MR. O'NEILL: But an entity who isn't building
11 that transmission when it's economic is essentially
12 exercising market power.

13 MR. BITTLE: Well, when you compare it to serving
14 it from an existing resource, is it economic?

15 MR. O'NEILL: Well, I mean you have to lay the
16 predicate for whether it's economic or not, but some--you
17 know, the interesting issue with the independent
18 transmission companies is they were more than anxious to
19 build their rate base with new transmission investments that
20 doesn't seem to carry over to the vertically integrated
21 utility.

22 MS. PERL: I have a question for Ms. Kimber. You
23 described a situation where munis were having trouble
24 getting transmission and that was in context back to the
25 good old days. Do you see that situation now versus then,

1 the result of changes in institutional arrangements or
2 changes in the market, or both?

3 MS. KIMBER: I'll take the easy way out and say
4 both. When I think about--many of these utilities have been
5 buying from one supplier for decades, all right, and
6 basically through their rates they paid for the power plants
7 and the transmission system that serves them now. What's
8 happening now because of the changes in the markets is that
9 that those power plants are now being used to be sold--that
10 power from those plants is being sold to other people. And
11 so it's--in this way they're being hurt, because they're now
12 trying to buy power from those same resources, but they're
13 having to buy at a much higher rate, even though they are
14 the ones basically who--who helped pay for it. So it's
15 partly--it's partly institutional and partly market.

16 MS. PERL: Okay, so they would have a long-term
17 contract with the plant, but not an ownership stake, and
18 when the contract with the plan expired?

19 MS. KIMBER: Well, they didn't have a contract
20 with the plant.

21 MS. PERL: Okay.

22 MS. KIMBER: They had the contract with the power
23 supplier, who had the majority interest in the plant.

24 MS. PERL: Okay.

25 MS. KIMBER: Okay, and so they were being served

1 from those--Iowa resources and under regulated rates, well
2 not--their wholesale rates would be negotiated, but they're
3 still getting their resources from those same plants. There
4 hasn't been--well, there's going to be a new power plant
5 going on line in Iowa, next--in 2007. But they are still
6 the same old resources that they've been using; it's just
7 that they're now paying significantly higher for it.

8 MS. PERL: Okay, do you see any changes or
9 increases in congestion being a problem?

10 MS. KIMBER: There are increases in congestion.
11 The number of flow gates in Iowa and on the borders of Iowa
12 have increased, I can't tell you how many more there are
13 versus 1989 or something, but if you look at the amount of
14 flow gates, there are more and more. Many of them are in
15 the eastern part of the state, some of those because of the
16 way that markets work now, there's a lot--you probably know
17 from the Alliant TLR task force, there were last year many
18 significant flows going through Iowa to serve other markets,
19 not Iowa. So it's the Iowa transmission grid that was
20 suffering from the way the power flows were occurring.

21 I wanted to say one more thing, you had asked
22 whether--LSCs relationship with this power supplier
23 affected, whether it litigated or not? And I think in Iowa,
24 because we're so dependent on very few power supply
25 resources and because the power suppliers aren't required to

1 serve us, there is no requirement that they have to sell to
2 us. Yes, those relationships with our suppliers do effect
3 whether we litigate or not.

4 In some of these cases that I mentioned earlier,
5 we were lucky to get power supply contracts that we were
6 able to get. There is no requirement for any power supplier
7 to serve us.

8 MR. RODGERS: Sebastian?

9 MR. TIGER: Question for Mr. Hilke. In regards
10 to, you had mentioned as a second best perhaps or a
11 structural solution a sort of Transco model. Maybe you
12 could elaborate a little bit on what the minimum
13 requirements to sort of fulfill sort of structural benefits
14 that would come with the Transco is, you know, does it have
15 to have multiple members? Can it have one member? What
16 would ownership have to look like or Board representation?
17 Have you guys given some thought to that or you yourself?

18 MR. HILKE: When I talked about a Transco, I was
19 talking of a Transco, which would be also classified as a
20 form of RTO, with the same basic requirements as the
21 conventional RTOs we have. What I was suggesting is that,
22 we've previously expressed some concerns about the sort of
23 efficiency or operating efficiencies of non-profit RTOs.
24 The Transco is a--which is also an RTO, would have some
25 improved operating efficiency incentives, but it would still

1 have all the same characteristics as an RTO, that's the
2 context which I was speaking of it, whether it's--whether
3 the original ownership was one, two or you know, a hundred,
4 doesn't make too much difference other than the notion that
5 they ought to be big enough to encompass the relevant
6 geographic market.

7 MR. TIGER: Mr. Roach, in regards to a behavioral
8 question in terms of in-market monitoring for transmission
9 market power; what one would look for? How one could, you
10 know, since there--there is debate as to whether there is a
11 record of its existence or not, what you would--what one
12 would look for, how one could document it and how it might
13 be possible to make it possible for market participants to
14 be able to see its existence in a transparent way? If you
15 have some suggestions?

16 MR. ROACH: I think an independent transmission
17 evaluator gets in and does add credibility, that's the point
18 that --

19 MR. TIGER: Well, what I'm getting at--let's say
20 you're not the independent, I think there you're predicated
21 on somewhat being inside, right. Here I mean, are there
22 sort of OASIS solutions? Could you create a super OASIS
23 that shows where there is availability of transmission and
24 when it's been, you know, its no longer existent or, you
25 know, stuff that could be posted; stuff that could be looked

1 at by market participants. It's not just a seal of
2 approval, but that's an, you know, an operational
3 transparency issue. Have you give some thought to that or
4 is that unwieldy and--

5 MR. ROACH: I haven't really thought--I think in
6 terms of specific cases, if someone is talking about
7 building a new expansion of this system, that becomes a case
8 it--I think, if someone's talking about availability for
9 example, and they've been denied availability and they feel
10 that that's because a particular power plant owned by
11 someone else isn't on for counter flow. Now, that can
12 happen, you know, how you get to that, in my mind right now,
13 that's a pretty intense research effort, it's not a routine
14 day by day thing. So when--when I speak of access to open
15 access, right now on my mind, it's more of an intense effort
16 here, an intense case-by-case effort here, it's more
17 accommodated by an independent transmission evaluator or
18 something akin to that. Am I getting to your question,
19 Sebastian?

20 MR. TIGER: I think so, I mean, I think there is
21 two elements, right. One is sort of a longer term access
22 meaning, new investment or interconnection or--I was
23 speaking more to the sort of short term availability of, you
24 know, capacity in a system at a particular point looking at
25 TLRs for instance, how they operate? You know, how

1 ultimately they get relieved and who gets that relief?

2 Issues on an operational level, you know, that
3 might be you know resolved and I guess that's not sort of
4 the direction of this conversation, but wanted to see if
5 there were things that could be done to the OATT essentially
6 not--that are non structural that would still be meaningful?

7 MR. ROACH: I hear you, I don't want to have any
8 thing that says, look, provide this information and TLRs
9 become a clear thing. I still--and that might be true, it's
10 not something I've give a lot of thought to, but I still
11 think even for TLRs, that sort of operational issue, some
12 credibility--maybe substantial credibility is gained by an
13 independent looking at.

14 MR. HILKE: A part of what my concern as
15 expressed earlier is that, the negotiations for transaction
16 rights are extremely subtle; that even you know, wait a
17 couple hours and I'll get back to you can kill a deal, and
18 how do you distinguish that that's--you know, an appropriate
19 business decision or a form of discrimination. I mean, we
20 go into people's records all the time and see the materials,
21 but when we look at the materials from people's records,
22 they don't get down to sort of minute-by-minute discussion
23 of what they've been doing.

24 In this kind of a situation where the transaction
25 is so delicate, I think it's almost impossible to prove it

1 unless somebody is, you know, mistakenly left a big sign
2 that says we're guilty.

3 MR. RODGERS: Commissioner Kelliher has some
4 questions and while his questions are being addressed, if
5 there is anyone in the audience that would like to come
6 forward and ask some questions or make a comment, please
7 approach one of the two microphones near the front of the
8 room. Commissioner Kelliher.

9 MR. KILLEHER: Thanks, Steve. I'll start with a
10 statement in the guise of a question. The Commission's
11 transition market power test focuses narrowly on the
12 question of whether, at least with respect to vertically
13 integrated utilities--whether vertically integrated utility
14 has an OATT on file. And if so, it's deemed to have
15 mitigated its transition market power. That--that pegs the
16 question whether Order 888 does preclude the exercise or
17 transmission market power. If so it seems the Commissions
18 policy is sound and it should be retained, but if it
19 doesn't, if Order 888 does permit undue discrimination
20 transition service, then it seems unreasonable to conclude
21 the compliance with an order that allows undue
22 discrimination, can possibly preclude exercise of
23 transmission market power. Now, Ms. Kimber addressed this
24 issue in her statement and she argued that 888 does--that
25 compliance with 888 is inadequate. And then gave some

1 specific examples, I appreciate that.

2 But, the Commission has twice found that 888 does
3 allow for the exercise of undue discrimination transmission
4 service. It did so in order 2000, the RTO order; it did so
5 in the SMD proposed rule and it had, you know, pretty
6 lengthy discussion of some particular flaws in 888. Now I
7 want to allow for the possibility that the Commission was
8 wrong in those occasions, I'm curious what the panelists
9 think, Ms. Kimber weighed in on this, but I'm curious what
10 the panelists think. Does 888, Order 888, preclude the
11 exercise of transmission market power? If not, do you think
12 888 should be revised? And any specific suggestions you
13 have on exact changes that should be considered, I would
14 appreciate, either now or in writing.

15 So if the panelists could just give a short
16 answer on whether they believe 888 allows for an opportunity
17 to exercise undue discrimination or they think it prevents
18 the exercise of transmission market power, I'd appreciate
19 that. And you know, a secondary question is should it be
20 revised? Thank you.

21 MR. HILKE: Since I'm at this end, I'll answer
22 first. Our view since 1995, when we first looked at Order
23 888, is it probably would be helpful but it wouldn't be
24 sufficient. And so I would certainly not be one who
25 advocates abandoning 888 and 889, but rather to understand

1 that that was in fact a transitional mechanism to help the
2 economy move towards structural reform which is what Order
3 2000 represents. So our view is not that it isn't a useful
4 thing to have had in place, but it is insufficient.

5 MS. KIMBER: Well, you--I guess you already heard
6 how I feel about it. I believe in Order 888B and I'll
7 provide written comments, so that--if I make a mistake here.
8 There is no requirement for a load serving entity to be able
9 to get power supply from its historical power supplier at
10 cost based rates. There is no requirement that the
11 historical provider has to continue serving that utility at
12 some reasonable price, and it seems to me that we're--what
13 we're experiencing in Iowa would lead us, that we ought to
14 have that right, to be able to get cost based rates under
15 those circumstances where we just don't have access.

16 MR. O'NEILL: Is it something about transmission
17 or the power sale?

18 MS. KIMBER: I'm talking about the power sale.

19 MR. O'NEILL: Okay, so you need more than just
20 the historical rights to the transmission?

21 MS. KIMBER: Well we need the historic--we need
22 effective rollover rights. Essentially what happens now is
23 that we have rollover rights, but they do us no good, if
24 we're trying to get a new power supply source. So I guess I
25 should've said that, we need those rollover rights for the

1 new power supply source, as well as the existing power
2 supply resources.

3 MR. BITTLE: I don't think that the open access
4 tariff prevents the market power abuse, if the entity wants
5 to do it, right. It is one of those things, that as you
6 look at, how do you move to a position where that would not
7 be, it is one of those things of how do you get new
8 transmission bill. The open access tariff does not provide
9 the incentive to get that new transmission bill that would
10 allow access to those additional resources and I think
11 that's where--what needs to be addressed is, how you get
12 that incentive to change from the existing to a new regime?

13 MR. ROACH: Yeah, I would agree with--I'll use
14 John's words, it's certainly useful to have open access
15 transmission tariff, but it's not sufficient and so you have
16 to think why isn't it sufficient? And what I'm saying today
17 is, on one score it needs to be enforced; we need to put
18 some richness to the basic concept of comparability, which
19 isn't even a concept that began with 888. It began in 1994,
20 with the AP decision but case precedent would let us give
21 some richness to that and beyond that we need some, if--you
22 know, if we're not going to get the RTOs right away, if
23 we're not going to get to John's structure result and he's
24 right, we need structural results. If we're not going to
25 get that right away, can we have interim structural action

1 that helps us get to these two issues that have been raised
2 about building out the system and then about monitoring
3 these very detailed transmission issues like, whether it's
4 TLRs or building out or network resource status? And do we
5 have some interim measures we could take, and again I think
6 getting the states involved and having this notion of
7 independent transmission evaluator are two interim
8 structural changes we could use.

9 MR. O'NEILL: Craig, we've been trying to do that
10 for 10 years. What new techniques are being brought to the
11 table to deal with that problem?

12 MR. ROACH: To better enforce?

13 MR. O'NEILL: Yeah.

14 MR. ROACH: Yeah.

15 MR. O'NEILL: I mean the--that's not the--this
16 isn't a new issue; we've been working on this problem for a
17 decade. And I'm--you know, and what I worry about is that I
18 don't know what new techniques are being brought to the
19 table in order to make this process better. Just announcing
20 that we're going to work harder which is what we've been
21 doing for ten years, I'm not sure gets us anywhere. As a
22 matter of fact it just delays whatever, you know, ultimate
23 result needs to be obtained.

24 MR. ROACH: Well, again I'm not--if you're asking
25 me do I want to do anything that delays implementation of

1 regional markets and RTO, I don't--

2 MR. O'NEILL: No, but your optimism sort to tends
3 to lead me to believe that you have some new techniques that
4 you're going to bring to the table.

5 MR. ROACH: No, again just putting--all I'm
6 talking about is what we do in the interim. And I do have
7 some optimism on new--what I would consider a new
8 demonstrated--newly demonstrated mechanisms. And again the
9 regional state committee that Ricky mentioned, I mentioned,
10 I think is a successful, it's a way to break through on what
11 is a very crucial issue on who pays. So I do have perhaps
12 new optimism, because I've seen one address that tough
13 issue. I've also seen an increase, a--its not brand new but
14 it's this use of independent evaluators on a utility
15 specific basis, you know, Steve mentioned that they're
16 looking for one, Tucson has one, there is others proposed.
17 So that's a new--newly demonstrated mechanism that I think
18 that can be used in the interim until we get to full
19 regional efforts, and then just give us a case.

20 MR. BITTLE: But just so you know, not everybody
21 in the South West power pool appreciates the RSC's proposal
22 for a new transmission as much as I do.

23 SPEAKER: That's true.

24 MR. RODGERS: Mr. Wheeler, do you want to comment
25 on the Commissioner.

1 COMMISSIONER WHEELER: Yes, thank you.

2 Commissioner, I would agree it's always a good idea to
3 periodically review your policies and standards to see if
4 they're accomplishing their intended purpose. I think in
5 this particular case there you do have--you have your
6 prescriptive statements, you have your statements of
7 intention, you have your enforcement, you have monitoring,
8 you have reporting, so you do have a lot of weapons in your
9 arsenal to ensure that your goals are being reached. But if
10 you're not satisfied with them by all means, you ought to
11 take a look at it. What I would caution against is
12 mandatory structural change based on what we've seen so far.

13 I think FERC made a determination in order 888
14 and again in its SMD rule that it was not necessary to
15 require divestiture, and when I talk about mandatory
16 structural change, I'm talking about divestiture or in some
17 cases mandatory RTO participation. I indicated to John,
18 we'd like to get one that works and that's what we're
19 pushing toward, but telling people they have to do this or
20 that or divest, I don't think is justified by the
21 circumstances that exist today and I would offer you, at the
22 risk of being redundant, that sort of the Arizona example
23 of, where we can make changes that on a voluntary and
24 cooperative manner, both the state with the market
25 participants with regional interests and with FERC in a way

1 that it gets you there or at least a long way there and that
2 is a preferable approach, at what point it can work that
3 way.

4 MR. KELLIHER: --how they should be weighed by the
5 Commission. Ms. Kimber suggested that transmission
6 constraint should be considered an extra side--the existence
7 of significant transmission constraints should be considered
8 an exercise of transmission market power and I can see how a
9 significant transmission constraint are--would--are very
10 similar to an import quota that a country might impose to
11 prevent products from entering their market. And if
12 transmission constraints are such that there's only one
13 seller in a market, we all agree that the seller should not
14 have market based rate authorization in that market since
15 it's equivalent to having a 100 percent market share. Is
16 that something we can agree on, a hypothetical like that?

17 MR. BITTLE: I certainly would agree with it.

18 MR. KELLIHER: You would not agree, Mr. Wheeler?

19 COMMISSIONER WHEELER: If I understood the
20 comment right Commissioner, no I would not. Just because
21 there is transmission constraints or congestion at a
22 particular time, I don't think that tells you anything per
23 se about whether that's a result of the exercise of market
24 power or whether that's inadequate capacity for the
25 particular transaction.

1 MR. KELLIHER: I didn't mean to suggest that the
2 existence of transmission constraints is necessarily an
3 exercise of transmission market power because to me there's
4 some intent that you can infer into and exercise of
5 transmission market power seems to suggest some intentional
6 act to exclude competitors but if the existence of
7 transmission constraints regardless of why they exist, if
8 there are transmission constraints, it could either be
9 considered an exercise of transmission market power as Ms.
10 Kimber suggests, it could be considered a barrier to entry,
11 equivalent to an import quota without any suggestion of
12 intent in erecting that barrier to entry.

13 It's a barrier to entry, if there's one seller,
14 it seems hard to avoid that conclusion, or the Commission
15 could just not weigh it at all.

16 COMMISSIONER WHEELER: Well, I guess the only
17 point I was perhaps quibbling with now that I understand
18 better what your question is, there seems to be a
19 supposition that somebody did something wrong as a result of
20 that condition, and often times which you may find if it's
21 simply the lack of adequate capacity, the question is either
22 the generator, in some cases, may have sited it in an area
23 where there was inadequate capacity and that's just the
24 consequence of that or it may be that new capacity is,
25 everybody agrees, is desirable but nobody is willing to fund

1 it, so you may have--you may have a number of reasons for
2 why that situation developed, and I wouldn't automatically
3 conclude you have to go find a culprit somewhere.

4 MR. KELLIHER: Yeah, I think transmission
5 constraints arise for reasons other than malevolence of
6 transmission owner but if it exists, is it a factor that we
7 should consider?

8 COMMISSIONER WHEELER: Well, I think that yes and
9 I am trying to think of whether it's best done here or best
10 done in a regional group or best done at the state level
11 but--but obviously somebody should be looking at that--

12 MR. KELLIHER: The question before us is can we
13 authorize market based rates to a particular applicant if
14 transmission constraints exist for whatever reason such that
15 it severely limits the number of competitors in a market,
16 the Commission, I think, up to this point has not really
17 considered that. When it comes to transmission market power
18 the only issue is there a note on the file, if so, you pass.
19 Should we consider transmission constraints, when we look at
20 transmission, market power or the other barriers to entry
21 leg, which is, I think, been fairly undefined up to this
22 point what that means.

23 COMMISSIONER WHEELER: I think you can, but to me
24 that's more a subset of was it caused by the improper
25 exercise of market power, if it wasn't and it was a result

1 of some other--

2 MR. KELLIHER: Well, I think other barriers to
3 entry--it's--if you look at it in that context your
4 basically looking at is the market functional, does the
5 market work, and I don't think you're looking at is
6 there--has there been intentional action on behalf of the
7 transmission owner.

8 MR. WHEELER: But, I guess my point is if it is
9 not attributed to improper action on the part of the
10 entity seeking market based rates, I don't know why you
11 would want to make that an automatic disqualification of
12 market based rates, particularly when--when at least in our
13 area, if you deprive, say, APS of its authority to charge
14 market based rates, you've actually hurt the market in at
15 least two respects.

16 MR. KELLIHER: But in my hypothetical I'm not
17 talking of APS, you have a--you have transmission
18 constraints exist to the point where there is a one seller
19 in a market. Should a single seller in a market be deemed
20 not to have market power and be allowed to charge whatever
21 the market will bear since they're the only seller? It
22 seems hard to argue the conclusion to that is, yes, they
23 should be granted market based rate authorization.

24 COMMISSIONER WHEELER: I think in the situation
25 you just posited, yeah, I think that's something the FERC

1 should take a look at. I can't tell you how you should take
2 a look at it, we haven't really thought of it in that
3 context. But, I agree that's a worthy issue to examine.

4 MR. ROACH: Yeah, I think your question is
5 actually pretty simple. I don't think anyone would argue
6 for giving unlimited pricing flexibility to a monopoly, to
7 someone who cannot be challenged. So I think that's right,
8 and to broaden that to the question you just asked a moment
9 ago, should transmission constraints be part of the market
10 based rate authority determination? I think so, yes.

11 MR. KELLIHER: Thanks, another question, Ms.
12 Kimber, I really enjoyed your comments, it's another
13 question drawn, another two questions drawn from your
14 comments. One is your point about the obligation of plan in
15 the OATT and your argument is that it's honored in the
16 breach. Do you think the--do you think the obligation
17 should be an obligation to build or should it be an
18 obligation to plan?

19 MS. KIMBER: I think it should be an obligation
20 to build but that the municipal gets to own--gets to own
21 that transmission to participate in the construction
22 investment in that transmission. I guess my biggest fear is
23 that at some point the TO says, all right we'll build this
24 transmission and you're going to pay for it. That's not
25 right either. You have to--it has to be that the Municipal

1 gets to own and participate in the transmission to its load
2 ratio share, so that it's owning as much transmission as
3 it's using and that benefits everybody. It helps the grid,
4 there's--we don't have any reason not to build transmission.

5 MR. KELLIHER: Okay, can I ask the rest of the
6 panelists, do you think it should be an obligation to plan
7 or an obligation to build in the OATT?

8 MR. BITTLE: I would say it needs to be an
9 obligation to build and the reason that I say that is we're
10 looking for a transition from where we are to get some place
11 and without that I don't think you will ever get the kind of
12 transition that we're looking for. Now, is it going to be
13 an easy thing to do? The answer is no, it's not. There are
14 two--you get into regulatory uncertainty when you go there.
15 There's regulatory uncertainty from the fact--can you get it
16 sited, there's regulatory uncertainty, can whoever builds it
17 actually get it into a rate base and recover for it. But,
18 do I think that that ought to be something that we do not
19 move forward and address, and the answer is, no. I think
20 that the only way to do that is to move forward and find a
21 way to address it.

22 MR. ROACH: I'd be concerned with an obligation
23 to build because I'm concerned that there's a potential for
24 consumers picking up a tab for something that's not of
25 benefit to them, but the obligation to plan has to be an

1 obligation to plan in a certain way. Certainly, an
2 obligation to plan collaboratively, I think that's
3 essential, an obligation to plan in a transparent fashion
4 and an obligation to plan on a comparable basis for all
5 suppliers and for all buyers, so, you know, I think it needs
6 some depth to it--that obligation to plan.

7 MR. KELLIHER: But, excuse me, with respect to
8 the obligation to build, do you think the concern is
9 overbuilding the transmission system?

10 MR. ROACH: Put bluntly, I--you know, just an
11 obligation to build gives me some concern for the consumer,
12 yeah.

13 MR. KELLIHER: Thank you. Mr. Wheeler?

14 COMMISSIONER WHEELER: I am struggling with the
15 question, because I am relating it to our state obligations
16 to plan for and build adequate and reliable facilities, and
17 even having to meet that obligation gives us some difficulty
18 interpreting what our Commission means by that and so part
19 of the issue here would be what is meant by planning? Are
20 we supposed to plan for everybody who wants to go anywhere
21 or anybody who's building generation, who doesn't know where
22 they want to go, but wants the option to go wherever they
23 want to go whenever they want to go there.

24 I think the regional approach of having regional
25 transmission groups, even though, they're at least at the

1 moment voluntary is a much better way of building a
2 consensus just telling us, we as the transmission owner need
3 to figure out what the needs of present and future customers
4 might be is a very difficult burden without having some
5 clarity as to the nature and extent of that. I do share
6 Craig's concern about the obligation to build, unless it's
7 accompanied by some certainty of how we can do that and the
8 cost recovery and the pricing of that.

9 So I am intrigued by the concept and we live with
10 it to a limited extent at the state level, but I'd have to
11 think that one through a bit more before I would say yea or
12 nay to it.

13 MR. KELLIHER: Thank you, and my last question
14 also drawn from Ms. Kimber and relates to your response is;
15 Ms. Kimber on page nine argued that she thought long-term
16 transmission rights were pro-competitive and they don't
17 preclude entry of competitor suppliers but they might
18 instead result in a more robust transmission system, and
19 that would seem to be related to, if you are arguing in
20 favor of an obligation to build, it would seem that long-
21 term transmission rights would probably accompany that. So,
22 I am curious what the panelists think about her comments
23 about long-term transmission rights, are they pro-
24 competitive or are they anti-competitive?

25 COMMISSIONER WHEELER: I'll start off,

1 Commissioner, I believe they're pro-competitive, at least
2 our discussions with generators who've located in Arizona
3 make it clear that having that assurance is appropriate or
4 necessary for their business plan, it's also necessary for
5 their financing and it gives projects like that a better
6 footing to get started and it decreases their reliance on
7 short-term transactions, which I think at least in the past,
8 has been one of the Commission's goals, so I would think
9 it's a beneficial step.

10 MR. ROACH: I would agree that they're pro-
11 competition in the sense that they help us get the
12 transmission system built to accommodate competition. My
13 issue with long-term rights is I want to know what one gets
14 for those rights--what is that a right to. To make it a
15 full incentive to invest, I think it has to be more than
16 congestion rights. I think it has to get into use rights
17 and I think that would make those rights an incentive to
18 build--to build out the system. So, you know, I think it's
19 pro-competition if it's done right and if it's truly made to
20 be an incentive to build, to pay for a new transmission.

21 MR. BITTLE: I think there you've got to look at
22 the concentration of who owns the rights, I mean, can it be?
23 The answer is, yes; but could it also be a detriment, the
24 answer is, yes.

25 MR. HILKE: And in general, long-term contracting

1 can be very helpful in a situation, particularly in which
2 there is potential discrimination, so outside of an RTO
3 context long-term contracting is almost a prerequisite for a
4 new generator to feel comfortable about coming in and that
5 also involves, you know, the investment in the transmission
6 to make that siting economically appropriate.

7 MR. KELLIHER: Thank you very much. I appreciate
8 it.

9 MR. RODGERS: There was one person from the
10 audience who was standing there for a while, Jack Hawks
11 awaiting to approach the microphone, if you want to come and
12 identify your organization?

13 MR. HAWKS: My name is Jack Hawks, with the
14 Electric Power Supply Association. I do not have a global
15 question for the panel, it's only for Steve Wheeler. Your
16 statement on that--when you ended your remarks about
17 vertically integrated utilities being necessary and
18 complimentary and compatible with competitive markets,
19 obviously you got my attention and I was--

20 My question is how many caveats do you attach to
21 that statement, and the specific ones I have in mind are:
22 one, membership in an RTO or at least in the Arizona
23 situation with the ISA; two, the fact that there is a no
24 native load preference and that you have retail choice or at
25 least fully--a fully contestable load, the way you said; and

1 three, the existence of--in a region of a lot of different
2 ownership of generation. Obviously, in Arizona you've got
3 10,000 plus megawatts of merchant owned, plus what the IOU's
4 own, plus what the public's would own, are those the three
5 caveats you had in mind with the statement on compatibility
6 or were you making it more generally?

7 COMMISSIONER WHEELER: Jack, I am not sure how
8 good an answer I can give to you on that. I was certainly
9 making it with reference to our own situation to the extent,
10 and I wasn't intending by that statement to limit it to
11 having to have those prerequisites present in order for the
12 statement to still hold, but I would think if--on a broader
13 scale if you were to try to apply it, is that always true in
14 all cases? I wouldn't go that far but I would say in the
15 past an industry model that's had vertical integration, I
16 think you can find many instances where the economies that
17 have resulted from that have been beneficial, and that their
18 continued existence can coincide with a competitive market
19 in a way that both benefit.

20 I just don't subscribe to the notion that a
21 robust competitive market and having vertically integrated
22 utilities are mutually incompatible. Now, there may be
23 areas where they are, just because of the way the market's
24 functioning or the way that the utility is behaving, but I
25 was just--I was railing against a categorical false

1 dichotomy.

2 MR. HAWKS: Okay, thanks.

3 MR. RODGERS: If there's no other questions, why
4 don't we break for now and reconvene at 1:25 where we will
5 have our second panel. Thank you very much.

6 (Whereupon, at 1:00 p.m., a luncheon recess was
7 taken.)

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1 disagree with. I think that's very helpful for all
2 concerned.

3 Without further ado, why don't I introduce our
4 first panelist today who is Sue Kelly, who is Vice-President
5 of policy analysis and general counsel with the American
6 Public Power Association. Sue?

7 MS. KELLY: Thank you. Is this working?
8 I want to thank you for giving me the opportunity to present
9 here today on behalf of APPA. And we are going to be
10 speaking on how to prevent or mitigate the exercise of
11 transmission market power by FERC-regulated public utilities
12 that hold market-based trade authority.

13 And we understand when you say transmission
14 market power to mean the misuse by holders of market-based
15 trade authority of their ownership or their control of
16 transmission facilities to benefit their own market-based
17 trade sales or generation facilities to the Dutchmen of
18 other power sellers. So that's my--that's how we defined it
19 and that's what I'll be speaking about.

20 I'm going to concentrate primarily on question
21 number 10 in the handout that you--agenda that was sent out
22 prior to the conference, which says, does the Commission's
23 pro forma open access transmission tariff adequately
24 mitigate transmission market power; if not, specify whether
25 there are ways the tariff could be modified or better

1 enforced to achieve this goal.

2 To answer Commissioner Kelliher's question, even
3 though he's not here, the open access tariff was a very
4 substantial improvement over the status quo anti, but it has
5 not erased undue discrimination in the provision of
6 transmission service. Residual transmission discrimination
7 is still an issue for APPA members as you heard in the
8 morning panel. I'm suggesting in my statement three
9 different approaches that the Commission could use to
10 address this problem.

11 But first, I actually want to agree with Mr.
12 Wheeler from the morning panel and worry a little bit about
13 that but, you know, I'm going to go ahead and do it. We do
14 not believe that vertical integration per se is nasty,
15 rotten and dirty. As a matter of fact, APPA members, many
16 of them are vertically integrated because they own the
17 generation transmission facilities they used to serve their
18 member owners.

19 In addition, some of them are vertically
20 integrated by contract. They may not own transmission but
21 they have long-term contracts for transmission, which they
22 use to move their resources, both owned and contracted for,
23 to their load. So they are vertically integrated by
24 contract.

25 So we don't think that vertical integration is

1 necessarily inconsistent with wholesale competition, as you
2 know, we've been early and strong advocates of wholesale
3 competition. I would note that public power members in
4 general rely, as a group, 70 percent or so, on third-party
5 supply. So we only supply 30 percent of our own generation.
6 We buy the rest on the market, which is why we have such a
7 strong interest in this issue.

8 I would note that most holders of market-based
9 trade authority, if you look at the list of entities that
10 hold that, are not in a position to exercise transmission
11 market powers simply because they do not have enough
12 transmission to do so. When it comes to transmission market
13 power in the market-based rate context, you're really
14 talking about a pretty small subset of the holders of
15 market-based trade authority, those that own and control
16 both substantial generation and transmission in the same
17 geographic area. And that generally means the investor-
18 owned utility service providers that have been the dominant
19 sellers and dominant transmission providers in their areas,
20 you know, since time immemorial.

21 The issue at hand is, therefore, what mitigating
22 conditions can be placed on their market-based trade
23 authority to mitigate the possible misuse of market power
24 and transmission. Let me talk a little bit about the three
25 conditions that we are suggesting here and that's only, you

1 know, we--obviously we have more but, I'm limited in time.

2 The first is enforcement of the network service
3 provisions of the open access tariff. The Commission needs
4 to revisit the network service tariff. Under the current
5 OATT, the network customers, who are usually embedded
6 utilities in the control area of the utility, are required
7 to pay a low ratio share of all the transmission system
8 fixed costs of that provider, based on their system usage.
9 And in return, those providers are supposed to include in
10 their transmission system, planning the loads and designated
11 network resources of their network customers.

12 As a matter of fact, if you look at section 28.2
13 of the tariff, it says "the transmission provider shall
14 include the network customers' network code, in its
15 transmission system planning. And shall consistent with
16 good utility practice, endeavor to construct and place into
17 service sufficient transmission capacity to deliver the
18 network customers' network resources to the network load."

19 So it's there, you were asking this morning,
20 Commissioner Kelliher, whether there is an obligation.
21 There is at least an obligation to, you know, use their best
22 endeavors to make sure that that transmission is planned and
23 constructed, okay? So I want to make that very clear.

24 In addition, transmission providers are supposed
25 to provide rate credits for the customers' transmission

1 facilities if they met the integration standard that's set
2 out in the tariff. And in addition, they were supposed to
3 also play credits for new transmission facilities on a
4 going-forward basis that were jointly planned. So the idea
5 was, or the hope was, of network customers that they would
6 become almost partners in the transmission system, partners
7 in the planning that--and that their loads and resources
8 would be treated comparably.

9 Generally, I have to say that has not happened.
10 Network customers have remained second-class transmission
11 citizens. There's been little joint planning of
12 transmission system facilities. In part, because if you
13 jointly plan, then you have to give the credits, if you
14 don't jointly plan, you don't have to give the credits. So
15 there's an economic disincentive to plan with network
16 customers, okay?

17 And when network customers attempt to designate
18 new network resources, especially when they attempt to color
19 outside the lines, which means to get a designated network
20 resource, which is not a traditional generation unit of
21 their transmission provider, they're told that service is
22 not available at all or is only available if there are very
23 substantial transmission upgrades constructed. And you can
24 imagine who's going to be paying for those.

25 That--so even though we are already paying a load

1 ratio share of all the transmission system facilities. So,
2 you know, that's the paradigm and I think Ann discussed that
3 this morning. She's an extreme case but, you know, that's
4 the kind of stories that we hear from certain of our
5 members.

6 The result is that network customers have not
7 been able to diversify their loads or, excuse me, their
8 resources to the extent that they'd hoped, and many of them
9 are renewing the power supply agreements they have with
10 their traditional suppliers, sometimes at higher market-
11 based rates. Others are pursuing what I call, the Robinson
12 Crusoe supply strategy, which is, build it yourself and
13 build it as close to your system as you possibly can,
14 because that reduces the transmission system risk. You know,
15 it's like making your own clothes.

16 The problem with that of course is that that does
17 not facilitate a robust wholesale market. Because what
18 you're doing is instead of going out you're building it
19 close to yourself and you're building it yourself. So that
20 is not the kind of behavior that, you know, we're supposed
21 to be seeing once we had open access tariff, but the
22 perverse operation is that that's often what is happening.
23 So the Commission needs to investigate these provisions of
24 the tariff.

25 The Commission has been very preoccupied in

1 recent years with RTO formation and standard markets
2 assigned, and you have been content to assume that unless
3 you hear about problems brought to you by customers, that
4 all is well. I don't think that approach is sufficient when
5 it comes to this network service.

6 Network customers are frankly reluctant to take
7 affirmative action because they have to depend on these
8 transmission providers and traditional power suppliers for
9 the vital services that they need; and the issues as Mr.
10 Hilke pointed out, are very subtle and very difficult to
11 prove. It's often simpler and safer to go along to get
12 along than it is to pull the tiger by the tail, especially
13 when you live in the cage of the tiger.

14 The Commission however, you all can ask these
15 hard questions. And you can ask whether they're jointly
16 planning, and if not, why not. You can ask if they're
17 providing credits for facilities, and if not, why not. You
18 can ask how requests for designations of new network
19 resources are being treated. What kind of a--system
20 assumptions are there in the model? How are third party
21 generator's request for designation as a network resource
22 treated?

23 These are all very important questions and if you
24 don't get the right answers in a particular case then you
25 need to think seriously about conditioning the market-based

1 rate authority of that seller to make clear its obligations
2 to its network service customers. You should require and
3 not just encourage joint planning. You should ensure that
4 proper credits are provided and you should ensure that
5 there's comparable treatment of network customers' new
6 resources and load growth.

7 All of this will increase the ability of network
8 customers to purchase from third party suppliers and that
9 will enhance and hopefully help a well functioning regional
10 wholesale power market. The second recommendation I have is
11 joint ownership of transmission facilities, and this was
12 discussed this morning, so I won't go into this in great
13 detail, but by diversifying transmission system ownership
14 among all the entities that the system serves, that will
15 reduce the ability of dominant transmission owners to
16 exercise market power.

17 And it will also resolve a lot of these disputes
18 about who should pay for what, if you actually have a chance
19 to own it rather than rent it, you might be more willing to
20 put some money in for it. And I think Ann discussed that as
21 well, so I will not go over it, except to say that this is
22 an alternative to allowing incentive rates. And you should
23 be asking people when they apply for IOUs that apply for
24 incentive rates, whether or not they've looked to other
25 sources of capital including their own network customers.

1 Another way to encourage it is to permit network
2 customers the opportunity to buy into the load ratio share
3 of the existing transmission system. And this is a big
4 step, but these customers are already paying their load
5 ratio share of the facilities and offering the opportunity
6 to own rather than rent with diversified transmission
7 ownership, and it would lay the foundation for a more
8 inclusive joint transmission planning process.

9 It's not a new or untested concept, it's in place
10 in a number of different arrangements and different areas of
11 the country including Vermont, Wisconsin, Georgia, Indiana,
12 Michigan, Minnesota--I mean it is done.

13 The third recommendation I have is regional
14 transmission planning and here I have to concur with the
15 comments of Mr. Roach. Even outside an RTO context, one can
16 encourage a grassroots regional transmission planning
17 process in which state authorities should have heavy
18 involvement. In the end, they're going to have to be the
19 ones that have to site it and justify it in State and local
20 communities, so you might as well get them involved up
21 front.

22 The development of such a grassroots open and
23 inclusive transmission planning process, I think would be a
24 substantial step forward in regions of the country that
25 don't have RTOs. And let me make clear here, I am not

1 suggesting RTO participation be made a requirement, I'm
2 suggesting that regional planning can be done in a variety
3 of contexts. Mr. Wheeler talked about the voluntary
4 regional and sub-regional transmission planning processes
5 that are taking place in the west with both jurisdictional
6 and non-jurisdictional utility participation. So it can be
7 done.

8 And such regional processes need to be inclusive
9 and allow meaningful input. There are many other aspects of
10 the OATT that we could talk about: ATC, rollover rights,
11 you know, transmission Q procedures, handling of study
12 requests but--and I don't have the time to talk about them,
13 and I very much appreciate the opportunity to have the time
14 that I did have. Thank you.

15 MR. RODGERS: Thank you, Sue. Appreciate that.
16 Why don't we turn to our next panelist this afternoon who is
17 John Stout. He is the Senior Vice President of Reliant
18 Energy, and he is representing the Electric Power Supply
19 Association this afternoon, welcome.

20 MR. STOUT: Thank you, Steve. Let me begin by
21 the usual caveat, you know, that I'm representing EPSA, the
22 comments that I make may not necessarily reflect the views
23 of all EPSA members. I'm really speaking from my personal
24 35 years of experience in this industry, 25 years as a
25 transmission planter and control center operator. And then

1 about 10 years ago I moved to the other side of the fence,
2 and now I'm a large, independent power producer with plants
3 all around the country and a large retail LSC with a lot of
4 retail loads scattered around the country.

5 I think you're going to find that the
6 presentation I make focuses on the premise that you heard
7 suggested this morning and that is, it's not necessarily
8 what transmission owners do that calls us transmission
9 market power, but the things that they don't do.

10 The first solution that I'd like to throw out for
11 you, since this presentation is about solutions, is that
12 FERC needs to promote transmission owners and operators to
13 use best available transmission technology. And let me give
14 you a simple example of what I mean by that, Dynamic Line
15 Ratings. The rating of a transmission path, in many cases,
16 is limited by the temperature limits of the conductor that
17 constructs that path, what we call Thermal Line Ratings.

18 Those line ratings are nothing more than a
19 calculation of what the temperature of that conductor gets
20 to be, when you have a certain amount of current flowing
21 through it and there's a limit to how hot a conductor can
22 get, either caused by the sag of the conductor or the
23 physical characteristics and the strength of the conductor,
24 it can start to deteriorate the conductor if you get it too
25 hot.

1 But going into the calculation of line ratings
2 are some assumptions regarding what ambient conditions are
3 rating that conductor under. And typically, those
4 calculations are based on worst-case ambient conditions.
5 Very high air temperatures like 95 or 100 degrees Fahrenheit
6 and very low wind speed almost near calm conditions.

7 The problem is those conditions don't exist 24
8 hours a day, 365 days a year. That is a worst-case
9 scenario. And when you use those sort of calculations to
10 say this is the thermal limit of what we can carry on the
11 line and, therefore the path rating that we can allow
12 marketers to use, you unfairly limit the flows across that
13 particular line. Those conservative calculations give you
14 very nice tables to use in your control center, to put out
15 in various filings and reports as to what the path ratings
16 are.

17 But unfortunately, they deny the public the
18 benefit of a lot of capability that are in those lines. You
19 know, I've got a lot of generators that produce more power
20 when the outside ambient air temperatures are cold, that's
21 typical to almost any combustion turbine. If I were to
22 refuse to offer that into the market, I'd be accused of
23 withholding capacity.

24 The same exact thing is true of transmission
25 lines. They can carry, in many cases, a great deal more

1 power during colder ambient conditions or periods when the
2 wind is blowing quite hard and yet that transmission
3 capability is denied from the market. People are literally
4 withholding transmission capacity. What dynamic conductor
5 ratings do is simply substitute a real-time calculation
6 based on ambient conditions of what that conductor can carry
7 at the time.

8 And this technology has been around for at least
9 10 or 15 years. When I was at the old Houston Line and
10 Power Company control center, we used it about 15 years ago
11 and implemented it on nothing more than a personal computer.
12 And what we found was, in one year of operations, as best I
13 recall, we had about a dozen situations where we had
14 overloaded transmission lines. When we went back and
15 checked to see what the ratings of the lines really were
16 based on the actual ambient conditions, not a single one of
17 those was actually an overload and we didn't have any
18 problems allowing the transactions to continue to flow and
19 not having to interrupt any customers.

20 This technology has actually developed quite a
21 bit from 15 years ago. They now have devices that you can
22 actually clamp directly on the conductor to measure
23 conductor temperature. And they can feed the output of
24 those devices directly into the computers, that feed the
25 OATT systems, so that people--the OASIS systems, I'm sorry,

1 so that you can actually calculate in real time what the
2 available transmission capacity is left on a particular
3 path.

4 This solution basically is to suggest that FERC
5 should not allow transmission operators to roadblock
6 competition simply by imposing overly conservative conductor
7 ratings on their facilities. They should require
8 transmission owners to provide these dynamic types of line
9 ratings. The technology is there; it's the best available
10 technology that's available to everyone in the market. Many
11 people are using it, but not everyone. And in fact,
12 everyone should be using it because not to use it is denying
13 a lot of the benefits of competition to customers.

14 The second comment I'd make is that FERC should,
15 in order to promote some additional solutions, should
16 promote the use of best available transmission practices.
17 And what I mean by that is if you stop and think about the
18 transmission constraints that limit the flow or path,
19 they're typically modeled by a computer program that takes a
20 snapshot of the system during a very brief period of time
21 where you have certain peak load conditions, you have a very
22 specific generation pattern, you have a single contingency
23 typically occurring where they study every possible
24 contingency in the system and identify the worst possible
25 single contingency, and in the worst-case ambient

1 conditions.

2 The risk of that particular event occurring is
3 really quite small. It may be one in every four or five, 10
4 years maybe. But that forms a boundary as to what you can
5 allow to have happen on the system that may require a new
6 independent power producer to have to build a brand new
7 transmission line just to fit--fix the grid, in the event
8 all those circumstances come together simultaneously.

9 In many cases, that's not a prudent thing to do.
10 The more prudent thing to do is to examine whether or not
11 there are operational solutions that can fix those problems.
12 Some of those operational solutions are incredibly simple,
13 in some cases all you have to do is open a switch, and
14 opening that switch relieves the overload without causing
15 any additional overloads on the grid. Most transmission
16 operators urge their planners and engineers and operators to
17 look for solutions like that, when the cost of building that
18 upgrade is coming from their pocketbook.

19 But when independent power producers are
20 interconnecting to the grid and situations occur where
21 operational solutions could fix the problem, in most cases
22 transmission owners say that operational solutions are not
23 permitted for a third-party independent power producer;
24 instead you have to pay for a major facility upgrade. I
25 believe it's critical that we make sure that in order to

1 avoid that situation from happening, that FERC require
2 transmission operators. If they use operational solutions
3 for their own customers and for their own facilities, they
4 should make them available for independent power producers
5 when they do the course of those interconnection studies.

6 The last comment that I'll make about operational
7 solutions is perhaps the most important type of operational
8 solution, it relates to congestion. You hear people all the
9 time talking about the need to have a system for curtailing
10 transactions when congestion exists on the transmission
11 system. That's a misnomer. In fact, it's very false and
12 misleading. No one actually curtails a transaction. If
13 they did, lights would go out because you wouldn't have
14 enough generation left once you turn the generation down to
15 serve the load. What actually happens when you have
16 congestion on the transmission grid is someone has to
17 actually schedule an offsetting flow.

18 So if you've got a flow going this direction
19 causing an overload, what you really do to fix this, create
20 another flow going the opposite direction that reduces the
21 net loading on that transmission facility. And you create
22 that offsetting flow by decrementing one generator and
23 incrementing another generator.

24 The people that operate transmission systems have
25 invested a great deal of money in very complex modeling

1 programs that allow them to identify with great specificity
2 exactly which generators need to be curtailed. It's very
3 easy to extend that capability, that practice one step
4 further and look at the other half of the equation, identify
5 which generators perhaps need to be incremented. So that
6 you combine the two of those and rather than curtailing
7 transactions and causing people to have to scramble for what
8 power to use to replace the cut transaction, you instead
9 just schedule that offsetting flow. It's something that
10 ISOs do everyday and it's something that the capability
11 exists for every transmission operator to do.

12 It's a simple matter of making sure that
13 transmission operators don't just do a halfway job when they
14 have congestion on the grid. It'll help reliability and
15 it'll help the economics for customers in the end by
16 improving the ability of people who do transactions to
17 manage the risk of congestion.

18 Let me close just by saying that I tried to point
19 out to you that not all of the actions that TOs do to cause
20 market power to be exerted or actions are in the affirmative
21 nature. Some of them are simply not doing things that they
22 ought to be doing. The impact though is exactly the same,
23 as if they took affirmative action to roadblock competition
24 that keeps the cost of transmission high. It roadblocks new
25 generation and it protects their turf. All those things

1 work to the detriment of customers.

2 And I believe that FERC, through mechanisms that
3 it has at its disposal, needs to take action to make sure
4 that those sort of roadblocks do not occur and the
5 transmission operators and owners are encouraged to use all
6 available best practice--transmission practices and best
7 available transmission technology. Thank you.

8 MR. RODGERS: Thank you very much, Mr. Stout.
9 Let's turn to our third panelist this afternoon, who is
10 Benjamin Hobbs, and who is a professor at Johns Hopkins
11 University. Welcome.

12 DR. HOBBS: Thanks for the opportunity to speak
13 today. I'm also a member of the California ISO market
14 surveillance committee, but anything I say here is my own
15 fault and not theirs or Johns Hopkins'. I'm also an advisor
16 to the Dutch government's transmission and market issues and
17 likewise, even though I'll be mentioning some of the results
18 of the studies for them, these are my own opinions.

19 I was asked to talk today because I guess I
20 represent the community that speaks computer modeling, in
21 the phrase that Craig Roach used this morning. I'm going to
22 be addressing the use of methods to assess the economic
23 benefits of transmission reinforcements, that is, the
24 benefits of congestion relief recognizing the potential for
25 strategic behavior.

1 Although most of my examples will deal with
2 strategic behavior by generation, it's also applicable to
3 strategic behavior on the part of transmission, which is
4 actually a huge issue in the case of Northwest Europe for
5 many of the reasons that John Stout just recommended. We
6 have very conservative engineers who'd like to have very
7 conservative thermal limits even though the systems are
8 winter peaking and don't ever approach those. It gives
9 certain countries distinct advantages in the market,
10 unfortunately.

11 My presentation is in two parts. First, I'll
12 talk in general how the economic rationale for transmission
13 reinforcements has changed under the new wholesale market
14 regime. And then second, I'll talk about a specific example
15 of an economic evaluation methodology that's been
16 implemented in the state of California by the ISO there.
17 It's a set of economic and risk analysis techniques that
18 attempts to, among other things, explicitly quantify the
19 market power mitigation benefits of reinforcements.

20 While first--this is reiterating the point that
21 Craig Roach made this morning and others have made, I'm
22 sure, in this room many times before, that the grid as it
23 exists today was designed for a different set of needs by
24 regulated monopolies who want a reliable system, it wasn't
25 built for trade.

1 Back in those days, subject to the legal
2 obligation to serve all demand at the regulated retail
3 price, a vertically integrated monopoly had no incentive to
4 withhold output and, you know, the issues of market power
5 and the benefits of transmission to mitigate that never came
6 up.

7 Contrasting that situation to an idealized
8 wholesale market regime in which owners of local generation
9 are financially independent of the transmission network
10 operator, we have a situation where owners of such
11 generation can increase profit by bidding and scheduling
12 their output so as to raise prices to benefit themselves.
13 And their ability to do this depends on all sorts of things:
14 how conservative the German engineers or the Arizona
15 engineers, whomever, are in defining thermal limits of
16 lines, the network configuration, the level and location of
17 loads, and the amount of capacity the firm owns.

18 In most large population centers, the limits of
19 the transmission network designed for the old regime can
20 convey tremendous market power to whomever owns generation
21 within those regions. So, I'll talk about a couple of
22 examples of this, a couple obvious ones and then maybe a
23 couple ones that maybe aren't so obvious of what sort of
24 problems this causes.

25 The obvious case is when the local load exceeds

1 the amount of capacity available to bring in power into a
2 local area. Then, if you have a generator who owns the
3 generation locally, all of it, they're pivotal and they can
4 raise the price well above marginal cost. And, as a result,
5 you see locational prices whose differences do not at all
6 reflect marginal generation costs. For example, early in
7 the California crisis in 2000 when the price cap in the
8 real-time market was \$750, the congestion between the
9 southern and northern zones was such that the price
10 differences were as high as \$700, even though the marginal
11 cost differences were an order of magnitude less than that.

12 Now even if no firm is pivotal, the isolating
13 effects in transmission can lead to price mark-ups and the
14 possibilities for this in the eastern interconnection were
15 shown by a Ph.D. thesis by Udi Thelman -- who I understand
16 now works for FERC but used to work at Hopkins -- where he
17 simulated the entire eastern interconnection, including 800
18 companies. But just because you had many companies in an
19 unconcentrated market didn't mean that there were many
20 places where there could potentially be market power
21 exercised and, in particular, his thesis identified the
22 midwest and the south, which between transmission
23 constraints and the relatively large size of the companies,
24 could present problems under an RTO-style wholesale market
25 regime.

1 Furthermore, Kirkoff's laws result in types of
2 market power that aren't envisioned in, say, natural gas
3 markets, for example, who can pay for a multi-plant company
4 to expand output from an uneconomic plant to congest the
5 line into a region, precluding competition from outside the
6 region.

7 Analysis by myself and, I have to confess, some
8 very enjoyable colleagues from within FERC, including Dick
9 O'Neill, we looked at the impact of increasing competition
10 in such regions, and that can actually lower competition in
11 the region as a whole and raise prices by causing
12 inadvertent congestion.

13 Kirkoff's laws can also give owners the phase
14 shifters, the ability to cause some congestion and lower
15 competition. So these are all things that need to be
16 considered in economic evaluation of transmission additions.

17 So we need to consider it, but it gets a lot more
18 complicated. A number of analyses have shown that if you do
19 factor in strategic behavior, the value of transmission
20 additions often increases but can also decrease, too. You
21 don't know ahead of time until you actually do the analysis.

22 For example, our analysis of the value of
23 additions in Northwestern Europe showed that the marginal
24 value additions under the market as it's structured now,
25 which is very oligopolistic, is roughly double that under a

1 situation where everybody bids cost.

2 But on the other hand, the value of reinforcing
3 the Dutch/Belgian interconnector, given the presence of a
4 very large monopolist who's somewhat protected by the
5 government on one side of that connector -- I won't say
6 which side -- it turns out the value in that situation of
7 increasing the connector is actually less than it would be
8 under competition. You don't know until you do the
9 analysis.

10 Okay. So modeling of market power when doing
11 economic analyses of transmission reinforcements is
12 difficult, but I think we ought to do it. And now I'd like
13 to tell you a little bit about how the California ISO is
14 trying to do that as an example of what might be done. To
15 my knowledge, they are the only ones who've tried thus far
16 in an actual transmission planning process to assess the
17 impact of transmission reinforcements upon market power and
18 what the benefits thereby are for consumers.

19 This is called the transmission economic
20 assessment methodology. It proposes five enhancements to
21 typical-type transmission studies, including multiple
22 scenarios and looking at the benefits, multiple
23 perspectives. For today, the important thing is what are
24 the benefits of relieving congestion in terms of increasing
25 competition?

1 And I'd like to talk about just a couple little
2 case studies. One is PATH 15, which actually preceded the
3 team methodology but included many of its principles. The
4 California ISO put together an empirical model which related
5 market conditions, the amount of excess supply, the amount
6 of contracted load, the amount of available transmission
7 capacity, to price cost mark-ups. And market conditions
8 were summarized by an index called the Residual Supply
9 Index, or RSI. Applying those mark-ups in a zonal market
10 simulation model provided then projections of what prices
11 and consumer benefits would be with and without an
12 improvement to PATH 15, which is the link between Northern
13 California and Central California.

14 Under a normal hydro year, the benefits to
15 Northern California load ranged under this model from \$12 to
16 \$70 million, depending on the amount of new generation
17 construction. And in a dry year, those numbers might be two
18 or three times that amount. 80 to 90 percent of those
19 benefits to Northern California consumers were calculated to
20 be due to reduced market power. That is, if you calculated
21 the benefits the way transmission economic planning is
22 usually done -- just by looking at production cost savings -
23 - you get a much smaller benefit to consumers; in fact, the
24 benefits shrink or evaporate almost entirely as a result.
25 The roughly \$300 million cost of the PATH 15 upgrade is much

1 more likely to be justifiable if market power mitigation
2 benefit is recognized.

3 Turning to PATH 26, which is the other famous
4 link in California, that study was completed last summer and
5 the results again indicate that recognizing market power and
6 the market power mitigation effect of additional
7 transmission capacity can drastically change the net
8 benefits picture. I'll refer to just a couple of the many
9 dozens of scenarios they considered; I'll highlight the
10 reference cases.

11 If you assume competitive behavior, cost-based
12 bid pricing, the benefits in 2008 overall to the Western
13 United States would be on the order of \$1 million, which is
14 very small compared to the cost of the facility. But if,
15 instead, you used the mark-ups that were predicted by the
16 Residual Supply Index analysis, the societal benefits grow
17 about five-fold and California ISO participants gain by
18 almost \$17 million. And in the year 2013, the other year
19 they considered, you see a similar relationship: very small
20 benefits if you assume everybody is being a nice guy and
21 bidding their cost; much higher benefits if people who are
22 favorably situated can raise their bids and exercise market
23 power.

24 They estimated that the most likely benefits to
25 the California participants was on the order of \$11 to \$18

1 million, which compares -- is roughly the same order of
2 magnitude as the costs of \$10 to \$20 million per year. So
3 it indicates that PATH 26 might be economically viable, but
4 would be a lot less likely to be so if market power
5 mitigation benefits are disregarded.

6 I'd just like to conclude with a couple of
7 caveats: one is that, although I recommend the use of
8 empirical and gain-theory models to simulate mark-ups, by no
9 means am I saying that the use of empirical mark-up
10 relationships in the California methodology is perfect.
11 There are all sorts of assumptions in the model
12 specifications, the system may have changed since the 2000-
13 2001 data they used in ways that are important for the
14 model, the model can't predict location-specific mark-ups.
15 So any single methodology or set of predictive mark-ups will
16 surely be inaccurate.

17 So the more reasonable course, though, is not to
18 disregard mark-ups altogether, but to develop alternative
19 plausible scenarios and mark-ups and explore their
20 implications for market prices and the benefits of upgrades.

21 The other thing I wanted to say is that I started
22 out my career 30 years ago assessing the environmental
23 impacts of overhead transmission lines upon ecosystems and
24 aesthetics. And my opinions haven't changed very much since
25 then about how desirable or undesirable stringing lines

1 across the landscape are. I don't think that transmission
2 reinforcements ought to be the primary structural response
3 to market power. Other solutions can, in many
4 circumstances, be less expensive while avoiding the need to
5 string new wires.

6 As an extreme example, Britain was considering a
7 very expensive undersea cable to Norway, not only in part
8 for market power mitigation, but that would have had a
9 miniscule impact compared to the impact over the last 10 or
10 15 years of diminished market concentration in the U.K.
11 market. So what I'm saying is that economic analyses of the
12 value of diminished congestion in power markets should
13 account for the effects on price mark-ups and strategic
14 behavior, and that accounting can significantly affect
15 project net benefits.

16 Thank you.

17 MR. RODGERS: Thank you, Mr. Hobbs, appreciate
18 that.

19 Our next panelist this afternoon is Paul McCoy,
20 who is the Executive Vice-President of Trans-Elect, and he
21 is today representing the Midwest Stand-Alone Transmission
22 Companies. Welcome.

23 MR. MC COY: Thank you. I'm appearing today on
24 behalf of the Midwest Stand-Alone Transmission Companies,
25 otherwise known as the MSATs, a group consisting of a Trans-

1 Elect subsidiary, the Michigan Electric Transmission
2 Company, along with American Transmission Company, Grid
3 America, and International Transmission Company.

4 The MSATs are stand-alone transmission companies
5 operating within the Midwest ISO. In total, we own and/or
6 operate 32,000 miles of transmission facilities representing
7 a gross investment of over \$5 billion. Service over these
8 facilities is provided at cost-based rates pursuant to the
9 terms and conditions of the Midwest ISO tariff. This is our
10 only business. We don't own generation resources, buy or
11 sell energy, or otherwise participate in the energy markets.
12 Consequently, our interests in this proceeding are distinct
13 from those of most other industry participants and do not
14 relate directly to Market-Based Rate authority. Instead, we
15 are interested in the broader issues which are likely to be
16 touched upon in this proceeding relating to transmission
17 ownership and operation. We believe we can offer the
18 Commission a unique and valuable perspective on several of
19 these issues.

20 First: the term "transmission market power" is a
21 misnomer in the context of this proceeding. When
22 considering whether to grant an energy seller Market-Based
23 Rate authority, the Commission is not concerned with
24 transmission market power per se but, rather, with the
25 potential for a seller to gain an anticompetitive advantage

1 in energy markets by virtue of its authority over
2 transmission facilities. In this context, the better term
3 is "vertical market power," defined as the ability of the
4 seller to make energy sales at above-market prices because
5 of its ownership and/or management of transmission. This is
6 a very important distinction.

7 Entities such as RTOs and stand-alone transmission
8 companies may own and/or control significant transmission
9 facilities, but they are not sellers of electricity and,
10 thus, would have no interest in using their ownership,
11 management, or control of these assets to manipulate market
12 outcomes or create any barriers to entry. This is one of
13 the important structural benefits of forming RTOs and stand-
14 alone transmission companies.

15 Second, the ability of an energy seller to
16 exercise vertical market power is only a small part of a
17 much larger problem that arises any time customers are
18 unable to acquire needed transmission service, are forced to
19 pay persistent congestion charges or have reliability of
20 their service compromised. If the cause of these problems
21 is, in fact, the exercise of vertical market power, then
22 remedies need to be pursued.

23 We think the most effective remedies are
24 structural, for example, the formation of transmission-only
25 companies. We have less confidence in behavioral remedies

1 such as adherence to standards of conduct provisions or
2 revocation of Market-Based Rate authority because we believe
3 such remedies require aggressive market monitoring, invite
4 prolonged litigation, create uncertainty, and generally
5 result in mitigation of short-term impacts rather than long-
6 term solutions.

7 Third, these transmission access and congestion
8 problems may also be caused by a basic lack of transmission
9 capacities in the particular region. Thus, we encourage the
10 Commission to keep the need for new investment in mind in
11 this proceeding and to explore alternatives for encouraging
12 such investment. Significant inter- and intraregional
13 investments will relieve congestion, improve long-term
14 reliability, and, importantly, expand access to transmission
15 service. In fact, many of the Commission's concerns
16 regarding access to transmission service in the exercise of
17 vertical market power would likely be reduced with
18 substantial investment in new facilities, which is most
19 likely to occur under a stand-alone business model where
20 there is no internal competition for investment capital.

21 In this regard, we believe strongly in the
22 transmission-only business model as a vehicle for getting
23 major projects built. The Commission has, itself,
24 acknowledged that stand-alone companies invest in
25 transmission at a rate roughly five times that of vertically

1 integrated transmission owners. The model is proving highly
2 successful in the midwest where MSAT members are pursuing
3 aggressive transmission planning and construction programs.

4 As an example, American Transmission Company
5 plans to invest approximately \$2.8 billion over a 10-year
6 period in transmission, construction, and maintenance
7 projects primarily in the State of Wisconsin. Michigan
8 Electric Transmission Company, or METSE, and International
9 Transmission Company have taken similar steps to enhance the
10 grid in Michigan. And Grid America provides investment-
11 planning services across its three-member, five-state
12 territory.

13 The Commission should be open minded to new ideas
14 in ownership structures while avoiding a one-size-fits-all
15 solution. As the Commission is no doubt aware, Trans-Elect
16 itself is part of a first of its kind public/private
17 partnership to build the expansion of PATH 15 in California,
18 which Professor Hobbs has just referenced. This important
19 project, which certainly reduces the opportunities for
20 market power, would not have been possible without the
21 Commission's willingness to embrace innovation and new ways
22 of thinking.

23 Again, I would like to thank the Commission for
24 providing the MSATs with the opportunity to participate in
25 today's conference and look forward to answering questions.

1 MR. RODGERS: Thank you, Mr. McCoy.

2 Our last panelist on this panel is Paul Bonavia,
3 who is the President of Commercial Enterprises for Xcel
4 Energy and who is today representing the Edison Electric
5 Institute.

6 MR. BONAVIDA: Thank you. Well, as Steve said, I
7 am appearing on behalf of Edison Electric Institute, which
8 is the association of shareholder-owned electric utilities
9 and it also includes the affiliated Alliance of Energy
10 Suppliers, which is a division of EEI. It includes
11 unbundled, bundled, and independent power suppliers, so we
12 cover a lot of ground here.

13 Our members include generation, transmission,
14 distribution, and service companies. We operate in retail
15 markets, in wholesale markets. We serve about 70 percent of
16 the ultimate electric consumers in the country. And we are
17 the largest segment of the buyers that we're talking about
18 and the sellers that we're talking about in these
19 proceedings.

20 My own company is Xcel Energy. We're an EEI
21 member. We've got four primary operating companies:
22 Northern States Power Company, Northern States Power Company
23 Wisconsin, Public Service Company of Colorado, and
24 Southwestern Public Service Company -- I got them all right.

25 We are a member of MISO, we're a member of the

1 Southwest Power Pool, and we operate where there is no ISO
2 or RTO. So we're in all the different market models as
3 well.

4 Many of the EEI members have Market-Based Rate
5 authority. Most purchase power sold under Market-Based
6 Rates. So we have a significant interest as a group in
7 liquid wholesale markets, in a Market-Based Rate
8 authorization process that protects against abuse of market
9 power, that protects against undue discriminatory behavior,
10 and provides a fair and practical approach to authorizing
11 the use of Market-Based Rates.

12 So here we are today to discuss, as the
13 Commission has requested, whether the standard established
14 in Order Number 888 for mitigating market power needs to be
15 modified to assure that electric-based rates are just and
16 reasonable under the Power Act. As a predicate to that, I'd
17 say that EEI does support wholesale competition, we support
18 continued growth in the wholesale market, and we believe
19 that the current standard for mitigating vertical market
20 power or transmission market power -- I think vertical
21 market power is the better term -- we don't think it does
22 require substantial modification, don't think you've heard
23 any reason to say that a substantial wholesale modification
24 is in order.

25 In our view, the critical issue at this time is

1 not so much open access and mitigation of market power. If
2 the panel this morning pointed out anything to the objective
3 observer, it was the need to develop energy infrastructure
4 to facilitate growth in transactions. That was the one
5 common thread through all of the testimony I heard right up
6 until Professor Hobbs just a minute ago.

7 EEI strongly believes that the development of
8 robust competitive wholesale markets for electric power
9 requires the Commission to follow through on the initiatives
10 that it's already set in place to encourage grid investment
11 and to increase transfer capability. That's what will
12 enable the solutions that people have touched upon.

13 The Commission's current open access and
14 functional unbundling standards, starting with Order 888 and
15 progeny, are effective, we believe. When a transmission-
16 owning utility wants to sell at Market-Based Rates, Order
17 888 says an open access transmission tariff has to be on
18 file and, when it is, it provides "requisite absence or
19 mitigation or transmission market power."

20 Interestingly, I think we can all find passages
21 from the prior orders that say nearly everything that anyone
22 wants to assert, which does get, I think, to a very
23 important point that comes out of all this. And that is the
24 need to get real facts behind significant policy decisions.

25 Then we have Order 889, the OASIS system. We

1 have Order 2004 with standards of conduct and extending that
2 to the relationship between transmission providers, their
3 energy affiliates, their marketing affiliates. We have
4 Order Number 2003. The Commission has implemented standard
5 interconnection procedures to protect against transmission
6 providers favoring their own generation. And, of course,
7 we've got the policy reflected in Order 2000.

8 If you take all of these orders as a complex,
9 they represent a very significant step, series of steps by
10 the Commission in the direction that we think has been
11 effective. Now why do we think it's been effective? You
12 know, the real question is does that complex of orders, does
13 that regime the Commission has created sufficiently mitigate
14 market power?

15 Well look at the record. Since Order Number 888,
16 that's 1996, the Commission has averaged about one
17 adjudicatory case a year on transmission market power. Most
18 of those cases, if you look at them case-by-case, address
19 conduct that in some cases is technically inconsistent with
20 the Commission order but the case points out that it
21 evidences no ability or intent actually to wield
22 transmission market power or to behave in an anticompetitive
23 way.

24 So what you have is an apparent -- not an
25 apparent, a real paucity of case law in which the Commission

1 -- based on real facts, not somebody coming with a quick
2 recitation of one side of a complex issue -- but real facts
3 developed in a real record has found discriminatory conduct
4 over a period of time. And I suggest that that does suggest
5 extensive compliance with the regime the Commission created.

6 In view of this paucity, it's hard to understand
7 how it can be suggested that the abuse of transmission
8 market power is common or widespread. You have vague
9 allegations, but I don't think that warrants generic changes
10 to an existing policy which is just in the process of
11 demonstrating its own effectiveness. Any additional
12 measures to mitigate market power have to be justified by
13 real facts rather than supposition. If there is evidence of
14 substantial discrimination, then the Commission should look
15 into mitigation and, failing that, the Commission should
16 deny Market-Based Rates. In other words, the Commission, in
17 my view, has the authority and the means to enforce its
18 policies.

19 I think it's instructive that we had a suggestion
20 this morning that what we really need is a precedent based
21 on real facts. Well, the difficulty with that is for the
22 Commission to set such a precedent, someone has to meet the
23 Commission halfway by filing a complaint and proving an
24 abuse and, from that record, will come the precedent that
25 was called for. In the absence of a complaint, in the

1 absence of evidence of a real abuse, you won't get that
2 precedent. What you'll get are sort of general statements
3 about the state of affairs.

4 So growth in competition in electricity markets
5 have expanded the use of the transmission grid. This, in
6 turn, has heightened the need for scarce transmission
7 capacity and it sometimes materializes or manifests itself
8 as reduced or shrinking available transmission capability,
9 increased transmission loading relief. Now those are simply
10 facts of the increased use and of the different nature of
11 the use of the transmission system. It does not suggest
12 discriminatory or wrongful behavior.

13 Importantly, the Commission's open access
14 policies reserve transmission capacity for native load
15 growth and network transmission customer load growth. As
16 the market expands, market transmission -- or market
17 transactions, rather, will increasingly compete with native
18 load for firm transmission capacity and in some regions new
19 and upgraded transmission infrastructure is needed to reduce
20 congestion to allow transactions to occur.

21 Now in order to encourage that and alleviate
22 concerns of discrimination, the Commission should be active
23 in supporting construction of cost-effective energy and
24 transmission infrastructure, whether it's stringing wires or
25 other forms of investment in the system, through all

1 business models, as Mr. McCoy suggested.

2 How does the Commission encourage that? Well, I
3 guess we can have a rule that says by golly you're going to
4 do it, you're just going to go build it and we'll decide
5 what you're going to build and when. I don't think that is
6 going to lead to the most efficient decisions and to the
7 greatest benefit to consumers. I think those will come when
8 all participants, whether it's public power, municipalities,
9 investor-owned systems, independent transmission companies
10 or any other form of participation, make rational decisions
11 based on clear rules and incentives as to how to deploy
12 capital. That's what a market needs. And I think, with
13 that kind of a regime, we will see improvements. And that
14 requires regulatory certainty and it requires cleaning up
15 some disincentives. We talked about siting this morning.
16 All the planning in the world doesn't overcome the
17 difficulties of actually getting a transmission line built.

18 So sufficient returns and manageable risks will
19 attract capital needed to encourage new investment. In
20 Order 2000, the Commission offered some ratemaking reforms
21 that could be tailored for particular markets to encourage
22 investments. The Commission, a couple of years ago,
23 proposed a pricing policy for expansion of transmission
24 that, unfortunately, has not been generically implemented.
25 If there are incentives, investors will invest and

1 transmission will be built, transactions will be increased,
2 throughput will be increased, and the sort of problems that
3 were touched up this morning will be remedied.

4 So in conclusion, the Commission's open access
5 policy has been a success. That is measured by the absence
6 of any proof or indication of widespread abuses of market
7 power. And that suggests that additional new policies are
8 not necessary to mitigate transmission market power.
9 Instead, the Commission should focus on ways to encourage
10 new investment and to encourage steps to increase
11 throughput. If we step back and look at the broader market-
12 based rulemaking, we would encourage the Commission to
13 explore ways to improve the screening process -- and
14 incidentally, there were questions this morning, including
15 Commissioner Kelliher's questions about transmission
16 constraints and how those factor into the determination of
17 whether or not Market-Based Rates ought to be granted,
18 Market-Based Rate authority.

19 In fact, in the screens, properly used,
20 transmission is taken into account. It is the single factor
21 that, probably more than almost any other, that defines the
22 relevant market. How much import capability is there? What
23 really are the economic resources available in a given
24 region?

25 If you look at some of the more innovative

1 approaches, like a contestable load analysis, you will find
2 that that, too, takes into account transmission constraints
3 in defining the market and in defining the presence or
4 absence of market power. So it's a good question and I
5 think a number of these screens do incorporate that.

6 Finally, there has been discussion about entry
7 barriers. It is important, when looking at entry barriers,
8 to distinguish between natural entry barriers -- the fact
9 that the facilities we're talking about here are capital-
10 intensive, they take a long time to build, they require
11 extensive permitting. That, unfortunately, is the world we
12 live in, versus the sort of entry barriers that are market
13 participant erects to exclude competition or to commit an
14 abuse.

15 So EEI looks forward to working with the
16 Commission in this rulemaking to identify reasonable
17 measures for assuring everyone that Market-Based Rate
18 authority will not be abused. We encourage the Commission
19 not to set the bar so high as to require additional
20 mitigation measures that will discourage utilities from
21 seeking Market-Based Rate authority, and that's going to
22 give you fewer entrants, fewer participants in a given
23 market if that were to happen. We think that would hamper
24 the continued development of competitive markets.

25 And that, I think, seems like a good place to

1 stop and I'll be available to answer questions, if you wish.

2 MR. RODGERS: Thank you very much, Mr. Bonavia.

3 I have just a couple of questions for you, Mr. Bonavia,
4 before we turn to others. You had mentioned in your
5 presentation that the biggest need you perceive to
6 developing competitive markets is to build more transmission
7 infrastructure but, as we've heard from a number of
8 panelists today, that is not happening in many parts of the
9 country. And I recognize that IOUs are not solely capable
10 of getting transmission built; there's a lot of entities
11 that are involved in that taking place. But it also seems
12 to me that they have perhaps the most prominent role in
13 getting transmission built. If you're a transmission
14 customer, you're sort of at the mercy of the entity who's
15 primarily responsible for taking the initiative to get
16 transmission built.

17 And so I'm wondering if the biggest need is to
18 get more transmission infrastructure built, but it's not
19 happening. What responsibility, if any, do you see that the
20 IOUs have for that?

21 MR. BONAVIA: Well, the IOUs at the state level
22 do have duties to serve. I think Mr. Wheeler talked this
23 morning about the fact that in many cases there are state
24 processes in which those questions are very extensively
25 examined under a regulatory authority.

1 In terms of the responsibility to actually build,
2 I guess, Steve, I would answer that question with two
3 related point -- at least I hope they're related. I'll see
4 if you think they are.

5 Number one, there's more going on here than you
6 think. To conclude from what was discussed this morning
7 that IOUs are not building anything, I believe, simply
8 misses important facts. Since 1999, the period of 1999
9 through 2003, investor-owned utilities have increased their
10 transmission investment by more than 12 percent annually
11 each year. That's a very significant amount of money. In
12 2003 alone, the commitment -- the actual expenditure by
13 investor-owned utilities on transmission infrastructure was
14 in excess of \$4 billion. That's a lot of money. That is,
15 in fact, putting money where your mouth is.

16 My own company in a smaller period of time -- I
17 didn't go all the way back to '99, I went back to 2000 and
18 just ran the numbers out of publicly-available information --
19 -- we've spent about \$660 million over that four-year period
20 on transmission. That's very close to two-thirds of a
21 billion dollars in one company alone.

22 So the suggestion that it's not happening really
23 isn't factual. Could more be invested, should more be
24 invested -- which is, I think, where you're really going
25 with the question, Steve -- I'm sorry. Did you?

1 MR. TIGER: Can I just follow-up on that? I
2 mean, a 12 percent investment level, what would that compare
3 to on the amount spent on generation, for instance, or the
4 amount spent on distribution in that same period, both by
5 IOUs, as well as by those that you serve and IPPs that
6 ultimately are getting onto the grid and using the grid?

7 MR. BONAVIDA: I don't know. I don't know how
8 much IPPs have spent over that period of time. I don't have
9 that, I'm sorry.

10 MR. TIGER: And is that a -- is the \$4 billion a
11 net investment number or a gross investment number? In
12 other words, is it taking into --

13 MR. BONAVIDA: Out of depreciation --

14 MR. TIGER: Yeah, and the retirements and --

15 MR. BONAVIDA: Oh I think it's real investment is
16 my understanding.

17 MR. TIGER: Just for clarification, I just wanted
18 to get a sense of --

19 MR. O'NEILL: Paul, I think the issue is not how
20 much you're investing, but where the investment is being
21 made. We've had people come in here and told us that the
22 people who are making investments are vertically integrated
23 utilities, are making investments to sites that they own.
24 But that doesn't help the people who want to get access to
25 other sites.

1 So siting, just the gross numbers of investment,
2 doesn't tell us anything about what we're trying to do here.
3 As a matter of fact, arguably, if you're just investing in
4 transmission to get the sites that you own, you're probably
5 increasing your market power.

6 MR. BONAVIDA: I can't break it down, Dick, by how
7 much of that is --

8 MR. O'NEILL: But the point I'm trying to make is
9 I don't -- you know, unless there's a better context, I
10 don't know what it means.

11 MR. BONAVIDA: Well I can give you an anecdotal
12 context, which, I guess is pretty much what this proceeding
13 has been about up until now, and I will tell you that my --
14 I'll again speak only for my own company. One of our most
15 substantial investments is being energized right now, about
16 to go into commercial service, and it's a tie between the
17 Southwestern Public Service Company system -- which is in
18 the eastern interconnect -- and Public Service Company of
19 Colorado, which is in the western interconnect, with an HVDC
20 converter station in the middle. It's a very substantial
21 investment. And it's not to a power plant, it's to connect
22 two systems across the interconnection. It's going to
23 increase throughput, it's going to increase transfer
24 capability.

25 A great deal of what we have spent money on is

1 pertinent to something the Commission heard about this week
2 in one of my own towns, which is connecting up two wind and
3 renewable resources. And that provides a whole lot of
4 options for people. That's very meaningful.

5 So again it's an anecdotal answer, I'm sorry I
6 can't do better; likewise with the other one. I could ask
7 that we get these numbers broken down for you if it's
8 helpful. But I can tell you that this is not just about
9 utility companies building generating plants and running
10 transmission lines to their own generation.

11 I can tell you with Public Service Company in
12 Colorado, we announced a stipulation on Friday, not yet
13 approved by the state commission -- maybe it never will be
14 approved by the state commission -- but it's to build a
15 power plant. That's the first power plant that that utility
16 has built in Colorado in 15 years, I think. It goes back
17 well before my time. The transmission that's been built in
18 that state has been to connect independent generators to the
19 network, once again increasing options, increasing the
20 number of market participants.

21 So it's an anecdotal answer to your question, but
22 I would not assume that the bulk of this is utility
23 companies trying to connect up to their own power plants and
24 lock people out of the market. I mean, I think that's
25 something that you really need to look into as you suggested

1 to me. I agree with you.

2 There's another piece to this question though
3 about building: you know, what has been built, who has
4 built it, why did they build it here, why don't they build
5 it there. And I'm always interested -- you know, it's some
6 form of degree envy, I guess. I'm always so fascinated with
7 economists who look at incentives. We've heard a lot about
8 incentives this morning. Well you've got an incentive to do
9 this, you've got an incentive to do that. Therefore, it
10 must be happening. Because, after all, you've got an
11 incentive.

12 If you only look at the incentive you choose to
13 examine and if you assume that behavior will follow that
14 particular incentive, you posit an extremely simplistic view
15 of how decisions are actually made. In fact, in the real
16 world, there are lots and lots of incentives and many of
17 them conflict. If you look at the way firms, whether they
18 are, by the way, public power, shareholder-owned -- I mean,
19 any firm, even the government, a firm of sorts. If you look
20 at the way firms allocate capital -- and now I will speak as
21 a shareholder-owned company -- they make decisions
22 fundamentally to invest capital in the business they're in
23 at a return greater than the cost of capital. And that's
24 the basic principle of corporate finance: you increase
25 shareholder wealth by earning a return that is in excess of

1 the real cost of capital.

2 And the real cost of capital under real cash
3 flows in a real project are largely dictated by the risk
4 structure of that project. Where you have tremendous
5 regulatory uncertainty as to whether you can ever get the
6 thing permitted or built, as to how you will recover the
7 cost, as to whether you will recover the cost, as to what
8 allocations will come out of it, that increases the cost of
9 capital. And in fact it's simply unreasonable to expect any
10 firm, including the government or an investor-owned or a
11 public power entity, to invest capital below what it
12 perceives to be its cost of capital. You're taking wealth
13 away from them.

14 So if we want to look at a set of incentives that
15 really reflect how people behave, what I'm saying is that
16 transmission will get built and it will get built according
17 to market principles, according to rules -- according to the
18 behavior of voluntary investors if they perceive that they
19 can earn a return at least equal to and preferably slightly
20 above their actual cost of capital. That's fundamental
21 finance.

22 MR. RODGERS: I believe Commissioner Kelliher had
23 a question.

24 MR. BONAVIA: Sorry. I know that's a long
25 answer.

1 COMMISSIONER KELLIHER: Thanks, Steve. I just
2 wanted to respond to your comments about the level of
3 transmission investment, because there was a statistic from
4 the Commission's State of the Markets Report last January
5 that indicated that the transmission system, in terms of
6 circuit miles, has expanded 0.5 percent over a five-year
7 period, I think '97 to 2001. So I think it's hard to argue
8 that there's a robust level of investment in transmission,
9 if you just look at -- in terms of circuit miles, it's
10 pretty feeble.

11 So that's my -- I do agree with you though that
12 the infrastructure is one of the issues. I think
13 transmission market power and the exercise of transmission
14 market power is a real issue. And inadequate investment in
15 the transmission system and constrained transmission system
16 makes it much easier to exercise market power and makes it
17 harder to detect it. So I think there's not just the one
18 issue of making sure we have enough investment in
19 transmission, I think transmission market power is a real
20 issue and they are related.

21 I have to admit, though, to some confusion over
22 why we don't have enough investment in the transmission
23 system and it's difficult from the Commission's point of
24 view -- at least from my point of view -- because you have
25 various hypotheses on why people aren't investing in

1 transmission. And unfortunately we can't accept them all as
2 equally valid or we would have policy that makes absolutely
3 no sense and we would be going in different directions.

4 There's this theory that the rate of return is
5 inadequate so you should provide a higher rate of return and
6 then the current owners would invest more into transmission.
7 But the level of investment by pipelines is pretty
8 significant and they have comparable rates of return.

9 You have the other theory, say, the FTC theory,
10 of well you should just divest and vertical integration is
11 the problem. I guess that would be the anti-trust point of
12 view. But if we adopted -- just look at those two theories:
13 if we adopted them both as equally valid, we'd be raising
14 rates of return for incumbent owners, while at the same time
15 mandating divestiture in some form.

16 Anyway, I think there's two issues. I would love
17 to know the real reason why transmission investment isn't
18 occurring, and any theories you have or any way you can help
19 decide which theories are real and which are not, I'd
20 appreciate.

21 MR. RODGERS: Mr. Bonavia, I'd like to ask a
22 question if you perceive a difference in how much
23 transmission is being built in traditional markets versus
24 those that are regarded as organized markets. You have a
25 foot in each, it sounds like, and from your sort of unique

1 perspective, do you see differences between how much
2 transmission is being invested in traditional versus non-
3 traditional markets?

4 MR. BONAVIDA: It's a very good question. The
5 RTO, the MISO market is just too new for me to say that I
6 can really discern a pattern, Steve. It just hasn't
7 happened for very long. Quite honestly, though, the thing
8 that probably more than anything else within our own system
9 separates where we tend to invest heavily versus where we
10 don't, it tends to come down to where do the government
11 policy makers tell us they want to invest. And where, for
12 example, you have a state that wants to promote renewable
13 energy and they engage in siting reform and they create a
14 regulatory scheme in which that form of investment is
15 favored, we invest. I mean, we do tend to take direction
16 from those who set public policy, and they're the ones that
17 have the last word.

18 MR. RODGERS: Does that suggest, though, that the
19 main reason for why transmission is not being built
20 sufficiently in some areas is not because of economic
21 incentives but because of state policies?

22 MR. BONAVIDA: It's a combination. Yes, it
23 suggests that state policies are a meaningful part. I don't
24 think it suggests that economic incentives are not a
25 significant piece of this. They are. I mean, again, the

1 pipeline example of Commissioner Kelliher is an excellent
2 example. And I've been in the pipeline business, too. And
3 I can say that in constructing an interstate pipeline versus
4 constructing a transmission line, the difference in siting,
5 the role of this Commission versus the multiple states, the
6 difference in rate recovery, in regulatory certainty that
7 affects cost recovery generally, the difference in cost of
8 capital, the use of financing techniques that are available
9 for interstate pipelines that are not available for
10 transmission.

11 So you've got tax policy, you've got regulatory
12 policy, you've got Federalism considerations, you've got
13 rates and cost recovery. There are real difference between
14 an interstate pipeline and a transmission line. Which one
15 would I rather invest in? I'd rather invest in the
16 pipeline. Lower cost of capital.

17 MR. TIGER: Let me follow-up with Mr. McCoy,
18 since you're representing those who have a bit of a before-
19 and-after. Maybe you could speak to what changed, other
20 than the one obvious incentive of having only one incentive
21 in a transmission-only company, between when things were
22 held by Trans-Elect when MSAT was in consumers or, speaking
23 for your colleagues in the Detroit Edison going to ITC, what
24 changed else, what else changed?

25 MR. MC COY: I think the changes are two-fold.

1 One you alluded to, and that is that our investment
2 decisions are based on clear, simple equation of return.
3 The returns that are offered to the stand-alone companies in
4 various ways -- each of us are situated slightly differently
5 -- are adequate. I don't think the Commission sees any of
6 the stand-alone companies in here suggesting that more
7 incentives are needed.

8 It's the clearness of the return versus
9 investment opportunity and the lack of the complication --
10 the second piece, the lack -- the fundamental thing, the
11 lack of the complication of having to optimize the whole at
12 the higher corporate level, where, quite frankly, in a
13 scenario where you're looking at an investment decision in
14 transmission which, quite frankly, may well reduce the
15 amount of money you earn in generation. The internal rate
16 of return that you would calculate in that company would be
17 very much higher than what you would publicly be quoted in a
18 regulated rate of return. So, you know, companies are doing
19 the right economic thing.

20 And thirdly, the planning process is more open
21 and transparent, and so there's little denial that the need
22 is there. But I think, quite frankly, it's the cleanness of
23 the investment opportunity and the lack of a need to
24 optimize the whole.

25 MR. RODGERS: Ms. Kelly?

1 MS. KELLY: I have to backtrack a little bit, but
2 I actually will start with the latest comment first. I
3 think Paul makes a very good point about their rate of
4 return being sufficient for a stand-alone entity to invest
5 in transmission. The real issue is whether that -- you
6 know, the money is going to come back to them in the form of
7 assured rate recovery. That rate recovery, I think, is the
8 real issue there.

9 I would note that this incentive rate theory has
10 been kicking around this Commission for a number of years
11 now. It started out during the dot.com boom, when we were
12 told that in order to draw incentive -- or investment in
13 electric utilities as compared to dot.com companies, rates
14 of return had to be higher to attract that investment. Then
15 they died.

16 Then it was told that in order -- in the internal
17 company to get the investment to be in transmission rather
18 than in the more profitable generation that there had to be
19 an incentive rate of return. Well, generation is no longer
20 so profitable in many cases.

21 So I'm kind of left wondering, you know, what's
22 the real problem here. I think the real problem is assured
23 recovery. And I am fairly skeptical about claims of the
24 need for incentives. If you, the Commission, set a rate of
25 return high enough to attract capital, you shouldn't need to

1 put adders on top of that. So I just want to get that said.

2 Going back to the issue of incentives to build
3 transmission, I must say that I believe that the line that
4 connects the SPS and PIASCO systems was built in part for
5 the incentive of getting the merger between those two
6 entities approved. So I think that's a special case and I
7 wanted to get that fact on the record.

8 Going to the issue of well we don't hear any
9 complaints so there must not be any problem, I would note
10 that my former law firm did represent Golden Spread Electric
11 Cooperative, which was a wholesale customer of SPS on their
12 network tariff, which contested SPS' Market-Based Rate
13 authority because of the substantial transmission
14 constraints coming into the SPS territory at that time. The
15 Commission decided, in its wisdom, not to consider those
16 claims and granted Market-Based Rate authority and Golden
17 Spread took them to the D.C. Circuit and got a remand
18 because the Commission had ignored the evidence of
19 transmission constraints and resulting possible market
20 power. That case was then remanded back here to the
21 Commission and my understanding is that after a long period
22 of time it has now been settled.

23 That just tells you what you have to go through
24 if you do file a complaint. So I just put that to you,
25 that, you know, having seen what's happened to people who

1 went before who did file complaints on this issue, it's not
2 exactly an incentive to continue -- you know, for other
3 people to follow them down that road.

4 MR. BARDEE: Ms. Kelly, you had mentioned the SPS
5 line, the same one that Mr. Bonavia had mentioned. And that
6 was my memory, too, that it was part of the merger
7 application here at FERC. I think it was the company's
8 proposal. And it took some years to get it completed.

9 The question I have is is that a solution that
10 the Commission should be more aggressive about pursuing at
11 this point? I mean, instead of the structural solution of
12 investors to RTOs, or instead of things like imposing cost-
13 based rates, should we be tying Market-Based Rates to
14 completion of grid upgrades, just going straight to the need
15 for infrastructure?

16 MS. KELLY: Well, that's a very interesting
17 question and, not having a good sense of where my membership
18 is on that, I'm not going to opine definitively because it
19 could be a career-limiting move for me --

20 (Laughter.)

21 MS. KELLY: -- especially given the newness of my
22 employment. I'd like to say here for a while.

23 But I will say that I think the joint planning
24 recommendation that I did put forth in my prepared remarks
25 kind of tends towards that direction. If you were to

1 require joint planning and equal consideration of all
2 network resources designated by everybody on an equal basis
3 -- one of the things that concerns me and which we have seen
4 in some systems is when you go to look at the transmission
5 system planning models, the assumption is that load growth
6 will be served from the sites where existing generation at
7 the incumbent already is. In other words, we'll stick
8 another unit here, we'll stick another unit there, that will
9 minimize the amounts of upgrades that are built and all will
10 be cozy. But the network customer is saying well I'm trying
11 to designate a network resource from outside, you know, your
12 control area, I want to bring in an interface or I want to
13 do something different. And the problem then becomes well,
14 then you obviously should pay for that full amount.

15 And I guess then the policy issue that comes from
16 that is well does that kind of upgrade actually benefit the
17 incumbent utilities native load customers as well? And that
18 gets to the issue of are they going to diversify their power
19 supply through RFPs and other things like that or are they
20 just going to continue to build under a cost-based paradigm
21 and, you know, put that in.

22 I guess my broader view is that that could
23 benefit the native load of the utilities if they have
24 broader access to competitive wholesale options. You can
25 have wholesale competition even if you have a vertically-

1 integrated utility as long as they're required to look at
2 all power supply alternatives, you know, rather than just
3 choosing to build and roll in. So I guess my view is it
4 does benefit, at least in that respect.

5 So I think if you get back to a joint planning
6 and comparable treatment of resources you may find that
7 these things start to shift without going all the way
8 towards mandating what you're discussing. And I wish I
9 could give you an answer, but the answer is I just don't
10 know so I better not opine.

11 MR. RODGERS: Mr. Stout, you had a comment you
12 wanted to make?

13 MR. STOUT: Yes, I'd like to comment on the
14 statistic regarding the amount of transmission that's being
15 built. I believe Paul said it's about a 12 percent increase
16 per year.

17 What we're really talking about here is three
18 different buckets: one bucket is transmission that's built
19 for interconnection of new generators, one bucket is
20 transmission that's built for reliability of the system, and
21 the third bucket is transmission that's built to enhance
22 economic competitiveness of the market.

23 There was a study done by DOE, I believe, two,
24 maybe three years ago where they actually broke out of the
25 amount of money that was invested in transmission how much

1 of it was for that first bucket, just the cost of
2 interconnecting brand new generation to the grid. And my
3 recollection, it was a major portion of the total amount
4 that was in the three buckets. There was just a small
5 bucket left for actual reliability enhancement and a much
6 smaller bucket left for the economically justified
7 transmission enhancements.

8 Addressing Commissioner Kelliher's question about
9 why are we not getting more investment in that third bucket,
10 I think there's three reasons: number one, if you simply
11 use the traditional cost-based tools for trying to justify
12 that investment, you come up short a whole lot of the time.
13 This is what Professor Hobbs was talking about. You have to
14 look at market behavior to really see the true value to
15 customers, and it's very difficult to model market behavior.

16 Secondly, there's a lack of consensus over what
17 the criteria is for saying is a good economic investment
18 versus not, because there's a lot of assumptions that have
19 to go into those models and there's also a question about if
20 it pays back in five years that may be good, but what about
21 if it's 10 years or 15 years. And the further out in the
22 future you go before payback occurs, the greater the risk
23 there is in investing in something where you're making a lot
24 of assumptions about what the market behavior is.

25 But the bottom line on what causes most

1 economically justified enhancements to fall apart, based on
2 my experience, is when you get down to saying who's going to
3 pay for it. Because then you get into a lot of turf wars
4 about who benefits, who gets the economic benefit of that
5 investment. And it's very, very difficult for people to
6 reach consensus because they always tend to vote their
7 pocketbook when it gets down to that level.

8 MR. RODGERS: I had a follow-up question for Mr.
9 Bonavia on something you had mentioned. You had stated at
10 one point that because of the fact that there's only been
11 one adjudicated case per year since '96 involving vertical
12 market power issues or transmission market power which, in
13 your mind, represented a real paucity of evidence on
14 transmission market power and that's proof that our OATT is
15 essentially working to solve that problem.

16 I'm wondering if you could comment on the
17 experiences though of some investor-owned utility merchant
18 arms that have tried to venture out into other parts of the
19 country outside their own service territory and tried to do
20 merchant generation there and have met with not much
21 success, shall we say, in most cases. And yet these are
22 people that have a lot of savvy in the business of energy
23 markets: they know the state process on siting typically
24 and they would know whether they were locating a plant in a
25 bad place or not, they would know the drill on how the OATT

1 works and how to get transmission service, and yet these
2 folks haven't had much success either.

3 MR. BONAVIDA: Good question. Again, what is
4 success? If success is building power plants, then look at
5 the massive overcapacity that was created during the period
6 of time you're talking about in many regions of the country.
7 And you have to ask yourself well, is that success? Is the
8 actual completion of a plant that's there as a new entrant
9 to provide competition in the market, to provide options to
10 customers, is that success?

11 MR. RODGERS: Could I --

12 MR. BONAVIDA: The other -- I'm sorry.

13 MR. RODGERS: Could I clarify my question?

14 I would assume that the folks engaging in that
15 business don't regard just getting the plant up as being the
16 measure of success, but rather getting their power to market
17 and making a profit on it.

18 MR. BONAVIDA: Yeah, that was the other half of
19 the question: from whose point of view? If it's from the
20 point of view of the consumer, again, I'll say there was a
21 fair amount of success in a lot of regions because that
22 overcapacity has done a lot for consumer prices.

23 For investors, well, my own company wrote off \$3
24 billion through an independent power affiliate. I would
25 call that a notable lack of success. How did that happen?

1 Well, spark spreads did not turn out to be quite what people
2 thought they would be when they agreed to finance the plant
3 and when the developers developed the plant. To some real
4 extent, though, that's what markets do. I mean, markets are
5 fairly ruthless about capital.

6 And, I mean, I don't really know what other
7 conclusion to draw from that. I don't think that you can
8 say that people who built independent power plants and then
9 found spark spreads tightening were victims of market power.

10 I think they were probably, speaking generally, mostly
11 victims of bad decisionmaking. And that's going to happen
12 in free markets. The customers, the consumers, did pretty
13 well in the deal.

14 MR. RODGERS: Thank you.

15 Other questions? Debbie, go ahead.

16 MS. LEAHY: I actually had a question that goes
17 to some statements that Mr. Stout made earlier, and I was
18 wondering if Mr. Bonavia could respond to them. Mr. Stout
19 was talking about sometimes you have to look at things
20 transmission owners don't do, and he suggested trying to use
21 best available transmission technology was one of his
22 examples. And I was wondering what your responses were on
23 that, do you think that you could be able to get more
24 transmission capacity that way?

25 MR. BONAVIDA: Well, first of all, I'm not an

1 engineer or a transmission expert, so please forgive me for
2 not giving a very good answer to the question as to specific
3 techniques that Mr. Stout discussed. I would certainly
4 defer to his greater understanding.

5 As far, though, as how to create incentives for
6 transmission operators -- and I would say it's not even so
7 much owners as it is operators. Obviously, in many cases
8 the operator is not going to be the owner but you probably
9 could still have some of those same issues arising out of
10 what was described as the innate conservatism of
11 transmission engineers.

12 How do you create greater incentives for them?
13 Well, you're going to have to look at the regional
14 reliability rules. I don't know to what extent practices
15 are consistent with or dictated by that. I don't want to
16 say that I know the answer; I'm saying that's one place I'd
17 look to find the answer as a manager of a company.

18 And then what about incentives? I mean, we have
19 independent transmission companies. We have operators of
20 transmission. Is there an incentive in the form of enhanced
21 throughput, of enhanced transactions across their line that
22 produce enhanced revenues if they follow transmission
23 operation practices that increase flows or increase
24 throughput across the lines?

25 It would probably be a good thing if those

1 incentives existed. And again, it's going to have to be
2 done consistently with reliability rules and with operating
3 reserve requirements and N-minus one contingency standards
4 and all the other things that operators are required to take
5 into account.

6 But I think it's a fair point. I really do.

7 MR. RODGERS: Commissioner Brownell, did you have
8 a question?

9 COMMISSIONER BROWNELL: I do. I just have a
10 couple of questions.

11 Sue, you talked about a mandatory regional
12 planning process without those horrible RTOs. Tell me how
13 that works and would you envision a process that ended with
14 identification fundamentally of perhaps those three
15 categories that were mentioned: building for reliability,
16 interconnection, economic benefit. Do you support or does
17 APPA support putting those out in an RFP process?

18 And then I'd like you to respond on behalf of
19 EEI, and anybody else who wants to comment.

20 MS. KELLY: Wow, there's a lot there. I'll try
21 and parse it, but if I forget pieces, let me know.

22 First of all, I actually put in my testimony the
23 idea of grass roots regional transmission planning process
24 with deep involvement of state commissioners. It's actually
25 very close to what Craig Roach discussed this morning, kind

1 of using the RSC by some other name or, you know, getting
2 the state commissioners in a region together to kind of form
3 the underpinnings of it but with an open, collaborative
4 process with all interested stakeholders in the region.

5 And I did note that those kinds of kind of
6 voluntary processes are underway in the west. There's four
7 different subregional groups, I understand, and both
8 jurisdictional and non-jurisdictional entities and other
9 market participants are involved in those things.

10 As to whether the result would be reliability
11 versus economics, I think that APPAs position -- a
12 consensus, obviously; you know, members have their own views
13 -- but the bottom line consensus position is that that
14 distinction has been less than helpful in getting needed
15 transmission built and, rather than spend our time wondering
16 how many angels dance on the head of a pin: is it needed
17 for reliability, is it needed for economics, that the issue
18 should be building a transmission grid that's robust enough
19 to support getting economic generation resources to load.

20 Now that does not mean to build every last single
21 piece of transmission. Number one, you just can't. And,
22 number two, that's not cost effective. And so one of the
23 calls that has to made in that regional process is what is
24 cost effective. You've got to strike the proper balance and
25 that, in the end, is oftentimes a political balance, you

1 know, let's be frank.

2 So I think I answered your -- and as to whether
3 it's mandatory or not, make it a condition of Market-Based
4 Rate authority for the dominant transmission providers in
5 the region and I suspect they will be there with coffee and
6 doughnuts.

7 COMMISSIONER BROWNELL: But we've seen some
8 different models emerging. The independent transmission
9 companies who, I think, have demonstrated actually a pretty
10 extraordinary commitment to investment that we have not seen
11 on the incumbent side. So are you open to an RFP process or
12 letting more people entertain the opportunity to bid on
13 projects that are identified as important?

14 MS. KELLY: I will say that, in terms of stand-
15 alone transmission companies, that there are municipal
16 investors in the ATC LLC, American Transmission Company, and
17 that is a model that we think is a very good -- you know,
18 that's one way of doing it. VELCO in Vermont is another way
19 of doing it. Joint ownership is yet another way of doing
20 it; that's the case in Georgia. So there are a number of
21 different models and I don't think we're against having
22 other people come in to build it, if they've got the money
23 and they can get the permits. I mean, the issue is getting
24 the needed infrastructure built and having a collaborative
25 regional process that tries to strike the right balance. I

1 think that's about the best answer I can give you.

2 COMMISSIONER BROWNELL: Thanks. That works.

3 Mr. Bonavia, do you want to take a shot at either
4 Xcel's position or EEI's position? And then I have a very
5 specific Xcel question. And then the others may comment on
6 the earlier question.

7 MR. BONAVIA: Well, first of all, Commissioner
8 Brownell, let me congratulate you. Up until just a couple
9 of those last statements, you had found where APPA and the
10 EEI companies are in agreement, which is it is important to
11 find approaches that foster building the necessary
12 transmission infrastructure. That really is how ultimately
13 you get out of this difficulty that people have discussed
14 from so many different viewpoints today. So I think we do
15 agree with that.

16 As far as joint planning, is it mandatory, is it
17 a condition of Market-Based Rate authority, is it
18 encouraged, how do you -- what could the Commission do to
19 encourage it? I would also agree with Sue about the
20 regional process that she described, and I think that's a
21 fine thing. We encourage that.

22 I will say that -- now I'll speak for Xcel
23 because I really can't comment on behalf of all the EEI
24 members. We own transmission jointly in a lot of places
25 with non-jurisdictional entities, with other IOUs. We

1 engage in joint planning; the Commission Staff has gotten a
2 briefing from something in the State of Minnesota that we
3 call CAPEX 20/20, which is a joint regional transmission
4 planning process that includes a non-jurisdictional entity
5 as a key member.

6 We have a process in Colorado, we're part of the
7 Colorado coordinated planning group, which includes non-
8 jurisdictional entities. The stipulation I referred to that
9 we filed last Friday in a Colorado planning docket to build
10 a power plant anticipates joint ownership of the power plant
11 with at least three non-jurisdictional entities, and that
12 will include -- there will be transmission infrastructure
13 related to that.

14 So that's a way of saying I don't -- certainly
15 from my own company I'd be very surprised if other EEI
16 companies didn't agree. Joint planning and joint ownership
17 can be very positive things. They can be very helpful. If
18 it helps demonstrate mitigation of perceived market power,
19 all to the good. That's a positive thing as well. We would
20 certainly embrace that.

21 COMMISSIONER BROWNELL: So it seems odd, given
22 the testimony we've heard this morning, and frankly
23 throughout the Midwest that TransLink was the model that
24 everybody endorsed, that Xcel seemed to back away from.
25 Could you comment on that and whether Xcel would entertain

1 revisiting that, since it seems to be such a popular notion?

2 MR. BONAVIDA: Xcel would entertain revisiting
3 that. We do revisit it and we talk about it. I've had
4 meetings about the possibility of finding a constructive way
5 to get that model going within the last week.

6 COMMISSIONER BROWNELL: Great. When you say
7 "constructive," was there something not constructive about
8 the earlier model? Because I haven't heard anybody say
9 adopt TransLink with changes. What we've heard is adopt
10 TransLink as is, which we have all endorsed at one point or
11 another.

12 MR. BONAVIDA: Honestly, I wasn't personally
13 involved enough in the TransLink evolution to say that I
14 really understand all of the reasons why we didn't see it as
15 successful. But, within the context of MISO and, for
16 example, within the context of the sort of planning, joint
17 planning that I was talking about, this CAPEX 20/20, to try
18 and streamline it and maybe reduce the cost a little bit,
19 reduce some of the cumbersomeness of it. If we could solve
20 some of those problems, we absolutely do not reject the
21 independent transmission model or participation in some form
22 of Transco as a way of going forward. We do entertain that.
23 We talk about it. We work on it. We have talked to some
24 other folks about it, other companies about it, and I
25 wouldn't want to say that it couldn't come back.

1 COMMISSIONER BROWNELL: Maybe you could kind of
2 give us a briefing offline on that, because I think the
3 perception among a number of the former participants in a
4 number of the state commissions is that, in fact, it is off
5 the table and was not a model that you were willing to
6 pursue. So I don't want to discuss that here, but maybe we
7 can talk about that since it really seemed to be the answer
8 to some people's concerns about market power issues.

9 And if you could respond, either on behalf of
10 Xcel or EEI, on the notion that maybe the incumbent is not
11 the only person to be considered to build out
12 infrastructure. Would you entertain the notion of an RFP
13 process or some kind of a competitive bidding process?

14 MR. BONAVIDA: I wouldn't reject it out of hand.
15 Properly structured, sure, we do it for power plants; I
16 would not rule it out for any other infrastructure as well.
17 If it's a cost-effective way to raise capital and, you know,
18 if it -- if it doesn't layer more costs on here than what
19 you really need.

20 So I would say that's a model -- speaking for my
21 company, anyway -- that that's a model that we would
22 consider.

23 COMMISSIONER BROWNELL: Great.

24 If any of the other participants want to comment
25 on any aspect of the three-part question -- although you

1 could comment on TransLink, too, if you wanted to.

2 (No response.)

3 MR. RODGERS: Commissioner Kelliher?

4 COMMISSIONER KELLIHER: I just wanted to respond
5 to a comment by Mr. Bonavia, who was responding to a comment
6 I made earlier about transmission constraints. And my
7 understanding is transmission constraints are considered
8 when determining which sellers can get to a market.

9 So in effect external transmission constraints
10 are considered to determine which sellers can get to the
11 boundary of a market, if you will. But they're not internal
12 transmission constraints within a market. Say a utility
13 home control area are not considered.

14 And the way our test operates--and if I am wrong,
15 please correct me--the way our test operates is if you can
16 get to the boundary of a market, it's assumed you can get
17 anywhere within that market.

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1 And so I do think there is -- I acknowledge that
2 they are considered to some extent currently, but I don't
3 think fully. And if I'm wrong, please correct me, politely
4 if you will.

5 (Laughter.)

6 MR. RODGERS: I think that is generally correct.
7 That's the starting point, that's the default is that we're
8 looking at the constraints at the boundary, not within it.
9 But if there were proper showing by someone in the case that
10 we needed to look at a narrower market, we would do so.

11 MR. BONAVIDA: And, Commissioner Kelliher, if I
12 can take this opportunity to make a plug. It's why
13 something like a contestable load analysis screen really
14 makes sense, because what you are asking there is, what
15 resources are available to the load in question that was
16 going out looking for supply.

17 And there, I think, you would capture the point
18 about capability to serve a given buyer. Whether that
19 capability was across the ties into a control area or within
20 the control area, I think you should be able to pick both of
21 those up. And that's why I think, that's one reason why I
22 think that test has a lot of merit.

23 MR. RODGERS: Are there any folks in the audience
24 that would like to come to the microphone and make any
25 comments? Please give us your name and your organization.

1 MS. PHILLIPS: I'm Margie Phillips of PSEG. This
2 question is for Sue Kelly. Long ago and far away, I think
3 it was 1996, PICO Energy Company filed a complaint against
4 Oglethorpe for violation of its transmission tower. And
5 FERC sat on it and sat on it and asked PICO to withdraw the
6 complaint because they really didn't have jurisdiction over
7 public power. So my question to you Sue is, in your offer
8 to invest in the transmission system, will your companies
9 agree to be FERC jurisdictional?

10 MS. KELLY: To which I would respond, Margie,
11 that that complaint was filed under Section 211, under which
12 all transmission providers including non-jurisdictional
13 munies are FERC jurisdictional.

14 (Laughter)

15 MS. PHILLIPS: You can answer the rest of it.

16 MS. KELLY: That's my answer.

17 MR. RODGERS: Remember, she is new on the job.
18 All right, if there's no other questions, why don't we go
19 ahead and adjourn this panel. I want to thank all of you
20 very much for very helpful remarks, and we will reconvene in
21 15 minutes, at 3:30. Thanks.

22 (Recess)

23 MR. RODGERS: If I can have your attention, why
24 don't we go ahead and get started with our final panel of
25 the day? We could have our panelists go ahead and get

1 seated, we will get started. I see that I've lost control
2 of the crowd that did not get any lunch and has gone with it
3 for 12 hours without any food. So why don't we go ahead and
4 get started with our first panelist today. Let's get
5 started with our first panelist who is Andrew Kleit; he is
6 professor of Energy and Environmental Economics at
7 Pennsylvania State University and he will kick off our final
8 panel of the day which deals with the topic of barriers-to-
9 entry, which is the third of four prongs that we look at in
10 assessing whether to grant market based rate authorization.
11 Professor Kleit, welcome.

12 MR. KLEIT: Thank you, I'm Andrew Kleit. I'm
13 professor of Energy and Environmental Economics at the
14 Pennsylvania State University. It is my pleasure to speak
15 here today on the issue of non-transmission barriers-to-
16 entry in electricity markets. Before I begin, I would like
17 to take the opportunity to congratulate FERC commissioners
18 and staff on their longstanding and ongoing efforts to bring
19 about competition to energy markets. This is a difficult
20 task, but I believe the country has been well served by
21 FERC's efforts.

22 I've been asked to speak again on non-
23 transmission barriers-to-entry. This is an issue of perhaps
24 limited importance today, as questions of transmission
25 access have dominated competitive issues in electricity.

1 Looking ahead however, it is not hard to see how electricity
2 markets may evolve into a situation where non-competitive,
3 non-transmission barriers-to-entry become of great economic
4 importance. The official notice lists several potential
5 non-transmission barriers-to-entry; I'd like to speak about
6 access to fuel, financial barriers, and competitive
7 solicitation by monopsonists.

8 To generate electricity, a generator needs access
9 to input fuel. Today the most common inputs fuels are coal
10 and natural gas. Conceptually, if a firm could control
11 these fuel inputs, it could control competition electricity
12 generation. This appears more likely in natural gas
13 pipelines than in the supply of coal. But even such a
14 scenario concerning natural gas pipelines has several
15 necessary conditions. A generator using natural gas needs
16 to have access to a natural gas pipeline.

17 For a pipeline to have the incentive to exercise
18 market power, the pipeline company must also own a
19 substantial part of the electricity generation in that
20 market. In addition, the pipeline company must also have
21 market power over supplying energy to new generation sites
22 in that market. Finally, the pipeline company must not be
23 subject to duty deal(?) rules that would preclude it from
24 reducing supply to new generators. Note that it's not
25 sufficient for a natural gas pipeline to have a monopoly of

1 a particular site in order to exercise market power, rather
2 it needs to have market power across the relevant market
3 area, and thus the location sites for new generation.

4 If it does not, any attempt on the pipeline's
5 part to restrict access will simply result in generators
6 being located at sites in that market that are served by
7 other pipelines. One factor that has been alleged to
8 constitute a barrier-to-entry in electricity markets is
9 access to capital markets. I'm somewhat much skeptical
10 about this. Financial markets have certain efficiency
11 properties that we all benefit from. Investors wish to
12 invest in projects that are financially viable and avoid
13 those that are likely to lose money. In that sense they
14 have the same goals as society in general: to fund
15 investments that make economic sense.

16 Thus, financial investors use the best
17 information available to them to invest their money. They
18 use the best information because such investments are taken
19 from these investor's own funds. I do not wish to imply
20 that such investment choices are perfect; indeed we know
21 that poor investments abound. But because such investments
22 are made by very people whose money is at stake, we can
23 expect them to be better in the long run than investment
24 decisions made by a government agency, no matter how well
25 staffed and well meaning that agency is. I would suggest

1 that arguments about access to capital markets potentially
2 reflect different problems. Of course, one natural
3 conclusion about a firm's inability to gain financing is
4 that the firm's projected activity is not likely to be
5 remunerative.

6 But then one may wish to understand why such a
7 conclusion was reached. It could simply be that the
8 investment is a bad idea, both from the investor's point of
9 view and from society's. Alternatively, investment in a
10 project could be difficult because of some imperfection in
11 the relevant market. In the case of electricity generation,
12 it could be the case that transmission market problems
13 preclude successful operation of an economically efficient
14 generation facility. In this case however, financial
15 markets are not the underlying economic problem. They are
16 simply the conveyer of information, thus they should not be
17 blamed. In short it's inappropriate to shoot the messenger.
18 The problem likely lies elsewhere.

19 Another potential barrier-to-entry in generation
20 can occur when a purchasing entity in a relevant market is
21 both regulated and has a very large market share. Such an
22 entity may have a regulatory evasion reasons to discourage
23 independent power producers from being established in its
24 region. In this case, efficient independent producers could
25 find it very difficult to find buyers for the electricity

1 they produce. Note however, that this scenario is driven by
2 three specific assumptions: First, the problem must occur in
3 a well-defined anti-trust market where a particular firm or
4 perhaps a set of firms, has a large market share and
5 purchasing power. Second, the particular firm in question
6 must have the ability or be at an uneconomic cost to supply
7 the vast majority of its needs internally.

8 Third, the relevant State authority must not have
9 sufficient vigilance to prevent this type of regulatory
10 evasion from occurring. This type of barrier-to-entry has
11 previously been referred to as the exercise of monopsony
12 power, though technically this definition maybe somewhat
13 inappropriate. Monopsony power refers to circumstances
14 where a firm that purchases a large share of the relevant
15 market's output, reduces its purchases and consumption to
16 lower its own acquisition price. In the case of electricity
17 however, the regulated utility cannot reduce it final output
18 of power because of its regulatory obligations. Instead it
19 reduces its purchases of power on the open market and
20 increases its own generation.

21 Given that this problem occurs, there are two
22 potential steps that can be taken to alleviate it. First,
23 the relevant purchasing utility can be induced to join an
24 effective regional transmission organization. This would
25 expand the geographic scope of the market alleviating the

1 utility's relevant monopsony power. FERC, to its credit,
2 has been clear in its support of RTOs. Second, the relevant
3 utility could be required to offer supplying firms
4 competitive solicitation for power supplies. Done properly,
5 such solicitations could open the market to more
6 economically efficient suppliers. The difficulty here
7 however is that the relevant utility can tilt the
8 solicitation in a variety of ways towards its own production
9 facilities.

10 For example, the utility could foresee a good
11 deal of new entry in its region in the next year. It could
12 then use the solicitation this year to enter into extremely
13 long contracts with its own affiliates. This could
14 effectively preclude any new firms from entering the market
15 next year.

16 I'd like to make one additional comment: FERC's
17 goal of the competitive electricity supply system rests upon
18 the belief that investors will continue to invest in
19 electricity generation in markets without rate of return
20 regulation. FERC has thus asked the investors to put their
21 money down in a regulatory system of FERC's making. This
22 implies that FERC must be very careful not to change its
23 rules in ways that adversely affect investors. It's
24 certainly possible that the commission will seek to rectify
25 any mistakes that it might have made, but I would ask that

1 the commission always be aware that, in the end, it must
2 maintain the confidence of investors for electricity
3 restructuring to be a success.

4 Again I appreciate the chance to speak here
5 today, and I congratulate the commission and its staff on
6 this technical conference and their continuing efforts to
7 promote competition in electricity markets.

8 MR. RODGERS: Thank you very much, Dr. Kleit.
9 Let's turn to our next panelist who is Steve Schleimer, who
10 is the President of Marketing and Regulatory Affairs with
11 Calpine.

12 MR. SCHLEIMER: Thank you. Just one minor
13 correction: my name is correct, I'm Steve Schleimer from
14 Calpine, I'm the Vice President of Market and Regulatory
15 Affairs. I guess, on my flight our here, I got promoted.

16 MR. RODGERS: Yes, you did, and I'm glad to be
17 the first to let you know.

18 MR. SCHEIMER: Thank you. I had to call him back
19 in home but -- I'd like to make two points in my discussion:
20 The first, I think, the FERC needs to start thinking more
21 expansively about what constitute a barrier-to-entry. You
22 know, I know economists have concocted definitions of what a
23 barrier-to-entry is, but, you know, the way I like to think
24 about it is, to the extent that I have existing, or new
25 generation which I'd like put into a certain area and I'm

1 willing to risk some of my own equity in order to prove that
2 I have a superior product, what's keeping me from doing so.
3 One answer is that I can't get my power to the customer.
4 The panels, the previous two panels before us discussed this
5 issue in detail and I won't go further here.

6 Aside from what's keeping -- aside from getting
7 my power to the customer, the other key item is being able
8 to make sure that there is someone to sell the power to,
9 which I'm going to focus on and I think is the focus of this
10 panel. If the utility refuses to purchase capacity or
11 energy from lower cost competing generators and there is a
12 relatively small amount of wholesale purchases that are
13 available for me to sell into from other utilities in the
14 area, there are insufficient -- there maybe insufficient
15 financial incentives for competing generators, such as
16 Calpine, to make the large capital investments needed for
17 new generation. So by refusing to purchase or to provide
18 adequate transmission service, the utility is essentially
19 closing its markets to competitors.

20 The second point I'd like to make is that FERC
21 should go further in applying its affiliate rules and its
22 competitive bidding guidelines to apply to situations where
23 the utility is either proposing to self build or is
24 proposing to acquire a new generation in order to rate base
25 it. It's clear that the affiliate and the bidding rules

1 apply if utility is dealing with its unregulated affiliate.
2 But it's not clear how they apply when a utility is not
3 dealing with its affiliate but is instead proposing its own
4 utility on generation. And the way I like to think about it
5 is, that within the utility itself, there is a procurement
6 function that acquires resources on behalf of its retail
7 customers. And there is a generation function that builds
8 generation and creates earnings for their shareholders.

9 Utilities earn money when the procurement arm of
10 the utility does a deal with the generation arm of the
11 utility, but they don't earn money when the procurement of
12 the utility does a deal with the generators such as Calpine.
13 So the same inherent conflict of interest that exists and
14 has been noted with affiliate transactions, I believe, is
15 the same conflict of interest even when there is no explicit
16 unregulated affiliate when the utility is essentially doing
17 a deal with itself.

18 Over the last several years, many of the dynamics
19 in the generation market, as you all know, have changed in
20 most parts of the country. Prior to the meltdown in
21 California and all the scandals that followed -- you know,
22 we had the development of the merchant generation sector,
23 where new generation was built against the forward curve
24 essentially, with an expectation of open access, utilities
25 buying their power in the wholesale market and not relying

1 on cost of service regulated generation, as well as the
2 opening of retail markets to competitive suppliers, many
3 generators including Calpine financed and constructed a
4 significant amount of generation without contracts at all,
5 really based on the idea that in a competitive world with
6 open access, if you are better, faster and cheaper, you
7 would win.

8 But that dynamic is fundamentally changed for
9 numerous reasons. Because of a lack of stability in the
10 regulatory structure, the delayed or non-existent
11 development of RTOs, as well as the absence of meaningful
12 retail access in many parts of the country, new competitive
13 generation is not now being built and nor will it be built
14 in the foreseeable future without longer terms PPAs with
15 utilities. And much of the existing generation is pretty
16 much left without adequate transmission service and left at
17 the mercy of their local utilities. At the same time, a lot
18 of utilities have moved away from their affiliate generators
19 and have gone back to "gone back to their knitting." They
20 have gone back to investing in traditional cost of service
21 regulated generation.

22 So we are in a situation today where instead of
23 seeking out the best resources for the customers, we believe
24 the utilities are using their monopoly as the retail
25 procurement provider to award contracts to -- you know -- in

1 the form of regulated generation to their regulated arm.
2 And because they're the only buyer, their processes, to the
3 extent they exist, are created to ensure that they are the
4 winner. I know quite a bit of time -- I'll just go through
5 a couple of examples really quick of what we've seen here
6 and then I'll just wrap up. I know quite a bit of time was
7 spent this morning discussing transmission. Well, I'll
8 point out that one of the key inputs into the generation
9 process is access to long-term firm transmission rights.

10 And in California, for example, the ISO market
11 redesign proposal, would have all along -- would have all
12 firm transmission rights allocated to the three IOUs who
13 could use them to ensure transmission deliverability of
14 their own generation, but -- including their new generation,
15 but not to new IPPs, and so this creates a real impediment
16 for allowing new IPP development being able to enter into to
17 longer term contracts. Another key input in some cases is
18 access to sites; without these, you know -- it's not the
19 case that a site is a site, is a site. There are certain
20 sites where there is better transmission access than others,
21 and the utilities generally hold these for themselves or
22 provided them to the affiliates.

23 One example is in the Pacific Northwest where
24 there is a significant -- there is thousands of Megawatts of
25 un-contracted for IPP generation. And despite that, the

1 utility up there recently sought and received approval to
2 build their own plant because it's on a "well located site."
3 Well, that maybe fine, it may really be a well-located site,
4 but a competitive generator who is affiliated with a very
5 large well-funded parent company submitted a bid into that
6 process that they would build a better plant at the same
7 site for a cheaper price under a longer term PPA that
8 guaranteed it. You know, that bid wasn't even considered
9 because the site "wasn't up for sale."

10 So in each of these situations I just mentioned -
11 - and there are others and I won't take time to go through
12 those here -- the opportunities to enter the market are
13 being foreclosed by the local utility in favor of the
14 utility's own generation or the generation of an affiliate.
15 For this reason, FERC has to consider affiliate and
16 competitive bidding rules differently and more expansively
17 than you have in the past to fit today's reality and what's
18 going on in many parts of the country. Just as we
19 recognized that -- just as it was recognized that the
20 customers are harmed when a utility self-dealt with its
21 affiliate, the same thing could happen when the utility --
22 retail procurement arm is dealing with the utility's
23 generation arm.

24 So what can the FERC do about it? Some will
25 argue that there is nothing they can do because FERC doesn't

1 have jurisdiction if the utility selects a self-builder,
2 like a turnkey project or what have you. And the response I
3 have, that Calpine has provided before, is that the grant of
4 market based rate authority is privileged to utilities and
5 not a right. If a vertically integrated utility and its
6 affiliate want the privilege to sell power at market based
7 rates outside their service territory, it must implement a
8 competitive solicitation process at home to eliminate
9 barriers to entry there, and be similar to reciprocity that
10 the commission has used in order 888 and elsewhere.

11 If an entity wants to take advantage of open
12 markets elsewhere on the system, it must be required to
13 offer open markets on its own system. This means whatever
14 affiliate and competitive bidding rules this commission
15 adopts as between a utility and its affiliates should also
16 apply within the utility itself. So in conclusion I just
17 encourage the FERC that they start thinking more expansively
18 about what constitute a barrier-to-entry in the generation
19 market. These barriers ultimately boil down to a company
20 like Calpine's ability to deliver my power to customers as
21 well as making sure that there are customers at the other
22 end to deliver it to.

23 On the transmission side, this means access to
24 contracts within the procurement arm of the utility, access
25 to information, access to sites, a truly competitive

1 procurement process and, as well as what was discussed this
2 morning, access to appropriate transmission service.

3 MR. RODGERS: Okay, thanks very much, Steve,
4 appreciate that. Our last panelist today is David Portnoy.
5 And I have you listed as Manager of Financial Services, if
6 you've not heard yet, but you are Manager of Financial
7 Services at Pace Global Energy Services, so welcome.

8 MR. PORTNOV: Thank you, I wish to be elevated to
9 President but -- Good afternoon, I'd like to take -- like to
10 thank the Commission for this opportunity to comment on
11 commercial operations of merchant power plants and the
12 barriers of owners of merchant power plants based in today's
13 wholesale power markets. Pace Global is an independent
14 energy consulting firm, which among other things specializes
15 in the commercial operations of merchant power plants.
16 Specifically, my firm has assisted lenders in the
17 restructuring of projects and acquirers of merchant power
18 plants with the establishment of counter party credit and
19 risk management policies, Master enabling agreements, such
20 as EEIs, WSPEPs and HISDAs agreements and the associated
21 credit provisions and responses to request for proposals.

22 There are certain market concerns that can be
23 mitigated by legislation; however, certain economic
24 realities cannot. Each market participant must agree to
25 transact with each other under mutually agreed upon terms

1 and conditions. Not all market participants are treated
2 equally, the large or more established credit worthy market
3 participants can dictate terms and conditions to the others,
4 which allow these counter parties to exercise control over
5 the wholesale market -- power markets. These counter
6 parties have the ability to control the wholesale power
7 markets by: one, controlling the terms structure of the
8 market or the lack of with regard to products; two, the
9 credit terms and provisions in master enabling agreements;
10 and three, there currently there exist a free option for
11 these market participants that the larger utilities and
12 larger financial institutions can take advantage of.

13 It is clear to me as these projects come back to
14 the subsequent holders, the lenders, they come back naked;
15 they comeback without the commercial agreements in place in
16 order to transact in a viable environment. They are the
17 prey for these larger utilities and larger investment houses
18 which have better credit terms and can extract value from
19 these power plants. Capacity values in these markets have
20 dropped significantly, and without the lack of the long-term
21 products in the market, there is no way to really bring
22 these power plants out of that dilemma. It really hits home
23 especially when we look at the credit terms in these master
24 enabling agreements, and these enabling agreements are the
25 only way that a IPP can transact in a far reaching

1 environment. They cover every type of transaction out there
2 on a daily basis.

3 It's imperative to understand that the credit
4 terms within -- contained inside these agreements, limit,
5 and hamper the ability of an IPP to actually survive in
6 today's markets. There has been a lot said about
7 transmission and the access to transmission. I've found in
8 commercial operations recently, you can acquire certain
9 transmission, but given the current spark spreads in certain
10 markets, the ability to move your power to another market
11 via these transmission costs are completely subsumed this
12 spark spread and make it no longer a reality. We believe
13 that -- as a firm, we believe that these markets will
14 correct in the future as they grow out and remove the
15 overabundance of supply.

16 I think that right now, if you were to really
17 look in as the FERC and look at the term structure of
18 products being offered by the monopolies that exist out
19 there, you will find that they're somewhat skewed in value
20 proposition and taking advantages of the current weakness in
21 the market. I'm here today to offer you a more commercial
22 kind of view of the market of someone who actually transacts
23 in the market on a daily basis. I've managed assets both in
24 NEPOOL and ERCARD(?) and currently oversee assets and SERC.
25 I welcome any questions that you may have and try to be

1 candid to answer them.

2 MR. RODGERS: Okay, thank you very much. Had a
3 couple of questions for Professor Kleit: you said, as I
4 understood it, that a pipeline won't have market power if it
5 just has control over one site -- and I assumed you meant a
6 generating site -- that competitors would be able to just
7 choose other sites to locate their generator. But what if
8 the site that the pipeline has control over is a critical
9 site inside a load pocket where competing generation cannot
10 get in because of transmission constraints?

11 MR. KLEIT: Yeah, it strikes me, the question
12 relates to semantics about what a relevant market is. And
13 if you define a relevant market as the smallest area where
14 you can exercise market power, then I think the load pocket
15 that you referred to would constitute a market for that kind
16 of analysis.

17 MR. RODGERS: Okay, you referred to monopsony
18 power, buyer market power, have you assessed or are you
19 aware of assessments of the likelihood of monopsony power
20 being exercised in electric utility markets?

21 MR. KLEIT: I'm sorry, I've read various filings,
22 but I can't answer your question directly. And, as I noted,
23 to call it monopsony power is somewhat of a misnomer because
24 there is no reduction in output by the purchasing firm; they
25 merely supplant outside power with inside power.

1 MR. RODGERS: Okay, you mentioned three criteria
2 that would have to be present, if I understood you
3 correctly, in order for monopsony power to be successfully
4 exercised, and one of them, as I understood it, was that
5 States must not have the ability to prevent the exercise of
6 monopsony power, is that correct?

7 MR. KLEIT: Well, as I wrote it, the relevant
8 State authority must have sufficient vigilance.

9 MR. RODGERS: Okay.

10 MR. KLEIT: So, the question is whether or not
11 the relevant State authority wants to get in the way of this
12 behavior.

13 MR. RODGERS: Okay.

14 MR. KLEIT: They generally would have first shot
15 at trying to stop it.

16 MR. RODGERS: But if they did not have an
17 incentive to stop it because it would benefit their retail
18 native load rate payers, would that take that criteria off
19 the table as something that would have to be met?

20 MR. KLEIT: Well, I think -- I'm not sure but I
21 believe by assumption, it would benefit their native load
22 payers --

23 MR. RODGERS: The exercise of monopsony power
24 would --

25 MR. KLEIT: No, no, I'm sorry, the -- I think we

1 are differing on what side of the question -- but I believe
2 that, were a local company to try to exercise this so called
3 monopsony power, that it would harm their native load
4 customers because they in the end would be acquiring power
5 at a higher price than they otherwise could. And this price
6 increase would be passed on to their customers.

7 MR. RODGERS: Okay, is there a monopsony power
8 test that you are aware of?

9 MR. KLEIT: No, I think that's one of the
10 difficulties here that the monopsony power argument would
11 depend on the circumstances. One question would be, I think
12 from the generators point of view, monopsony power depends
13 on whether or not they have alternatives besides the large
14 local company, and you can solve that problem perhaps by
15 inducing the company to create a larger market and joining,
16 for example, an RTO. From the customer's point of view
17 however, this might occur whether or not the firm had a
18 large market share in a relevant market or not.

19 MR. RODGERS: Steve, you had a comment?

20 MR. SCHLEIMER: Yeah, just I wanted to comment on
21 a couple of things: One is on this issue of -- I forgot, I
22 don't know exactly the way you stated it -- but States
23 having vigilance to oversee the exercise of the monopsony
24 power or would have you; what I've personally witnessed is -
25 - and I'm speaking of the west because that's my expertise -

1 - is that in many states, and I think this is general rule,
2 many states the State regulator really doesn't have the
3 legislative authority to look at how the utility is doing
4 its procurements, especially longer term procurements.

5 I mean, you know, that in one instance the State
6 regulator is really limited to reviewing whether there is a
7 need for the new resource, not how specifically the utility
8 went about getting the resource or whether it implemented a
9 competitive procurement process, et cetera, really limited
10 to need, and when the project comes on three, four, five
11 years down the road, then they look at whether the
12 expenditures on the project were reasonable. And I think
13 that you will find that general kind of approach existing in
14 a lot of places, you know, in another State like in Oregon,
15 the Utility Commission there generally approves what the
16 utility puts in its resource plan, which may be its own
17 project or PPA or what have you, but then it's really up to
18 the utility to go and do what it's going to do. And again
19 the oversight of the State regulator is really limited to
20 reviewing the need for the resource and, after the fact,
21 were expenditures on this particular resource reasonable.
22 So I'd say in some cases, they don't have vigilance over
23 what kind of activity that's going on right here. I'd say
24 there is also --

25 MR. BARDEE: In terms of the latter part, whether

1 the expenditures were reasonable, are you saying that some
2 or a significant number of States don't have the rate
3 authority to exclude from rates, costs incurred on an
4 option, if there were cheaper option they should've taken
5 instead? You know, if the company decided to buy a plant or
6 build a plant when in fact there was other contemporaneous
7 options that were notably cheaper, would the State
8 Commission be allowed to say, well, you spent 5 million
9 dollars on this, but there is power over there from company
10 B for 4 million and we are only going to let \$4 million in?

11 MR. SCHLEIMER: I'd also note that, you know,
12 part of the problem that we have with that is that that's
13 three or four years down the road and that's just, you know,
14 way too late. I mean, you know, to solve some of these
15 issues, I think you have to do them upfront.

16 MR. RODGERS: If you have specific evidence or
17 information about which States do or do not have that
18 authority, I'd be interested in hearing that in your written
19 comments.

20 MR. SCHLEIMER: Okay, okay.

21 MR. RODGERS: Go ahead.

22 MR. PEDERSON: Mr. Schleimer, if I could just
23 back up a minute, I thought I heard you say that if the
24 utility were to choose to run its higher priced generation
25 rather than buying cheaper power from a competitor, that

1 customers could be harmed. Would it also be a possibility
2 that a utility might, in a monopsony situation might take a
3 long-term strategy of doing precisely that in order to drive
4 competition, the lower priced competition out of the market
5 or bar them from even coming in?

6 MR. KLEIT: I think that there may also be a
7 political calculation here. That is a little bit outside my
8 area of expertise, but I could imagine a situation where a
9 utility doesn't want the example of low priced competition
10 in its region, so it acts to deter it for local political
11 reasons. I'm not sure if that gets to your point or not.

12 MR. PEDERSON: No, it's not, I think -- what I
13 think I'm hearing is yes, customers can be harmed on one
14 hand, but as a long-term strategy, the utility might take on
15 that strategy in an effort to better the corporation in the
16 long run.

17 MR. KLEIT: Well, right, I mean, I hypothesized
18 here a situation where the local regulatory authority for
19 whatever region isn't -- doesn't have sufficient ability or
20 vigilance to look out for the interest of customers.

21 MR. PEDERSON: Okay, fair enough, and Mr.
22 Schleimer, if I could -- if I could just ask you a quick
23 question. I thought I heard you say that one of the -- you
24 expressed concern that some utilities were not using their
25 procurement divisions and rather they're going back to cost

1 of service rates, and which I take to be a self-build
2 option. And I thought I heard you say that a well
3 structured, competitive solicitation might solve that
4 problem, but wouldn't that only work as long as the self-
5 build option is not part of the RFP? In other words, if the
6 self-build option is part of the RFP, don't we still have
7 the same problem?

8 MR. SCHLEIMER: I think it's difficult, but, you
9 know, for example in California, they have a proposed
10 decision out by the California PUC, that would have all
11 resources -- the utilities, the three IOUs would go out for
12 PPAs as well as -- they don't call it self-build, but a
13 turnkey project where the utility gets someone else to build
14 the project for them, then turn it over to the utility, you
15 know, here's the keys and they put into rate-based, which is
16 a similar concept to the self-build and you know, they are -
17 - have thought about putting those together and how you
18 would evaluate those together, mandating an independent
19 evaluator, so that there's a third party that could see how
20 these things were being evaluated. I mean there are ways of
21 comparing the two items, but I think the key is to implement
22 rules similar to the competitive bidding rules, where you
23 have an independent evaluator and a lot more information out
24 in the public.

25 MR. RODGERS: One question I had for all three

1 panelists is, as you are aware, we have currently Four
2 Prongs for assessing whether an applicant should be granted
3 market-based rate authority, and there's not a lot of
4 specific interest that we typically have raised in filings
5 regarding the barriers-to-entry prong. And from what I've
6 heard today from the panelists, it occurs to me that a lot
7 of the barrier-to-entry concerns have overlapped in the
8 areas like affiliate abuse, would overlap into areas of
9 vertical market power, and I'm wondering if this panel
10 thinks the Commission needs to have a separate prong for
11 barriers-to-entry or whether it just needs to consider these
12 issues as part of other prongs.

13 MR. KLEIT: I'm not sure how to answer the
14 question about which prong it should be in or a different
15 angle. But what strikes me is that it may be required to
16 change your model of what generation competition really
17 means. You can think about one extreme model, which we saw
18 on the California Power Exchange, which is where everyone
19 sells on spot. And just everyday you sell power whatever
20 that price is. But, what may be evolving is the situation
21 where instead of selling on spot, you simply sell entirely
22 on contract, or almost entirely on contract. And in that
23 case, you need to make sure that the markets are open to
24 potential entrants to the market, that there are places they
25 can sell the firms on contract. Now, whether or not that

1 should be in a particular prong, is a little bit difficult
2 for me to answer.

3 MR. RODGERS: Either one of the other panelists
4 have a comment on my question?

5 MR. SCHLEIMER: I'm also having a hard time
6 coming up with a specific answer to that. I think though
7 that, as I tried to point out, there are pieces associated
8 with the barriers-to-entry that aren't necessarily
9 associated with transmission or even with the affiliate to
10 the extent that the utility is, you know, as I tried to
11 point out, you know, the procurement arm of the utility is
12 basically for closing opportunities by just doing
13 transactions with the generation arm of the utility. Or,
14 for example, if the utility is refusing to buy from IPP
15 power under contract-basis and then later coming back and
16 trying to buy the IPP power, the whole power plant on a
17 distressed asset basis. I think that those are items that
18 are worth examining and I don't know where they get looked
19 at in the other prongs.

20 MR. RODGERS: Mr. Schleimer, if I could follow up
21 on some things you mentioned earlier in your presentation.
22 You suggested the Commission to look at, as part of the
23 barriers-to-entry review, utility access to the best
24 generating sites. And I was wondering if you could tell us
25 how would we detect that if it was an improper barrier-to-

1 entry that was being erected. What would constitute proof
2 of that, and suppose the utility just said that it needed
3 that site and was acting prudently to provide new generation
4 for load growth for its native load customers?

5 MR. SCHLEIMER: Well, I think that, you know,
6 probably the most blatant example would be where, you know,
7 utility would provide that site to an affiliate at terms and
8 conditions that are significantly different or cheaper,
9 whatever, than you'd see -- than you would expect them to
10 provide that to third parties. I mean that probably would
11 be the most blatant way of testing.

12 MR. PEDERSON: Just a follow up on that, I think
13 we've heard throughout the day, we've heard a lot of
14 discussions on joint planning of transmission upgrades and I
15 was wondering if -- if joint planning of the transmission
16 would alleviate some of the concerns over which sites are
17 the best?

18 MR. SCHLEIMER: I don't know the answer to that.

19 MR. RODGERS: I got a question for Mr. Portnoy.
20 How would a utility erect barriers-to-entry by limiting
21 access to credit? Could you elaborate on what you meant by
22 that?

23 MR. PORTNOY: Specifically, when you deal with an
24 IPP, in the current stages their credit criteria is fairly
25 low at this point in time, it's sub-investment grade. Now,

1 the commercial contracts require certain provisions
2 depending on your credit worthiness and for the most part
3 you are acting at a disadvantage with regard to the
4 utilities which are superior usually on the credit standards
5 and which cause a IPP, depending on the term structure
6 there, to put up an independent amount, a performance amount
7 and margining depending on the contract.

8 These can amount to hundreds of millions of
9 dollars, and depending who currently owns the IPP, in the
10 hands of many of the financial institutions that have taken
11 back who've already felt the brunt of this are now unwilling
12 to provide additional credit to back Stock Commercial
13 Operations and therefore, it's very difficult for them to
14 breathe in the market.

15 The other thing that's very interesting about
16 that concept is that the term structure, which is being
17 offered in the market, it seems that most of the IPPs are
18 willing, or can manage to provide insignificant or
19 sufficient enough credit to transact in the day ahead,
20 hourly, maybe some of the monthly markets, however not the
21 long-term markets, thereby providing a free option to the
22 larger entities out there that can take advantage over that.

23 What I mean by the free option is that if there's
24 a marginal -- if the plant's strike price or the marginal
25 cost of generation exceeds what's currently being offered by

1 just a little bit, most of the IPPs in that particular
2 market, which are running pretty similar technology, from
3 the heat rate will dispatch and you'll watch the price
4 degrade that day. You'll see the prices start to degrade
5 because of all the power that's being placed on the daily
6 market, and what the larger participants have realized is
7 that they can take advantage of this on a consistent basis,
8 and they actually can even look at it from a little further
9 out saying, we will offer you a tolling deal for this summer
10 and pay for it over the next successive months.

11 But really the capacity payments that you see are
12 -- really amounts to blood money and it's barely enough to
13 keep these projects afloat so when they deal with an
14 affiliate they typically have the credit capacity of the
15 parent -- the parent behind it.

16 MR. RODGERS: If the Commission wanted to look
17 into issues along the lines you suggest, what kind of
18 evidence or proof would we look for?

19 MR. PORTNOY: I think it's quite simple looking
20 in some of the RFP package and the credit requirements
21 behind them. I mean they're fairly significant depending on
22 the terms and if you realize that these projects are -- have
23 very little access to credit and really can't participate to
24 that level you will see -- in the RFP packages you'll see
25 that a, you know, a BBB has to put up 5 million worth of

1 independent amount, then it's responsible for dollar for
2 dollar margining as the mark-to-market exposure increases
3 where you would see like an A would be -- have an unsecured
4 threshold of say, \$50 million which is significant.

5 MR. SCHLEIMER: I just want to add one thing to
6 that is that the way that we look at it to some extent is
7 you know, there's two kinds of worlds and two kinds of
8 credit requirements that are associated with those worlds:
9 one is your typical power marketing system, firm, liquidated
10 damages type contract which has one set of credit
11 requirements associated with it, you know, the mark-to-
12 market type credit requirements associated with it, so to
13 the extent that prices in the market go up or down, you
14 know, there's different requirements for amounts of credit
15 you need to put up.

16 The other one is credit requirements associated
17 with -- contracts or power purchase agreements that are
18 associated with specific assets and in those cases you can
19 have credit solutions which are very different than the
20 credit solutions you'd find over here. If you have a stand-
21 alone asset backed power purchase agreement you can, you
22 know, create stand-alone entities and ring-fenced entities
23 etcetera, so that when you put the package together, the
24 financing package, you can have a credit worthy financing,
25 you know, Calpine has done this for some of our plants in

1 Colorado, et cetera.

2 So, you know there's ways, you know, besides the
3 fact that you can make it a stand-alone entity, the fact of
4 the matter is, you know, you have a plant there, the plant
5 is not going to get up and walk away. So to some extent you
6 have a different risk profile for the utility and I think
7 that's ultimately what this comes down to is, you know, what
8 is the appropriate amount of insurance that the utility is
9 going to buy, you know.

10 For companies like us to provide different levels
11 of credit, you know, it costs different amounts and what's
12 the appropriate level, you know, we were involved in
13 negotiation where it, not quite literally but almost
14 literally, got to what kind of credit were we going to
15 provide in case a meteor hit the power plant, okay. Now
16 that seems a little farfetched and it actually didn't quite
17 get there, but it almost did. So you know the question is,
18 you know, what is the right level of balance between, you
19 know, risk exposure to, you know, to the -- to utilities
20 customers and to companies like ours.

21 MR. KLEIT: Let me follow up on that, I think,
22 first of all you have to understand from the utilities point
23 of view if they're going to issue a long-term contract they
24 have to know they're doing it with a solid partner. So it's
25 not surprising they would put into the contract

1 specifications a number of things to insure them against
2 default by the provider. The second thing is, as Steve has
3 pointed out, is it may be possible for the generating firm
4 to come up with a financial package that satisfies these
5 criteria. But one key is to be willing to do things in
6 different ways when you go out and look for financial
7 partners and the other thing is, as I suggested before, is
8 that if you can't get that financial packaging it may simply
9 be that the investment is a bad idea.

10 MR. TIGER: I guess it sort of depends on how we
11 define the barrier of entry in terms of whether it's related
12 to -- it seems that the whole credit issue is it's a party
13 that's making a contractual decision, you know, and I don't
14 think that that's necessarily creating a barrier-to-entry in
15 the systemic way that we're thinking about it. It may be a
16 barrier-to-entry to a particular party that doesn't fit
17 those criteria at that particular time, but to get back to
18 your point about or your claim that access to capital
19 markets because of -- they operate perfectly and efficiently
20 can just be an indication of bad investment opportunities
21 and, therefore, itself isn't the real barrier-to-entry it's
22 just an indication. You then make it the end of your point,
23 you say that FERC policies create the markets that in turn
24 determine whether there is in fact, you know, financing
25 available for those very markets.

1 So in some ways you seem to be admitting that at
2 some point the availability of finance, of financing, or of
3 capital markets access is in fact a potential barrier-to-
4 entry. Of course, that's if the market design is so
5 terrible that nobody's going to enter. So, I guess I've
6 just talked my way into not really asking you a question,
7 but I guess I just wanted to tie it into the question of
8 we're in this situation where we don't really need that much
9 new entrance, but Mr. Portnoy, perhaps or Mr. Kleit, could
10 it not be after you get through a lot of the excess
11 generation that you actually do need to either rely on long-
12 term contracts or on market based merchant generation for
13 the next level of new build. And, that if those aren't
14 available because, you know, there is this affiliate abuse
15 from the generators that, in fact, there might be a barrier-
16 to-entry based on the lack of finance?

17 MR. KLEIT: Let me try to address a couple of
18 points, I mean I -- financial markets aren't perfect but I'd
19 suggest they generate lots of information for us. And if
20 FERC has a bad regulatory regime and continually changes
21 policy, I think it's going to be very difficult for firms to
22 invest. To sell that kind of regime to investors, when an
23 investor comes, and you come to an investor and you say,
24 "Invest a \$100 million in my plant, looks very good," and
25 then the investor says, "Well, what if FERC changes the

1 rules as they just did?"

2 Now, the second point though is something I
3 referred to why I don't think this is so much of a problem
4 now but maybe in the future. Today, in many places, we seem
5 to have a glut of generation. If you think about the anti-
6 trust, the theory of barriers-to-entry to the extent there
7 is such a theory, it seems to assume that a market is in
8 what economists call equilibrium. That there is no tendency
9 for change, that the number of firms is stable.

10 In that circumstance you ask, what if two firms
11 in the market merged and tried to raise price, would there
12 be sufficient new entry to discourage or end that price
13 increase. And that's the stage, as you suggested, that
14 we're simply not at yet. That we haven't seen the shake out
15 in this industry to reach this kind of hypothetical
16 equilibrium talked about in the anti-trust context.

17 MR. RODGERS: Commissioner Brownell, did you have
18 some questions?

19 COMMISSIONER BROWNELL: I do. I have a couple of
20 questions. And I'm sorry I had to step out, so if this is a
21 redundant question, just throw something at me and I will
22 get it from the transcript. Continuing along the lines that
23 Sebastian was going in -- I think Sebastian jump in here if
24 I'm not -- I appreciate the fact that investors expect the
25 rules to be clear and investors don't like surprises and

1 that they act on information.

2 In my observation, I think shared by a few of
3 them is, they acted on information and rules they thought
4 were clear when they invested in a lot of independent
5 generation, particularly in the Southeast. They assumed
6 that the rules about access to transmission were pretty
7 straightforward and enforceable, and so the meltdown and the
8 horrific loss of capital there was that perhaps the rules
9 were just wrong. And so you can have rules that encourage
10 investment but they don't encourage the right kind of
11 investment. And along that line, I think -- I'm wondering,
12 I'm quite sure you're not saying this, that the only safe
13 place for investors to go is that regulated model as opposed
14 to where we're trying to go where there are a variety of
15 opportunities for investors, but rules that they can
16 actually rely on in a way that I think they couldn't before.
17 Are we disagreeing or not? I'm just --

18 MR. KLEIT: Commissioner, I don't believe we're
19 disagreeing.

20 COMMISSIONER BROWNELL: Okay. And you talk about
21 changing the rules and I think you said, "As we have done,"
22 or maybe as you say, "We're doing it." Okay. I -- that
23 wasn't your comment. All right. Thanks. I just wanted to
24 be sure we were on the same page. I'd like to hear a little
25 bit more about the situation in the Northwest, that very

1 specific situation. Can you give me an estimate about
2 perhaps what it costs the ratepayers in terms of making a
3 choice that really didn't offer competitive solicitation?

4 MR. KLEIT: No, I can't, because one of the
5 problems there, and this is pervasive elsewhere, is all of
6 this information is confidential and it's information that
7 we don't get to see and a good chunk of the public doesn't
8 get to see. Certain members of the utility, obviously the
9 Utility Commission and staff et cetera get to see it but
10 it's something that we don't, we don't know what the numbers
11 are.

12 COMMISSIONER BROWNELL: So, is it a situation
13 similar to one in which maybe you guys all filed a complaint
14 that was later withdrawn because the company changed the
15 rate. Is this a similar situation to Georgia?

16 MR. KLEIT: You know, I don't know.

17 COMMISSIONER BROWNELL: Okay.

18 MR. KLEIT: I don't know.

19 MS. BROWNELL: Okay. So, among the other things
20 that needs to happen at the state level -- I'm thinking of
21 things over which we have control -- things that have to
22 happen at the state level is more transparency in the
23 process and a set of rules that actually allows them to
24 compare competitive bids, apples to apples. You talked
25 about land costs, we've seen that in a number of other

1 states. I think Florida had that problem for a while as
2 well.

3 MR. KLEIT: Yeah, you know, the confidentiality
4 issue is a really big issue because of the perceived
5 competitive nature of information. Even information going
6 out 10 years from now on what utilities, loads and resources
7 are perceived to be confidential by the utility or --- and
8 is adopted by the local Regulatory Commission. What ends up
9 happening is that the only entity that really knows what
10 resources it needs is the utility itself. And so it puts
11 out RFPs which is general descriptions of what it needs, and
12 I can point to a specific case where it happened where
13 utility put out that it needed the, you know, the
14 procurement arm put out a RFP that it needed a peaking
15 resource. And the generation arm of the utility had a bid.
16 And everyone else put in their bids as well for a peaking
17 resource.

18 Now, the utility won, it picked itself, and did
19 it win with a peaking resource? Well, no, not really. It
20 won with a resource that was a peaking resource for one
21 year. And then it turned into a base load capacity
22 resource. And it only need, that was --

23 COMMISSIONER BROWNELL: Wow, how magical.

24 MR. KLEIT: Yeah, that was the only -- that was
25 the most valuable because it was the only one who knew that

1 that's what the system really needed. And, it's that kind
2 of information that I think is critical that needs to get
3 out there to really have a fair process.

4 COMMISSIONER BROWNELL: Okay. I'm just looking
5 for solutions because of course I'm very impatient with this
6 kind of stuff. So the solution is actually -- I'm thinking
7 of a two-fold solution: One is, maybe a kind of the
8 independent arbiter of the RFP Process who can look at the
9 information without compromising competitive information but
10 who is independent and has no dog in the hunt; is that --
11 would that help?

12 MR. KLEIT: Yeah, that would --

13 COMMISSIONER BROWNELL: Okay. And then secondly,
14 a more honest and open regional planning process that may be
15 looked at a variety of solutions where you could kind of
16 look at the competing solutions but also kind of what the
17 transition in terms of longer-term issues would be.

18 MR. KLEIT: Yeah. I think --

19 COMMISSIONER BROWNELL: Okay. Anymore? I'm just
20 trying to figure it out.

21 MR. KLEIT: Those two things as well as a more
22 open, transparent procurement process --

23 COMMISSIONER BROWNELL: Uh-huh.

24 MR. KLEIT: That put all the relevant information
25 out there that bidders need to know to tailor the best

1 product for the customer.

2 COMMISSIONER BROWNELL: Uh-huh.

3 MR. KLEIT: That along with independent evaluator
4 and a better review process.

5 COMMISSIONER BROWNELL: You know, it's too bad
6 that NARUC hasn't sent a representative here and we would
7 hope, in their comments they might respond to some of the
8 issues that have been raised that states could take
9 responsibility for -- I think we are seeing some states like
10 California look at that independent evaluator in ways to
11 make that process more transparent, but maybe our colleagues
12 at the state level would either individually or collectively
13 would like to comment on how that might better serve the
14 customer, which is what I hear you saying.

15 MR. SCHLEIMER: Yeah, and -- but I also think
16 though that -- it's very true, it needs, you know, there
17 needs to be State focus on it. But I also think that, you
18 know, there is potential FERC angle, and that is to the
19 extent that the utility wants to have market-based rates and
20 participate in the wholesale competitive markets outside of
21 its service territory, it has to have a wholesale
22 competitive market inside its service territory. It's a
23 reciprocity issue that I think the FERC could deal with.

24 COMMISSIONER BROWNELL: Good. We love to take it
25 upon ourselves to solve the problems of the world. But Mr.

1 Portnoy, you talked a little bit about potential
2 discrimination in terms of credit terms, which is an issue
3 near and dear to my heart. Could you just give us a quick
4 summary of, you know, kind of some examples of that, and
5 maybe in comments amplify the record with some specifics so
6 we can begin to get more focused on that issue. Although
7 we've been discussing it, I think maybe we have a little
8 more work to do.

9 MR. PORTNOY: Okay. I would say, as part of
10 competitive RFPs, I've seen, depending on the counter
11 parties for the same type of product across the credit
12 curve, a deviation in the credit requirements. I would say
13 that on a -- someone who had a triple A credit -- which is
14 very difficult to find in general, maybe more like an A
15 credit -- would receive 80 to a \$100 million of unsecured
16 limit, down to zero pretty quickly when you hit the triple
17 Bs, negative.

18 And it seems to me that this prevents us, a large
19 majority of the market participants to compete, given the
20 margining requirements that are there, and what you do see
21 as an efficient market, you see that there's intermediaries
22 that step in and credits leave, which also take away the
23 value from the independent producers inhibiting their
24 ability to grow and survive. And then what -- and you see
25 that the -- I agree that the financial institutions are

1 adding liquidity and transparency, BB, of these instruments;
2 but it seems somewhat counterproductive in my mind that, at
3 least the earlier premise that if I have a piece of iron in
4 the ground of the same technology with two different credit
5 types, that I should expect any less performance from either
6 one of them, if they're the same offering(?) technology in
7 the same market, selling to the same off-taker that I should
8 bear any further credit encumbrances just because I'm a
9 double B, especially if I'm willing to provide that the
10 contract could be assigned or second lien on the asset
11 itself. It just dumbfounds me.

12 And you see that the financial institutions that
13 take back these plans are sitting there wondering exactly
14 how they can extract significant margin without the use of
15 credit. And several years ago the threshold for credit was
16 significantly lower. I don't believe the risk has changed
17 dramatically in the sense of depending if you're selling to
18 an off-taker on a long-term contract with iron in the
19 ground, proven technology on a base load contract, how it is
20 changed even though with the downfall of Enron and other
21 large energy merchants.

22 But the plain vanilla long-term PPA out there,
23 the 10-year base load contract, 500 megawatts round the
24 clock, it just dumbfounds me how there is two entities just
25 receive different pricing with regard to their credit

1 levels, and it's significantly different.

2 COMMISSIONER BROWNELL: So the answer to the
3 response which is going to be, "Why should I take the risk
4 of somebody with a lower credit rating?" is that you can get
5 the second lien for the assignment; does that answer the --

6 MR. PORTNOY: I believe many of these assets are
7 willing to put second and third liens, and I believe -- I
8 mean, I don't think inherently the need for power has
9 changed when it takes it from a particular generator. I
10 just don't really see the deed that anything has really
11 changed from the profile or the requirement for the need of
12 load. I think that what you see happening is that since
13 you've such a inferior credit, you're forced to sell other
14 products such as unit contingent power versus firm LD, and
15 there's a deep discount for that type of product. You are
16 forced to sell a day ahead. You're forced to sell everyday
17 which causes a unique burden, and then the financial markets
18 themselves are unwilling to lend against that type of
19 contract because there's no surety in cash flows there.

20 And I just like to comment on something earlier
21 that the Professor brought up about financial markets. In
22 my mind, financial markets gravitate to the least or the
23 lowest denominator. So what they see in the market today is
24 the worst case of a merchant generator fully exposed, no
25 credit out there, willing to take any penny above marginal

1 cost in generation. They look at that and then they say,
2 "We'll discount it 50 percent," so, you know, in essence
3 these guys really don't have access to financial markets
4 because the risk is too high.

5 You find that this credit solutions that are
6 being put out there, so these special purpose entities for
7 the most part can survive, are structured deals with credit
8 enhancement that strip the value away from entities working
9 now. And quite honestly, I think in the near term it's the
10 people who would like to flip those assets for a higher
11 profit. And if you actually look into what's going on in
12 the markets right now on the pricing of distress debt,
13 you'll see that over the last couple of months those prices
14 have increased dramatically and people who are trading on
15 the distress debt themselves are making 100 percent returns
16 annualized.

17 COMMISSIONER BROWNELL: Thank you.

18 MR. RODGERS: Are there any questions or comments
19 from those in the audience? Seeing none, let me just close
20 with a couple of administrative matters, procedural matters
21 I think will be of interest to those in attendance.

22 We had issued a notice a couple of weeks ago,
23 actually the notice that announced this conference also
24 mentioned that in late January there would be a two-day
25 technical conference dealing with other market power issues.

1 And those dates are January 27th and 28th. We will have a
2 two-day technical conference that will deal with the other
3 two prongs of FERC's market power test: Affiliate of dues
4 specifically, dealing one day, and then a revisit of the
5 generation market power prong on the other day.

6 Also wanted to mention that those interested will
7 be able to file comments on today's technical conference and
8 there will be a notice coming out imminently announcing
9 that; it will probably be some time in early January.
10 Probably around the 10th of January or so that we will give
11 for comments on that, give a little extra time, because
12 we're going over the holidays. And lastly, I wanted to
13 mention again that transcripts for this tech conference will
14 be available probably in about 12 days' time. It will be in
15 the public record at that time. Want to thank very much our
16 last group of panelists today. Very much appreciate your
17 being before us and giving us helpful comments and our
18 meeting has concluded.

19 (Whereupon, at 4:36 p.m., the technical
20 conference was adjourned.)

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