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UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

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MARKET-BASED RATES OF :  
PUBLIC UTILITIES TECHNICAL : DOCKET NUMBER: RM04-7-00  
CONFERENCE ON GENERATION :  
MARKET POWER AFFILIATE :  
ABUSE ISSUES :  
- - - - -X

Commission Meeting Room  
Federal Energy Regulatory Commission  
888 First Street, NE  
Washington, D.C.  
Friday, January 28, 2005

The above-entitled matter came on for technical  
conference, pursuant to notice, at 9:00 a.m., Steve Rodgers,  
presiding.

REPORTED BY: Pam Jenkins

## 1 APPEARANCES:

2 CHAIRMAN PAT WOOD, III

3 COMMISSIONER JOSEPH T. KELLIHER

4 COMMISSIONER SUDEEN G. KELLY

5 STEVE RODGERS, OMTR

6 MICHEAL BARGEE, OGC

7 DEBORAH LEAHY, OGC

8 MARY BETH TIGHE, OMTR

9 DAVID HUNGER, OMTR

10 BRYAN CRAIG, OMOI

11 DAVID TOBENKIN, OMOI

12 JERRY PEDERSON, OMTR

13 KELLY PERL, OMTR

14 RICHARD O'NEILL, OMTR

15 CLIFFORD FRANKLIN, OMTR

16 MORNING PANEL 1

17 R. ALAN KELLEY, SENIOR VICE PRESIDENT OF

18 GENERATION AMEREN CORPORATION

19 ROBERT M. "BERT" GARVIN, COMMISSIONER, WISCONSIN

20 PUBLIC SERVICE COMMISSION

21 DAVID DERAMUS, PARTNER AND VICE PRESIDENT, BATES

22 WHITE, LLC

23 TERRY HUVAL, DIRECTOR LAFAYETTE UTILITIES SYSTEM,

24 REPRESENTING TAPS

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PANEL II  
STEVE CORNELI, VICE PRESIDENT OF REGULATORY  
AFFAIRS, NRG ENERGY, INC., REPRESENTING EPSA  
ED COMER, GENERAL COUNSEL, EDISION ELECTRIC  
INSTITUTE  
JAN SMUTNY-JONES, EXECUTIVE DIRECTOR, INDEPENDENT  
ENERGY PRODUCERS ASSOCIATION  
DENNIS EICHER, PRESIDENT, POWER SYSTEM  
ENGINEERING  
ALLEN FREIFELD, COMMISSIONER, MARYLAND PUBLIC  
SERVICE COMMISSION

## P R O C E E D I N G S

1  
2 MR. RODGERS: This is day two of our three-day  
3 testimony dealing with market power issues in the electric  
4 market. And the subject of today's panels are affiliated  
5 use and reciprocal dealing issues, as well as other factors  
6 that the Commission should consider in determination of --  
7 regarding the grant of market-based rate authorization.  
8 Factors that may not be rebutted in the current four part  
9 test.

10 The affiliate abuse and reciprocal dealing issues  
11 have been a part of FERC's four prong test for a number of  
12 years now. And we have two panels this morning.

13 The first panel will run until probably about  
14 11:00 o'clock, and we'll take a fifteen or twenty minute  
15 break. And then we have the second panel that will begin at  
16 that time. And so that is a difference in our schedule from  
17 what was reported in the two notices. So the conference  
18 today will probably end around 1 p.m. and the other end at  
19 4:30 p.m., as was put in the notices.

20 With that, why don't we go ahead and get started  
21 with our first panelist, who is Alan Kelley, Senior Vice  
22 President of Generations for Ameren Corporation. Welcome,  
23 Mr. Kelley.

24 MR. KELLEY: Thank you. Good morning.

25 As Mr. Rogers said, my name is Alan Kelley, and

1 I'm the Senior Vice President of Generation for Ameren  
2 Corporation. I'd like to thank the Commission for offering  
3 me this opportunity to be here today.

4 In its conference agenda regarding this panel,  
5 the Commission asked whether its current regulations and  
6 enforcement policies used to address affiliate abuse and  
7 reciprocal dealing are adequate? I believe that they are.

8 Particularly, as bolstered by changes made in the  
9 last year. The Commission's current policies, effectively,  
10 ensure that the affiliates of franchised utilities receive  
11 no preferential treatment. And that affiliated and non-  
12 affiliated entities compete on a level playing field. By  
13 contrast, it would harm both consumers and competition if  
14 the Commission changed its current policies in a manner that  
15 placed affiliates at a competitive disadvantage, relative to  
16 non-affiliates.

17 I will elaborate on both of these points. Before  
18 doing so, however, I would like to briefly discuss the  
19 unusual circumstances in which Ameren operates. Those  
20 circumstances create the context for my comments today.

21 Ameren is an electric and gas utility holding  
22 company, with operations throughout the Midwest. Ameren  
23 owns, among other assets, four utility operating companies  
24 in Illinois and Missouri that together serve 2.3 million  
25 electric customers. Owing in large part to the policies of

1 the Illinois Commerce Commission and the Missouri Public  
2 Service Commission, the asset make-up of Ameren's utility  
3 operating companies differ markedly by state. Ameren's  
4 Illinois-based operating companies have largely divested  
5 their generating assets and now are essentially "wires only"  
6 companies. In contrast, Ameren's Missouri-based operating  
7 company, AmerenUE, continues to own and operate the vast  
8 majority of the generation resources on which it relies.

9 In addition to its utility operating companies,  
10 Ameren owns two major non-utility generating companies and a  
11 power marketer. Ameren's non-utility generating companies  
12 own approximately 5,700 megawatts of generating capacity  
13 that is used to serve the power needs of Ameren's Illinois-  
14 based operating companies, and is marketed into the  
15 wholesale power markets in the Midwest.

16 Ameren recognizes the importance of protecting  
17 consumers and promoting wholesale power markets in which all  
18 participants compete on a level playing field. The  
19 Commission is committed to these goals which can be put at  
20 risk if franchise utilities give preferential treatment to  
21 their abilities. Codes and standards of conduct, among  
22 other things, ensure that affiliated generators or marketers  
23 do not receive preferential access to transmission  
24 information.

25 Similarly, the Commission's policies on affiliate

1 transactions ensure that affiliates are placed on a level  
2 playing field with non-affiliates for long-term power and  
3 asset sales.

4 These current policies adequately protect against  
5 affiliate abuse and considerable dealings. Since 1991, the  
6 Commission has used the Edgar Standards to evaluate market-  
7 based rates in affiliate power sales in order to assure that  
8 such transactions are not the result of affiliate abuse, and  
9 that proposed prices are consistent with competitive  
10 outcomes.

11 Twice in the last year, the Commission has  
12 extended Edgar's reach to enhance the security of affiliate  
13 transactions in other contexts. First, last February, the  
14 Commission extended the Edgar Standards to cover cost-based  
15 power sales between affiliates. Second, in a July order  
16 involving Ameren, the Commission held that the Edgar  
17 Standard would apply respectively to transfer of  
18 jurisdictional assets between affiliates.

19 In that order, the Commission also established  
20 guidelines for competitive solicitations and stated that if  
21 utility issuing a request for proposals following these  
22 guidelines, it would be much to satisfy the Edgar Standards.  
23 Highlighting the core of its concern about affiliate abuse,  
24 the Commission further state that the fundamental objective  
25 of the solicitation guidelines is that the affiliate should

1 have no undue advantage over non-affiliates in the  
2 solicitation process.

3 As indicated in this order, the Commission's  
4 current policy when an affiliate abuse to protect consumers  
5 and competition by preventing preferential treatment for  
6 affiliates and assuring that affiliates and non-affiliates  
7 compete on equal footing. As long as the Commission retains  
8 those goals, its code and standards of conduct regulations,  
9 and expended use of Edgar tests are up to the task.

10 The final question posed by the agenda on the  
11 exhibit for this panel; however, could be read as raising  
12 the question of whether the Commission should offer its  
13 policies on affiliate abuse. That question asks do even the  
14 legitimate affiliate dealings impede the development in  
15 competitive wholesale markets?

16 If the Commission were to answer this question in  
17 the affirmative, it might conclude that in addition to  
18 preventing preferential treatment for affiliates, and  
19 assuring that affiliates and non-affiliates compete on a  
20 level playing field, the Commission should also restrict  
21 legitimate affiliate dealing. Any such shift in the goals  
22 of the Commission's policies on affiliate abuse would be, in  
23 my view, a great mistake.

24 Commissioner Kelliher stated last July that the  
25 Commission has a legal duty to protect competition, not

1 competitors. If the Commission were to adopt policies and  
2 place affiliates in competitors disadvantage relative to  
3 non-employed entities, it would harm the consumers and  
4 competition. Competition breeds efficiency, which creates  
5 the greatest benefits for consumers in the long-run. If  
6 competition were stifled, such as by placing affiliates at a  
7 competitive disadvantage, consumers would suffer in the  
8 long-run. As long as there is no preferential treatment,  
9 affiliates must be allowed to compete with non-affiliates  
10 whenever and wherever they want.

11 Ameren's Illinois-based utilities, for example,  
12 will be holding an auction next year for all of their power  
13 needs beginning January 1, 2007. Their affiliates must be  
14 permitted to bid in this auction -- which Ameren, with  
15 stakeholder and ICC input, has designed to comply with the  
16 guidance provided by the Commission in its July 2004 Ameren  
17 and Allegheny Energy orders. Prohibiting Ameren's  
18 affiliates from participating will not only be patently  
19 unfair, but will result in less competition and, most  
20 likely, higher prices.

21 There may be instances in which an affiliate is  
22 the most efficient provider of power based, for instance, on  
23 their knowledge of the area built up over long years of  
24 service. In such instances, consumers benefit from the  
25 selection of that most efficient option. Competition also

1 benefits because less efficient competitors are forced to  
2 build up their own knowledge in offerings. Placing  
3 affiliates at a competitive disadvantage by restricting  
4 "legitimate affiliate dealings" would amount to an  
5 unwarranted subsidy to non-affiliated entities by promoting  
6 their selection even where they are not the most efficient  
7 alternative. Ultimately, consumers would suffer and pay  
8 higher prices as a result.

9           Again, I want to thank you for offering me the  
10 opportunity to participate in today's discussion. I would  
11 be happy to answer any questions, if you like.

12           MR. RODGERS: Thank you, Mr. Kelley. We  
13 appreciate that. Why don't we next turn to Robert or Bert  
14 Garvin, who is a Commissioner for the Wisconsin Public  
15 Service Commission. Welcome.

16           MR. GARVIN: Thank you. Thank you for giving me  
17 the opportunity to participate today in your important  
18 technical conference. My name is Bert Garvin, I am a  
19 Commissioner on the Public Service Commission of Wisconsin,  
20 and I'm testifying today on behalf of the Commission.

21           The PSCW has consistently supported the FERC's  
22 efforts to eliminate undue discrimination in transmission  
23 service, and promote more competitive wholesale electricity  
24 markets in the United States. By assigning control over our  
25 state jurisdictional transmission facilities to a FERC

1 approved RTO as a matter of state law back in 1998,  
2 Wisconsin has demonstrated its commitment to establishing  
3 the federal-state partnership needed to foster more  
4 wholesale competition, as well as a more robust transmission  
5 system that benefits Wisconsin consumers and provides  
6 greater reliability in the Upper Midwest.

7 I want to commend the FERC for initiating this  
8 dialogue as part of its ongoing public efforts to reach out  
9 to stakeholders in order to re-tool its market-based policy  
10 and develop necessary mitigation measures to prevent the  
11 unlawful exercise of market power in bulk power markets.  
12 Since today's proceeding focuses on just one prong of FERC's  
13 current four-prong approach for assessing market power in  
14 electric markets relating to affiliate abuse, I think it  
15 might be helpful to make the initial observation that state  
16 regulatory commissions like the Public Service Commission of  
17 Wisconsin share the FERC's interest in preventing the  
18 exercise market power, promoting market efficiency and  
19 ensuring careful regulatory oversight of affiliate  
20 transactions.

21 While NARUC has no official policy on this  
22 matter, it is fair to say that the main differences between  
23 federal and state regulators may relate to the actual  
24 mitigation measures employed to achieve our shared objective  
25 in preventing affiliate abuse. In today's volatile energy

1 markets, there is little room for error for either federal  
2 or state regulators in carrying out our statutory  
3 responsibilities to ensure just and reasonable rates for  
4 wholesale and retail customers, respectively.

5 I have seen firsthand, the tremendous challenge  
6 we face in balancing our state's policy objectives of  
7 fostering greater wholesale competition, while ensuring  
8 price stability for retail consumers during a time of rising  
9 fuel costs, environmental costs, as well as capital costs  
10 for needed new generation and transmission investments. For  
11 these reasons, I hope the FERC will continue this important  
12 dialogue with my colleagues at NARUC to address any  
13 perceived "gaps" between federal and state regulation of  
14 affiliate transactions that respects our respective  
15 jurisdictions.

16 The FERC has correctly reminded us that the  
17 ability of a FERC regulated public utility to sell wholesale  
18 electricity at market-based rates under 205 of the Power  
19 Act is a privilege, not a right. At the same time, I agree  
20 with Chairman Wood that the revocation of market-based rates  
21 should be reserved for truly odious behavior. In the  
22 context of 205 applications, the FERC has consistently  
23 stated in cases involving sales agreements between  
24 affiliates, it is essential that these transactions be above  
25 suspicion so that ratepayers are protected and market forces

1 are not distorted. The FERC, through its application of the  
2 Edgar test has approved many bulk power -- affiliate bulk  
3 power sales resulting from competitive bidding processes  
4 after determining that the proposed sale was the result of  
5 direct head-to-head competition between affiliated and  
6 competing nonaffiliated providers.

7           There is considerable variation among the states  
8 regarding the type of regulatory oversight over affiliate  
9 transactions. The Public Service Commission of Wisconsin,  
10 for example, has extensive statutory authority to regulate  
11 affiliate transactions governing both the construction of  
12 new generation facilities through affiliates and the sale of  
13 electricity between utility and non-utility affiliates  
14 within a holding company system. Like other state  
15 commissions, we also have broad authority to deny recovery  
16 in retail rates of any imprudent costs associated with  
17 affiliate transactions.

18           While the FERC clearly has jurisdiction to  
19 implement mitigation measures it feels are necessary to  
20 mitigate market power in the area of bulk power sales  
21 between affiliates under 205, there appears to be  
22 considerable uncertainty over what the focus of FERC's  
23 affiliate abuse policy should be, as stated in the questions  
24 put to this panel; such as whether the focus should be on  
25 merely protecting competition in the wholesale market,

1 wholesale captive customers only and wholesale and -- for  
2 wholesale and retail captive customers.

3 There also appears to be uncertainty over the  
4 ability and willingness of state PUC's to carefully review  
5 affiliate transactions, or whether there are real or  
6 perceived state regulatory failures regarding affiliate  
7 transactions.

8 I reviewed the testimony of a number of the  
9 panelists that appeared here in December, who suggested in  
10 their testimony that state regulators currently lack either  
11 the will or the ability to adequately address any perceived  
12 affiliate abuses.

13 For example, one witness suggested that state  
14 Commissions lacked a familiarity with competitive issues and  
15 mainstream thinking about competitive issues. While I do  
16 not share the view that state regulators lack either the  
17 resources or vigilance to protect retail customers from the  
18 higher costs that result from affiliate abuse. Those  
19 concerns, along with the other questions we consider today  
20 are illustrative of the need for greater clarity and  
21 coordination between federal and state regulators to develop  
22 enforceable protective conditions to prevent affiliate  
23 abuse. It's imperative, in my view, that we work together  
24 to ensure that the competitive implications of affiliate  
25 transactions are carefully analyzed and remedies developed

1 to ensure that neither competition nor customers are harmed.

2

3 In my view, the FERC's affiliate abuse policy  
4 should primarily focus on protecting captive wholesale  
5 customers, and not on protecting competition in the  
6 wholesale market, and certainly not protecting retail  
7 customers. While customers can seek redress from regulators  
8 for damages caused by affiliate abuse, in many ways, the  
9 harm's competition or potential competition has already  
10 occurred. More importantly, simply asserting that a remedy  
11 has been crafted to protect competition in the wholesale  
12 market could have the adverse unattended consequence of  
13 improperly intruding upon state jurisdiction and capacity  
14 resource planning for retail service.

15 Where I see the greatest potential tension or  
16 conflict arises from the FERC's decision in the Ameren case  
17 last summer to apply the Edgar Standard to affiliate  
18 acquisitions under 203 of the Federal Power Act. The  
19 extension of the Edgar test for market-based sales  
20 arrangement with affiliates to public utility acquisitions,  
21 state approved affiliate generation is a significant  
22 departure from prior FERC policy and may represent  
23 significant encroachment on the traditional role of state  
24 PUCs for generation of resource procurement, planning and  
25 supply adequacy.

1           The reason this potential encroachment worries me  
2           is that it invites the FERC, using its 203 authority in the  
3           Edgar test to second guess any future state approved  
4           generation resource procurement decision that results in  
5           that acquisition of an affiliate plant with the construction  
6           of new facilities through an affiliate that fails to follow  
7           the FERC interpretation of the Edgar test.

8           In an "all peaker" environment adhering to the  
9           FERC's requirement will not be onerous and may be welcome by  
10          many of my state commissions. Where I expect it to be  
11          difficult to adhere to FERC's new mandate is in the cases  
12          involving future state PUC approval of proposals by both  
13          certain entities to acquire or construct much needed base-  
14          load facilities. The need to replace aging base-load fleets  
15          in the upper -- base-load plants in the upper Midwest will  
16          become even more urgent over the next decade with tougher  
17          environmental standards. A number of states, like mine, are  
18          currently grappling with or will soon face the difficult  
19          policy decisions that come with the replacement of its aging  
20          base-load generation fleet.

21          There are multiple price and non-price factors  
22          that must be considered by load serving entities and state  
23          regulators in considering which mix of generation and  
24          procurement is in the public interest and will ensure  
25          reliability. In those cases, state commissions will be

1 asked to consider a wide variety of different proposals  
2 ranging from wholesale merchant plants, traditional rate-  
3 based facilities or affiliate arrangements in order to meet  
4 urgent base-load generation needs. My concern is that the  
5 FERC's latest foray into affiliate generation acquisitions  
6 may have the unintended effect of adding regulatory  
7 uncertainty and potentially stifling future innovative  
8 approaches to constructing and financing new base-load  
9 generation facilities.

10 In summary, I hope the FERC will continue this  
11 important dialogue with state regulators in order to provide  
12 greater clarity in our mutual efforts to protect wholesale  
13 competition and competitors, and retail customers from  
14 affiliate abuse. While this aspect of today's technical  
15 conference is focused on preventing affiliate abuse, I would  
16 also encourage the FERC to also work with the states to  
17 address the more fundamental issue needed to have healthier  
18 wholesale markets. And that's the critical need to have --  
19 to foster greater transmission investment in our country.

20 Thank you for giving me the opportunity to  
21 participate and I look forward to any questions. Thanks.

22 MR. RODGERS: Thank you very much, Commissioner  
23 Garvin.

24 Let's next turn to David DeRamus, who is a  
25 partner and vice president with Bates White, LLC.

1                   MR. DERAMUS: Thank you very much. Bates White  
2                   LLC is an economic consulting firm. And I'd like to thank  
3                   the Commission and Commission staff for the opportunity to  
4                   present my comments in today's forum. And I should also  
5                   note that while my comments today aren't sponsored by any  
6                   individual market participant, I have recently testified on  
7                   behalf of Calpine and Occidental Chemical in Entergy and AEP  
8                   market-based re-application.

9                   Before I address the issue of buyer market power,  
10                  which I consider to be one of the most significant  
11                  manifestations of affiliate abuse in electric power markets  
12                  today, I'd like to make a few comments about the overall  
13                  importance of a thorough consideration of affiliate abuse  
14                  issues, especially within the context of market-based rate  
15                  proceedings.

16                  Given the amount of attention focused on the  
17                  generation market power screens, including not only  
18                  affiliate abuse, but also transmission market power and  
19                  barriers to entry. I'm especially concerned that these  
20                  should not become sidelined and ultimately neutered as  
21                  substantive issues in market-based rate applications.

22                  And I apologize in advance because my comments  
23                  today are a little bit longwinded, but the length of  
24                  comments is somewhat motivated by this perception.

25                  The issue of affiliate abuse arises in many

1 different Commission proceedings. Most obviously in Section  
2 205 proceedings involving specific transactions between  
3 vertically integrated utilities and their wholesale  
4 generation and marketing affiliates. The issue of affiliate  
5 abuse may also arise within the context of acquisitions. As  
6 I noted in my comments, in the Commission's June 2004  
7 Technical Conference, acquisitions and, particularly  
8 distressed acquisitions, may be motivated by attempts to  
9 foreclose the wholesale market to competing generators,  
10 reflecting the incentives of some market participants to  
11 artificially discriminate in favor of their own generating  
12 units. In fact, such acquisitions can provide good "natural  
13 experiments" to use the term often used by Thomas, to test  
14 the hypothesis of whether a market participant is engaging  
15 in affiliate abuse. If there is a change in dispatch or  
16 transmission access of the generating unit after the  
17 acquisition, and there is no other change in market  
18 fundamentals or infrastructure accompanying the acquisition,  
19 that can be a strong signal of affiliate abuse.

20 In market-based rate applications, the Commission  
21 has both the opportunity and the obligation to assess  
22 whether, taken as a whole, an applicant is able to exercise  
23 market power through whatever means are at the applicant's  
24 disposal, including affiliate abuse.

25 In making this assessment, the Commission should

1       conduct a "searching inquiry" into the issue of affiliate  
2       abuse, as it would in reviewing a specific inter-affiliate  
3       transaction that requires Commission approval. Just as the  
4       Commission would be ill-advised to apply a simple "check-  
5       the-box" approach in approving a specific inter-affiliate  
6       transaction, e.g., by asking whether an applicant has on  
7       file an appropriate code of conduct. So, too, would the  
8       Commission be ill-advised to rely on such a "check-the-box"  
9       approach to affiliate abuse issues in market-based rate  
10      applications.

11                 In considering how high to set the "bar" for  
12      evaluating whether an applicant is able to exercise market  
13      power as a consequence of affiliate abuse, I would propose  
14      that the "bar" be set reasonably high, since affiliate abuse  
15      is one of the main underlying means by which market power  
16      can be exercised in wholesale markets, particularly in  
17      markets without a fully functioning RTO. Furthermore, even  
18      the potential for affiliate abuse results in self-  
19      reinforcing market power problems, since it perpetuates  
20      artificial advantages of an incumbent and establishes a  
21      barrier to entry for new competitors.

22                 Failing to identify the potentials for affiliate  
23      abuse, therefore, has long-term negative consequences for  
24      competitive markets and these are consequences that the  
25      Commission should not underestimate.

1           In thinking about the standard to be applied in  
2 assessing all of the other three prongs of the Commission's  
3 market power test, I should also caution the Commission  
4 against focusing solely on the behavior of the applicant and  
5 ignoring the consequences of the structural features of the  
6 market at issue. For example, in a given market, there may  
7 simply be no bona fide competitive solicitation process or  
8 independent auction markets, and thus, no mechanism through  
9 which competing generators can gain access to an adequate  
10 source of the wholesale market -- an adequate share of the  
11 wholesale market in order to discipline the pricing behavior  
12 of the applicant. That absence alone, independent of any  
13 explicit actions or intent by the applicant may be  
14 sufficient to foreclose competition from certain markets.

15           I have noticed a similar overemphasis on  
16 behavioral issues in the Commission's inquiry into whether  
17 applicants have "erected" barriers to entry, instead of  
18 inquiring simply whether such barriers to entry exist,  
19 regardless of the applicant's role in erecting or  
20 perpetuating those barriers to entry. The mere existence of  
21 barriers to entry, such as a lack of adequate transmission  
22 capacity for new entrants, can be sufficient to prevent a  
23 market from resulting in competitive prices and should be an  
24 important consideration before granting an applicant market-  
25 based rate authority.

1           I should also note that the approach I am  
2 suggesting in evaluating the other three prongs of the  
3 Commission's market power test is no different than the  
4 Commission's approach to assessing generation market power.  
5 In the latter, the Commission makes its determination of the  
6 potential for the exercise of market power based on the  
7 structure of the market, i.e. the level of concentration in  
8 the market, rather than on the applicant's past pricing  
9 behavior. I am simply suggesting that a lesser standard not  
10 be applied in evaluating the other three prongs of the  
11 Commission's market power test.

12           The issue of affiliate abuse is one area in which  
13 economists, attorneys and regulators use the same terms but  
14 often with varying assumptions about what those terms really  
15 mean. As an economist, I define affiliate transactions to  
16 encompass potentially any exchange of a good or service  
17 between related parties, i.e., any transaction for which the  
18 terms are dictated by administrative fiat, and not by a bona  
19 fide market mechanism.

20           Thus, when a load-serving entity uses its own  
21 generation facilities to deliver power to its native load  
22 customers, and when it transports that power over its own  
23 transmission lines, I consider that entity to have engaged  
24 in a series of affiliate transactions, regardless of whether  
25 or not there are observable accounting entries recorded for

1 separate legal entities. I consider the potential for  
2 affiliate abuse to be largely independent of the legal  
3 structure of the applicant, since it is the substance and  
4 not the form of the transaction that matters for economic  
5 analysis.

6 This perspective is important to have in mind in  
7 assessing the efficacy of a code of conduct as a means of  
8 preventing affiliate abuse. If, for example, an applicant's  
9 code of conduct is inapplicable to certain inter-affiliate  
10 or affiliate transactions, considered broadly, simply  
11 because of the legal structure of the firm or the particular  
12 nomenclature applied to the affiliate, then clearly such a  
13 code of conduct could not prevent affiliate abuse, even  
14 before considering the substance of the code of conduct  
15 itself.

16 In other words, an applicant should not be able  
17 to "define away" the problem of affiliate abuse by  
18 implicitly or explicitly restricting its code of conduct  
19 from applying to important affiliated entities and  
20 transactions.

21 Consistent with the need for a "searching  
22 inquiry," the Commission must assess whether an applicant's  
23 specific code of conduct within the context of the  
24 applicant's business structure and practices, will be  
25 effective in preventing affiliate abuse. Otherwise, relying

1 on a code of conduct to prevent affiliate abuse without  
2 fully understanding how it will operate within the  
3 applicant's actual business could result in the Commission  
4 actually sanctioning preferential treatment of affiliates.

5 As a general matter, I should also emphasize that  
6 I have little faith in the efficacy of such behavioral  
7 remedies to affiliate abuse, but rather have a strong  
8 preference for structural remedies, as I will discuss  
9 further below.

10 Affiliate abuse constitutes any behavior through  
11 which a market participant is able to provide discriminatory  
12 advantages to its own competitive operations as a  
13 consequence of its regulated monopoly operations. The most  
14 obvious form of affiliate abuse occurs when a utility is  
15 able to cross-subsidize its unregulated marketing operations  
16 with its regulated operations, i.e., offering wholesale  
17 customers with lower cost power by inappropriately shifting  
18 costs onto its captive retail customers. I can also  
19 emphasize, of course, that gaps can occur which I believe is  
20 a primary concern in Edgar. "Transmission market power" is  
21 also effectively a form of affiliate abuse, since when it  
22 occurs a vertically integrated utility typically uses its  
23 monopoly power over transmission service in order to provide  
24 its own generation affiliates, with advantages that are not  
25 afforded to competing generators.

1            Yet another form of affiliate abuse, is the  
2            exercise of buyer market power in which a vertically  
3            integrated utility uses its regulated monopoly native load  
4            franchise and its resulting position as the dominant actual  
5            or potential buyer of wholesale power in a given market in  
6            order to foreclose access by competing generators to the  
7            wholesale market.

8            Buyer market power, of course, is simply the  
9            flip-side of seller market power, and can result in equally  
10           anticompetitive outcomes. When there is only one buyer of a  
11           good or service in a market, that buyer is often able to  
12           dictate the terms of the transaction that are more favorable  
13           to the buyer than would be expected under competitive  
14           conditions, and typically with a negative impact on ultimate  
15           consumers as well.

16           The type of buyer market power that I am most  
17           concerned about in the electric power industry is when a  
18           vertically integrated utility is able to foreclose competing  
19           generations from the wholesale market by simply refusing to  
20           purchase power from competing generators, even when power  
21           from competing generators is available at a lower cost.

22           The incentives for a utility to engage in such  
23           foreclosure is typically not to drive down the price of  
24           purchased power below a competitive level, although that too  
25           may occur in certain instances. But rather in order to

1 substitute its own higher cost generation for lower-cost  
2 competing alternatives. Since a regulated utility can  
3 maximize its profits by maximizing its rate base, it has an  
4 incentive to discriminate in favor of its own generation,  
5 even if that generation comes at a higher cost than  
6 competing alternatives, in order to ensure the continued  
7 inclusion of that generation in its rate base.

8 Thus, in order for such buyer market power to be  
9 a significant concern with respect to competitive  
10 foreclosure, the utility typically must own a substantial  
11 amount of generation of its own generation relative to its  
12 native load. Whether a utility is able to foreclose  
13 competing generators through its monopoly position as the  
14 transmission owner, as has typically been the Commission's  
15 concern, or through its monopoly position with respect to  
16 native load, the impact on the wholesale market is the same,  
17 and fewer participating suppliers ultimately result in the  
18 increased wholesale prices.

19 I have noticed that in these discussions,  
20 attempts are often made to draw sharp distinctions between  
21 "generation market power," "transmission market power,"  
22 affiliate abuse, and barriers to entry as if they refer to  
23 very different types of market power. In most cases,  
24 however, the central issue to be addressed with all four  
25 prongs is whether the applicant is able to increase prices

1 or foreclose competition in wholesale generation.

2 The Commission's four prong test for market power  
3 provides an appropriate framework within which to review the  
4 structural conditions of a market, the applicant's position  
5 within that market, the potential impact of the applicant's  
6 continued control over transmission, the potential impact of  
7 the applicant's position as a significant purchaser and a  
8 significant seller in the wholesale market, and the  
9 applicant's observed behavior, i.e., its demonstrated  
10 ability and willingness to use its dominant position in  
11 order to raise prices or foreclose competitors.

12 In many instances, I do not consider these issues  
13 to be neatly separable; rather, they all reflect different  
14 aspects of an applicant's overall ability to exercise market  
15 power. Thus, while affiliate abuse as a conceptual matter  
16 deserves a full airing, it should not and cannot, be  
17 considered in isolation from the other prongs of the  
18 Commission's market power analysis.

19 Given the large number of applicants requesting  
20 market-based rate authority, I realize that the Commission  
21 inherently faces a tradeoff between accuracy and expediency  
22 in establishing guidelines with which to identify the  
23 potential for affiliate abuse.

24 Unfortunately, a "bright line" test for affiliate  
25 abuse that simply requires a code of conduct veers far too

1 much towards expediency, with a very great risk, and in my  
2 mind, a near certainty, of authorizing market-based rates  
3 for some participants with the clear potential to engage in  
4 affiliate abuse, and thereby distort the functioning of  
5 competitive wholesale markets. For similar reasons, the  
6 Commission would also be ill-advised to wager on an OATT  
7 alone to ensure against transmission market power, or to  
8 wager on a limited checklist approach to identifying  
9 barriers to entry.

10 The Commission is not alone among regulatory  
11 institutions in struggling with how to identify the elements  
12 of a "workably competitive" market and even what constitutes  
13 permissible market behavior in order to provide market  
14 participants with regulatory certainty, while also  
15 fulfilling their legal mandate to protect competition and  
16 the public interest.

17 I would suggest that many of these issues raised  
18 in market-based rate applications ultimately require a "rule  
19 of reason" type of approach, as is often used in antitrust  
20 analysis. The alternative, effectively forcing all concerns  
21 into a "per se" or "bright line" test is almost guaranteed  
22 to result in the exercise of market power; and worse,  
23 regulatory protection for the exercise market power.

24 I do think that the Commission has embarked down  
25 the right road in its approach to analyzing generation

1 market power by setting up indicative screens that are used  
2 to simply establish a "rebuttable presumption" of market  
3 power, or lack thereof, a procedural device that  
4 appropriately balances the competing demands for accuracy  
5 and expediency.

6 I would suggest that the Commission follow a  
7 similar "rebuttable presumption" approach with respect to  
8 affiliate abuse, as well as with transmission market power  
9 and barriers to entry, which are simply subsets and  
10 supersets of affiliate abuse, respectively. For example,  
11 there should be a rebuttable presumption of affiliate abuse,  
12 or at the very least, the potential for affiliate abuse, and  
13 hence market power if:

14 (1) an applicant is a vertically  
15 integrated utility with continued ownership and control over  
16 transmission;

17 (2) there is no fully functioning RTO  
18 in the market at issue;

19 (3) there is significant capacity from  
20 lower cost competing generators located within the  
21 applicant's control area;

22 (4) there is continued dispatch of the  
23 applicant's higher cost generation despite the availability  
24 of lower cost competing generation; and

25 (5) there are complaints by

1        intervenors that, if ultimately proven true, would  
2        constitute affiliate abuse.

3                Including the other prong to the Commission's  
4        market power analysis in such a "rebuttable presumption"  
5        approach is even more imperative, if, in addition, an  
6        applicant also fails the generation market power indicative  
7        screens, since it is necessary to consider the other three  
8        prongs in order to properly perform the Delivered Price  
9        Test.

10               The Delivered Price Test is a largely theoretical  
11        exercise that derives a market supply curve, based solely on  
12        the marginal costs for each generator, providing capacity-  
13        based market shares at various price levels. While such an  
14        exercise is useful, it is still incomplete until compared  
15        against actual historical sales based or generation market  
16        share data. Such a comparison, in turn, can raise a number  
17        of important questions.

18               How closely do the results of the Delivered Price  
19        Test compare to the applicants' actual market share? Is the  
20        divergence attributable to transmission constraints that  
21        effectively establish a barrier to entry to competing  
22        generators? Is the divergence attributable to affiliate  
23        abuse, e.g., preferential access to transmission service,  
24        the exercise of buyer market power, the imposition of  
25        additional costs on competing generators that are not borne

1 by affiliates, or other means of impeding or foreclosing  
2 competing generators from participating in the wholesale  
3 market?

4 The answers to these questions ultimately  
5 determine the conclusions one draws from such a generation  
6 market power analysis. Thus, an overall assessment of  
7 market power and even generation market power alone cannot  
8 be accomplished if each of these prongs is placed in a  
9 vacuum.

10 Finally, as I indicated above, I do not consider  
11 codes of conduct or other behavioral forms of mitigation to  
12 be adequate in preventing affiliate abuse, even if such  
13 behavioral mitigation is fully specified. Ultimately, I  
14 believe that some form of structural mitigation is needed in  
15 order to prevent affiliate abuse, as well as in order to  
16 address transmission market power and barriers to entry.

17 Obviously, a fully functioning RTO, complete with  
18 wholesale auction markets, goes a long way towards  
19 mitigating affiliate abuse and preventing the foreclosure of  
20 competing suppliers. However, I also think the most  
21 important features of RTOs can be implemented without  
22 necessarily going all the way to an RTO, i.e., by  
23 establishing independent administration and oversight of the  
24 transmission network, along with well functioning  
25 competitive solicitations or auction markets.

1                   In order for competitive solicitations and/or  
2                   auction markets to be effective as a general means of  
3                   preventing affiliate abuse, whether in the context of  
4                   market-based rate applications or requests for approval of a  
5                   particular transaction, it is imperative that they be  
6                   reasonably designed, independently administered, transparent  
7                   to all participants and free from a "commingling" of  
8                   affiliates and employees on both sides of the transaction at  
9                   issue. To the extent that the Commission increasingly looks  
10                  to competitive solicitations or auction markets to protect  
11                  against the exercise of market power, the Commission will go  
12                  a long way towards advancing wholesale competition.

13                   Thank you very much.

14                   MR. RODGERS: Thank you very much, Mr. DeRamus.  
15                  Why don't we next to our final panelist this morning, who is  
16                  Terry Huval, the Director of Lafayette Utilities System in  
17                  Lafayette, Louisiana and he is here today representing the  
18                  Transmission Access Policy Study Group.

19                   MR. HUVAL: Good morning and I thank you for  
20                  giving me the opportunity to be here. My name is Terry  
21                  Huval. I am the Director of Utilities of the Lafayette  
22                  Utilities System in the heart of Cajun country. And I  
23                  appreciate this opportunity to experience what winter is  
24                  really like. We don't get much of that stuff in Louisiana.  
25                  I am testifying on behalf of the Transmission Access Policy

1 Study Group, TAPS and the Lafayette Utility System. TAPS is  
2 made up of transmission dependent utilities in about thirty  
3 states. You know, with the overall mission of trying to  
4 help all of us determine how to interact with FERC, and the  
5 other entities concerning having an open and non-  
6 discriminatory transmission access.

7 I want to tell you a little bit about Lafayette  
8 Utility System. We're a consumer-owned utility system that  
9 was founded in 1896 and has been providing electric service  
10 and water and waste water service to our community since  
11 that time.

12 We have our own generation. We've built  
13 generation in Lafayette, gas fired generation through the  
14 years. We also have partial ownership in a coal fired  
15 generating unit a hundred miles north of us that we're 50  
16 percent owners of that plant. It's Rodemacher; it's called  
17 the Rodemacher Power Plant. We're 50 percent owners of that  
18 plant. CLECO owns 30 percent of it and LEPA owns 20 percent  
19 of it. And so we depend on the transmission grid to get  
20 that power to Lafayette. It's pretty essential for us in  
21 our operation.

22 We also have, because of where our geographic  
23 location is, probably the most -- the largest  
24 interconnection point that lies between Entergy and CLECO.  
25 And so, not only does our transmission system provide for

1 our needs, but it also, because of interconnections that we  
2 have with CLECO and Entergy, provides for many of their own  
3 needs because the powers flow through us. So what happens  
4 to their systems has a very direct impact as to what happens  
5 to our system.

6 The first question on the panel is: Are current  
7 regulations and enforcement that the Commission uses to  
8 address affiliate abuse and reciprocal dealing adequate?

9 Our answer is, no. And whether the answer is no  
10 or yes, how would you know? How can you tell if it's really  
11 working or it's not working? You can have a antidotal  
12 information like what we're providing here to say here's  
13 where we think it's working, here's where we don't but  
14 outside of that, we really don't have the -- I don't think,  
15 the specific information to currently answer that question.

16 The bottom line as we see it is that the  
17 transmission grid as we experience it is not open and non-  
18 discriminatory, that we do think that that's evidence of a  
19 failure -- preference abuse by Entergy. I mean, you can  
20 tell, I'm not a lawyer or an economist. I'm an engineer  
21 that operates the utility system. We live in this world  
22 every day. And I guess, the simplest way I can describe our  
23 position on this is that no matter what rules you put in  
24 place, no matter what authority you put watching what  
25 someone is doing, and how much you try to separate

1 transmission and generation, you're not going to change a  
2 corporation's DNA. There's still going to be an incentive  
3 for that corporation to produce what's the best that a  
4 corporation as a whole. And so, there's going to be an  
5 environment that's conducive to companies trying to find  
6 ways to bolster their assets to the greatest benefit of  
7 their own. That's what we've seen happen here.

8 From our perspective, whatever's happening on the  
9 Entergy system isn't working to the consumer's benefit as a  
10 municipally owned utility system, that's our focus. Our  
11 consumers, are our shareholders and they are our customers.  
12 And rules on their own won't work. And I'll just give you  
13 an example of what we've been facing in Lafayette for the  
14 last several years.

15 We had a for a long time had long-term firm  
16 transmission agreements with CLECO to get power from our  
17 Rodemacher Plant to Lafayette. Well, the CLECO and Entergy  
18 systems are so close to each other that you have the seams  
19 issue, where the power flows where the power flows and it  
20 has impacts on others and it can create problems for all of  
21 us.

22 We had in 2002, 4 TLRs, four transmission loading  
23 relief instances occur. That was 4 in 2002. In 2003, that  
24 grew to 48. Last year, it grew to 76. And each time that  
25 happened, what it meant is that we had to cut back on our

1 Rodemacher power coming into Lafayette, which is \$20 per  
2 megawatt hour pour and crank up some natural gas units that  
3 were build in the 1960s and early '70s at \$75 per megawatt  
4 hour of power which meant our customers ended up paying more  
5 for electricity as a result of that. Not because of  
6 anything that we were doing wrong. It was simply because of  
7 the situations that occurred outside of our control. And,  
8 of course, that was -- we requested reimbursement of that,  
9 or at least some consideration of that, some sharing of that  
10 and we were told absolutely not. That's your problem. That  
11 Entergy has also redispatched to accommodate TLRs. But what  
12 they failed to note was that in our case when that happens,  
13 we're selling \$1.5 million to 55,000 customers, because it's  
14 all within our area wherein their respective cases, it gets  
15 watered down considerably because they don't have as much of  
16 that to have to do in their system.

17           There is a transmission system stranglehold as we  
18 see it. We are not able to take advantage of the market.  
19 Now, remember, you know, three and four years ago, we were  
20 able to take good advantage getting power on a short-term  
21 basis at really good prices that we all were able to enjoy.  
22 We have not had that experience in recent times. In fact,  
23 you know, we have the Energy Authority is which is a joint  
24 action agency out of Florida that helps to the municipally  
25 owned utility systems to be able to market power, both in

1 buying and selling and in the 2,300 some odd instances, they  
2 tried to buy power from us, they only were successful half  
3 the time. But when you have that kind of rate going for  
4 you, they'll say well half the time it's still good, you  
5 start losing confidence in the ability to be able to get  
6 that type of power on the open market.

7 We asked ourselves what happened between 2002 and  
8 2003. Why did we jump from 4 TLRs to 48 TLRs, and 76 TLRs  
9 last year? Well, after all the smoke cleared and there was  
10 a lot of it, you got to take -- you found out that, you  
11 know, it's new -- there was a new Acadia Plant that was  
12 built on the transmission in CLECO, from Entergy and CLECO  
13 transmission systems that seemed to be part of the problem.  
14 I'm not going to say it was all of the problem. It  
15 certainly was an issue that had to be dealt with. It  
16 wasn't the plant itself. It was mainly the way -- when that  
17 plant was approved to come on the system, Entergy did the  
18 studies to determine how it would effect the system. But  
19 instead of Entergy looking at how the system normally  
20 operates, it just said, here's all the resources on the  
21 system, so we're going to plug them all in and say, hey,  
22 this could work. You could put this plant on, it's not  
23 going to have any adverse impacts on the system. But we  
24 were never consulted in Lafayette about that. And so, there  
25 was no recognition of the fact that we take almost all of

1       our power from a coal generated plant a hundred miles away  
2       that uses that system. It was assumed that we would be  
3       running our power -- our power units in Lafayette at full  
4       throttle, even though that's not what we normally did. And  
5       so the assumptions that were used to say that that plant  
6       could be tied onto the system, we think were invalid. And,  
7       you know, it -- maybe it was just an error, maybe it was the  
8       way they think they'd need to do it. We've seen other  
9       situations where the same thing has happened. We have had  
10      to decide to build a new power plants in our community.  
11      Now, that sounds strange when I see Entergy testifying that  
12      they have over 1700 megawatts of IPPs tied to their system,  
13      so supposedly there's robust competition that's available.  
14      Why should we have to build new generating units, why can't  
15      we just buy from somebody else? Well, because we can't  
16      trust the transmission grid. We're not going to expose our  
17      customers to having blackouts because of transmission issues  
18      that we have no control over them, and where we see very  
19      clear evidence that there are problems.

20                    When we decide to build our own generating units  
21      NRG approached us and said, look, we have this Bayou Cove  
22      facility, 40 miles west of Lafayette, tied to Entergy  
23      System, why can't you buy power from us? And we did some  
24      studies. We thought, hey, maybe we could do that. It was a  
25      stressed system, NRG was going through some difficult

1 financial situations at the time. We did studies and  
2 determined it would be nice to have it, but we can't get the  
3 power in here. We can't get the power 40 miles away back  
4 into our community, so we had to build our own generation  
5 units.

6 We have kind of been exposed to this weekly  
7 procurement process that's in place. It just seems to us  
8 it's an issue of the big dogs eat first, and the little dogs  
9 don't have much left. Where -- and I know it's real  
10 scientific sounding, the situation where Entergy as being  
11 the owner of the transmission system and having its -- its  
12 units available to operate that that provide them the  
13 greatest advantages on that market, and after the market is  
14 soaked up, the transmission system is soaked up, we don't  
15 have much possibility of getting power to us.

16 You know, our -- our feelings is that the  
17 transmission investments have been minimal. And we don't  
18 know if that's by default or by design. But it certainly  
19 would seem that if you're dealing with an increasingly  
20 competitive market where market rates are going to prevail,  
21 that if there's an inadequate transmission that it can  
22 produce benefits for the owners of generation on that  
23 transmission of the incumbent provider.

24 I read a couple of things that were disturbing to  
25 us. In the 2002 Annual Report, and I'll read this because I

1 can't remember all the words. It highlighted the capital  
2 reserves of Entergy was planning to invest and it was "to  
3 take advantage of market opportunities as others run into  
4 trouble." You know, for us, it seems like it's one thing  
5 "to take advantage of opportunities" created by a  
6 financially distressed IPPs in this controlled area, but  
7 it's another more serious thing if entities contributing to  
8 that financial distress by preventing the IPPs from  
9 obtaining transmission access to get their power to market.

10  
11 And testimony follows with the House Committee on  
12 Energy and Commerce in March 13, 2003, by Christine Tizak,  
13 an electric utility analyst with Schwab Capitol Markets  
14 Group. Ms. Tizak highlighted the conflicting stories  
15 analysts are hearing from utilities and IPP owners. There  
16 probably isn't one instance you get to hear both sides of it  
17 from two different perspectives.

18 "Investors are confronted with the following  
19 conundrum. In the southeast, for example, incumbent  
20 utilities' CEOs have been bragging to Wall Street about  
21 their plans to buy assets presently owned by financially  
22 distressed independent power producers and put them into  
23 rate base. It is interesting for investors, who are  
24 familiar with the business plans of both the IPPs and the  
25 investor owned utilities that the independent generation

1 assets, when owned by an independent can't seem to get  
2 transmission capacity to move power today, yet these same  
3 assets are being touted as a productive part of an  
4 incumbent-owned portfolio. Where should dollars be  
5 invested? Which story is the truth?"

6 That brings our case in point, the Perryville  
7 Plant located in North Louisiana. Not tied to us, not  
8 anything that we have any direct benefit from. But it was  
9 built by CLECO in 2002 from somewhere reportedly at about  
10 \$336 million. Entergy was looking to buy it for \$170  
11 million just two years later. You know, were the  
12 assumptions used to determine that that plant could be tied  
13 into the Entergy transmission grid, flawed with the same  
14 invalid assumptions that were used to tie the Acadia Plant  
15 into the units and into the area around Lafayette, I don't  
16 know. But whatever it is, it's turned out very clearly what  
17 to Perryville is that they couldn't get the power out of the  
18 unit, so they couldn't keep the business viable.

19 You know, indicated -- I guess a bunch of  
20 indications that there are problems out there. You know,  
21 and there are solutions to these we believe and, you know,  
22 the TASK white paper about the effective solutions to  
23 getting needed transmissions built at a reasonable cost is  
24 certainly a very good starting point and a good place for --  
25 to take a look at. You know, how do you get in a situation

1 where you have joint planning or you have some third party  
2 built to ensure that the transmission system is being  
3 operated in an open and non-discriminatory way.

4 We believe that market rates ought to be denied  
5 to companies where there's inadequate transmission. Where's  
6 there's inadequate ability to promote robust competition.  
7 You can't have both. You can't have both -- enjoy the  
8 benefits of a market-based rates while still operating in a  
9 way that limits competition.

10 In our particular case and this is a -- this  
11 Lafayette speaking here, is that, you know, we think Entergy  
12 ought to be forced to join some type of RTO, like the  
13 Southwest Power Pool, so you have a real outside third party  
14 that's looking at how these transactions are being done and  
15 being sure that the cheapest cost generation is being made  
16 available to consumers first, and going from there.

17 We, again, believe in the notion that the open  
18 non-discriminatory access will result in true competition.

19 I thank you for your attention. I'll be looking  
20 forward to answering any questions that you may have later.

21

22 MR. RODGERS: Thank you very much, Mr. Huval. I  
23 had a couple of questions I wanted to ask. Picking upon  
24 what we were just talking about regarding this Perryville  
25 plant. I've heard from others, and I don't know if this is

1 correct or not, but I've heard from others that part of the  
2 problem that CLECO had with using that unit its load, was  
3 that it was not positioned or located in a good place for  
4 getting the power from the unit to where its load was. It  
5 was much better situated, ironically, for meeting loads on  
6 Entergy's system.

7 Is it that your understanding or is there -- do  
8 you have a different view on that and that that was  
9 ultimately why CLECO has decided it was appropriate to sell  
10 that?

11 MR. HUVAL: Yeah, I don't know. But it would  
12 just seem to me before I'm going to start spending \$336  
13 million on a plant, I would try to be sure that it's going  
14 to benefit my purposes. And so the question I would have in  
15 return is, why was it build then if this wasn't going to  
16 work? I mean, modeling transmission systems is not rocket  
17 science. It's something that's proven. It's something  
18 that's done, and you know, and what controls, whether you  
19 have the right answer or not, is what assumptions you use in  
20 the process. So I don't know if there's any -- if it did  
21 turn out to be in the wrong place after it was put in  
22 service. But why did they make that investment if that was  
23 potentially the case?

24 MR. RODGERS: Well, I think the answer I've heard  
25 from some on the IRU side is that, you know, some of these

1 generating plants were being built without making sure that  
2 the transmission plants were being, or are in place now  
3 before the plant is built. And so I'm not, by any means  
4 suggesting that it is generally the case. But I've  
5 certainly heard that that is the case on some occasions that  
6 the people building the plants didn't, you know, do all that  
7 they should have perhaps to make sure that transmission  
8 would be available.

9 MR. HUVAL: Yeah, and I -- you know, I don't live  
10 in that part of the world everyday. But I thought that  
11 before any of the IPPs would build new plants, that one of  
12 things that they had to be doing was contacting the owner of  
13 the transmission system there, to ensure that there would be  
14 compatibility. And that they'd create an unstable condition  
15 and then create, you know, some situations that might be  
16 inadvisable.

17 But, again, I have not ever done that ourselves,  
18 so I don't know, but that's the way that that works. But it  
19 would seem to me that would have been prudent to do so.

20 MR. RODGERS: And when you-all built, or bought  
21 into a portion of the Rodemacher Plant which was 30 or 40  
22 miles away did you say from --

23 MR. HUVAL: It's 100 miles away. We did that in  
24 1979.

25 MR. RODGERS: Okay. Did you-all have adequate

1 transmission at the time you bought into that unit, and just  
2 over the years that's then degraded, or has been used up  
3 more and more, so that what was once adequate no longer is?

4 MR. HUVAL: Yeah, some of that predates me. But I  
5 appreciated it was adequate transmission initially. In  
6 fact, it was a situation where CLECO wanted to sell part of  
7 the plant. They needed the money at that time to do that.  
8 And part of the deal was fine, we'll buy power from it but  
9 it's outside of our city. We never have gotten a -- we  
10 never have owned a generating unit outside of our city, so  
11 we need to be sure we're going to have transmission. And  
12 they had transmission available. As I appreciated through  
13 the years, that had been upgraded to meet the needs, the  
14 needs in the 80s and early 90s, if it was. And then now we  
15 face the situation we have today.

16 I must comment, I failed to mention that there is  
17 -- there is an effort by CLECO and Entergy to try to help  
18 out the transmission grid situation. It seems -- initially  
19 it seems to be -- something that it would do to try to be  
20 helpful but it looks as though there were some additional  
21 benefits that both companies would incur by doing so, by  
22 allowing -- by adding some additional transformation on the  
23 system. It provided some opportunities for them to buy and  
24 sell power also. So there's certainly some benefits we're  
25 going to gain from this. Also some benefits that they're

1 going to be gaining beyond what they're going to be getting  
2 out of the transmission rates associated with that.

3 But, in answer to your question, there was  
4 adequate transmission available and it continues to be  
5 adequate until we got into the early part of this century.

6 MR. RODGERS: But you're not suggesting that it  
7 would be wrong that the transmission provider would be able  
8 to benefit from something they're doing on a system  
9 development --

10 MR. HUVAL: No, no. I don't think -- I don't  
11 think it's wrong at all.

12 MR. RODGERS: And then are these upgrades you're  
13 talking about that CLECO and Entergy are now undertaking,  
14 would those help solve the problem that you have with the  
15 Rodemacher Plant?

16 MR. HUVAL: They will help -- they will help to  
17 mitigate that. And maybe some investments that we have to  
18 make on our own to be able to deal with the cross flow  
19 between the two companies. But outside of that, it  
20 certainly goes a long way in mitigating that particular  
21 problem.

22 MR. RODGERS: To what extent are your  
23 transmission access problems related to seams like this  
24 between SUP and Entergy, as opposed to other factors?

25 MR. HUVAL: Repeat that question.

1                   MR. RODGERS: To what extent, do you think your  
2 transmission access problems, getting that power from the  
3 Rodemacher Plant up to the City of Lafayette, to what extent  
4 are those associated with the fact that you just happen to  
5 be in a seam between Entergy and SPP.

6                   MR. HUVAL: Well, it hasn't been a problem  
7 before. You know, well, we have to -- the way we're looking  
8 at it is that what changed from when there wasn't a problem  
9 to where there is a problem and as we see it, it's -- you  
10 know, a new generation being put on the system and changing  
11 the way that the system is operated. And that's what has  
12 caused the problem. And to us, it seems like that should  
13 have been all determined on the front end. It should have  
14 been something that, if there was going to be a shift in how  
15 the powers are -- that the power was going to flow, if there  
16 was going to be a situation where it would create additional  
17 constraints on the system, that all the parties that would  
18 be affected by that in that area should have been consulted  
19 and we weren't.

20                   MR. RODGERS: You mentioned in your comments that  
21 there was some plan as I understood that, that Entergy felt  
22 that was on the system that they either did not do, in your  
23 view, a correct transmission impact study. And they also  
24 didn't consult with you besides and ended up having an  
25 adverse effect on your ability to get power from the

1 Rodemacher Plant to your city. Which plant was that?

2 MR. HUVAL: That was when the Acadia Plant was  
3 put in.

4 MR. RODGERS: Acadia? Okay. And you mentioned  
5 that as a result of that action, there's a -- you mentioned  
6 blackouts, or the risk of blackouts?

7 MR. HUVAL: No. What the problem is is that  
8 whenever you have these TLRs declared, and you may be aware  
9 that it goes up to a level 6, that we've had a large number  
10 of these fall at a level 5, which means complete re-dispatch  
11 of what's taking place there. And if that's not done, if,  
12 for example, one day that these old units that we have in  
13 place, we can't up fast enough to be able to deal with that,  
14 with the TLR situation, then you could run into a situation  
15 where you actually have to start curtailing load. And so  
16 when we were looking at what we needed to do to meet the  
17 growth of our community and to ensure that the reliability  
18 is where we need to be, there was almost no question in our  
19 minds that we didn't have generation within our community to  
20 be able to help insulate us from that. Because it was a  
21 situation that we could not -- that we couldn't have very  
22 much impact. The transmission systems are owned by others,  
23 and we would have to depend on it to be operated in such a  
24 way that it's reliable. But we certainly having that many  
25 TLRs being declared, as far as adding questions in someone's

1 mind as to, you know, is this thing reliable enough or do we  
2 have to get power from somewhere else.

3 MR. RODGERS: Okay. And I had just one more  
4 question, then I'll call on some of my colleagues here.  
5 Back at our December conference that we did here dealing  
6 with two other prongs that the market power screens, the  
7 transmission market power and barrier to entry prongs, Ricky  
8 Bittle was here that day. He's with Arkansas Co-op Group  
9 and I recall him commenting that he was -- he was generally  
10 satisfied with Entergy's transmission planning process. But  
11 what I'm hearing you say today is, that your experience has  
12 not been the same. And I'm wondering, first of all, you'd  
13 give clarification on that? And secondly, would you  
14 attribute that different impression to maybe the Arkansas  
15 operating company maybe having a different approach than  
16 what the one in Louisiana, or to what do you interpret that?

17 MR. HUVAL: I don't know. I don't know. I will  
18 answer the first part of your question. Is that we sort of  
19 haven't been satisfied with the situation we found ourselves  
20 placed into because of the -- of the work that Entergy had -  
21 - and I'm presuming it's them. I mean, it may be that  
22 someone else is involved in making those decisions on how  
23 those units are tied into the system and how it affects the  
24 system.

25 But we certainly have -- have had serious

1 concerns about the way that's done. And you know, have, I  
2 think, through our discussion and through the noise that  
3 we've made about it is that we are now more involved in  
4 those discussions with them. So that's certainly helpful.  
5 But it doesn't delete the problem that we had to begin with.  
6 And looking at the broader policy issues on how this is done  
7 and how these IPPs are located on the systems that they  
8 can't get their power out. That just seems that put a lot  
9 of question marks in our mind as to, you know, how that was  
10 done, and what the incentives are to make that happen.

11 MR. RODGERS: And you said that they're now  
12 involving you more. How recent is that?

13 MR. HUVAL: That's been in the last several  
14 months. I guess, last five or six months.

15 MR. RODGERS: Oh, several months. But the  
16 problem that you're talking about in terms of the desire  
17 that you have to be involved more in the transmission  
18 planning is gone?

19 MR. HUVAL: It just didn't happen. Those  
20 decisions on that plant were probably about two to three  
21 years ago and maybe a little -- a little bit longer but we  
22 weren't involved in those. I mean, we thought we were  
23 involved. We thought we knew what was going on. And there  
24 were some joint discussions that we'll had. But that, on  
25 putting in a new plant, that way and so on, there was no

1 involvement in the discussions with us at all on that.

2 MR. RODGERS: Dick, did you have some questions?

3 MR. O'NEILL: Yeah, thanks. Mr. Huval, whose  
4 service territory is Tibidel in?

5 MR. HUVAL: Pardon me?

6 MR. O'NEILL: Tibidel.

7 MR. HUVAL: Tibidel is in Entergy's area, yeah.

8 MR. O'NEILL: Just out of curiosity. All right.  
9 Let me -- if we -- if we find a utility has violated our  
10 affiliate rules one way or another, should we change that  
11 policy to where it's done in terms of affiliate rules?

12 MR. HUVAL: Is that a general question you're  
13 asking?

14 MR. O'NEILL: Yes, to everybody.

15 MR. HUVAL: I guess my perspective is that maybe  
16 their rule change would work. And I don't know exactly how  
17 that would work. But it's -- whenever we are looking at how  
18 to deal with a situation like this, you have to look at what  
19 the incentives are. I made in one of my comments, but  
20 you're not going to change the DNA of a corporation. They  
21 still are going to be -- even though they're not supposed to  
22 talk to each other and deal with each other, there's still  
23 going to be that incentive to do what's best for the  
24 corporation as a whole. And as long as all those decisions  
25 are being made under that same umbrella where the generator

1 and the transmission company are owned by the same company,  
2 you're going to have situations where folks are going to be  
3 incentivized to try to make the greatest of those assets.  
4 And so, rules by themselves perhaps don't solve the problem.  
5 It needs to be more of a structural thing, I think.

6 Mr. DeRamus commented on that. It needs more of  
7 a structural perspective as -- so the incentives don't move  
8 you into the direction that causes these problems.

9 MR. KELLEY: I'll just respond to that briefly.  
10 My understanding is that your policy is that affiliate rules  
11 are violated that the Commission could take actions  
12 including loss of market-based authority. And I think some  
13 of the folks have said that, you know, that the entities out  
14 there have a strong probability that they do. But that  
15 would pretty much be the kiss of death as we would look at  
16 our company to have our market-based capabilities taken  
17 away. It would clearly be a career changing action on the  
18 part of those who are involved in violating those rules in  
19 our company. So I would suggest that we look at that pretty  
20 strong.

21 MR. O'NEILL: So you think it's a good incentive?

22 MR. KELLEY: I think it's a strong incentive.

23 MR. O'NEILL: So the next time we catch somebody  
24 we should probably do -- I mean, if you don't do anything,  
25 then there's not much of an incentive if the Commission

1 doesn't act. It's going to take a little bit of market-  
2 based rate incentives or changes or anything.

3 MR. KELLEY: Well, I'm sure you'll do the right  
4 thing.

5 MR. RODGERS: I was wondering, sort of following  
6 up on that. The context in which the affiliate abuse issues  
7 often come to the Commission and in the context of an  
8 applicant's market-based rate file, either an initial  
9 request for authorization, or a triennial request. And I  
10 think, traditionally the Commission's approach has been, or  
11 I'll at least say this is my understanding, that if one were  
12 found to have market power in some way, shape, or form the  
13 Commission's as far as the approach, I think, has been that  
14 we would take away that entities market-based rate if there  
15 was not some way adequately mitigate that market power.  
16 But, Mr. Huval, I think was suggesting and I think maybe Mr.  
17 DeRamus as well that, I mean, we shouldn't just stop there,  
18 by taking away someone's market-based rate. There's a  
19 larger mitigation issue that's involved here. Is that  
20 correct? Or would any of you like to comment on that?

21 MR. DERAMUS: I'll take the first shot at it. I  
22 think the issue is there are certain procedural issues that  
23 I don't pretend to have any greater insight into as an  
24 economist than attorneys or regulators, in terms of what  
25 types of actions that the Commission can take and

1 jurisdictional issues of what's in the state jurisdiction  
2 versus federal jurisdiction. But I do think it's important  
3 to -- to -- in the instance of an applicant coming to the  
4 Commission for market-based rate authority, it's important  
5 for that application to be approved conditional on some  
6 particular action. That the Commission can't -- can't grant  
7 it or can't grant that market-based rate application if the  
8 outcome is going to be anti-competitive. And so, it's  
9 perfectly appropriate for the Commission to then say, if you  
10 want to have this privilege of charging market-bases rates  
11 which I see as more -- I'd go a little bit further than the  
12 Commission on that. I just think it's going to be fair that  
13 the Commission grant market-based rates when there are the  
14 structural conditions for competition to actually play out  
15 in a given market. But it's also imperative that the  
16 Commission can't grant it if those structural conditions  
17 aren't there. Therefore, I think it perfectly appropriate  
18 for the Commission to say, if you show me that there are  
19 very active marketing institutions out there. You can't  
20 have markets, in my view, without institutions. You can't -  
21 - unless you have competitive options markets. If there are  
22 barriers to entry, as much as somebody -- you step back from  
23 even all the intent issues, and just say there are  
24 transmission -- serious transmission constraints within this  
25 control area and there is -- there's lot of theoretical

1 traffic, because it's interested in an IPP system and right  
2 in the middle of the control area with lots and lots of  
3 unused capacity. But if there are transmission constraints  
4 that wholesale customers can't get to that plant, then the  
5 applicant himself shouldn't be granted market-based rate  
6 ability.

7 MR. O'NEILL: I've just got a good question but  
8 with the interest involved. I assume that that NRG plant  
9 would have been counted as a competitor in our market-based  
10 screens?

11 MR. HUVAL: I don't know. I'll presume also.  
12 But I don't know.

13 MR. O'NEILL: So but it could get to you?

14 MR. HUVAL: That's correct.

15 MR. RODGERS: Ms. Perl, did you have a question?

16 MS. PERL: May I please. The question's for  
17 Commissioner Garvin. There is some concern about  
18 unintended consequences when FERC wants to protect the  
19 wholesale market and when we get to those. Because if you  
20 look at the Allegheny order, you look at Ameren on the 203  
21 side, that weighs out that we have to protect affiliate  
22 sales from affiliate abuse, the best way to do those, have  
23 an RFP that lays out how to do it. And given some of your  
24 time -- time arises from planning, moving a base-load plant  
25 that's at least five years down the line. If you have an

1 RFP, you have time. So I don't -- where is your concern?

2 MR. GARVIN: That's a pretty broad question to  
3 try to define it. The concern as a state regulator -- first  
4 of all, I want to express my appreciation for the FERC for  
5 its timely jurisdiction on the Entergy's facilities last  
6 year. That involved a case where we did build base-load  
7 clients through affiliates.

8 And, I guess, the concern state regulators have  
9 are in talking to my colleagues before I testified today is,  
10 what is the FERC going to do when we're dealing with a state  
11 that don't have a compulsory mandatory bidding processes?  
12 What's going too happen in those situations where an  
13 affiliate through a state procurement decision is awarded  
14 the right to construct a facility. Is that, is the market  
15 power concerns that the FERC , are they going to review that  
16 in (inaudible). I think the consensus is, probably, or yes.

17 And the concern is that state regulators, when  
18 we're dealing, particularly with base-load and planning for  
19 that would take five to eight year planning horizon. The  
20 state's are actually an independent evaluator. I mean, we  
21 are, in the construction authorization case, we consider  
22 that we entered it. There was not a -- well, we had in a  
23 midnight was a compulsory two-stage competitive bidding  
24 process. We gave the applicant the ability to present how  
25 they evaluated for both. I should also say, state law

1 allowed them to present this affiliate proposal, that that  
2 was not a regulatory order. And those type of situations,  
3 there are a number of non-price factors that are considered  
4 when you decide that. It's not where you're just replacing  
5 a peaker. We could have easily done in that case, if you  
6 were asked, you know, apply all the evidence through  
7 production cost filing, et cetera. Do you want to look at a  
8 three-year window or at a longer horizon and in those  
9 situations, we decided to look at coal. And base-load coal  
10 that those were an affiliate. Now, if there's a mandatory  
11 bidding process that the FERC is going to order states to  
12 do, I don't know how you're going to set up the parameters  
13 where you're going to scrap -- because really you're talking  
14 about you want to look at three years or longer.

15 MS. PERL: Are you -- so, you're worried that  
16 you're going to be forced to -- forced to the higher end of  
17 the supply curve, whether you need coal? Is that what  
18 you're saying?

19 MR. GARVIN: I'm saying, that there are --

20 MS. PERL: You don't want to forced to consider  
21 all the peakers, or only mid-rangers.

22 MR. GARVIN: Well, you want to have the maximum  
23 flexibility as the decision maker, in terms of deciding  
24 what's in your state's -- we are not a retail choice state.  
25 There are a number of quantitative and qualitative factors

1 that goes into those decisions. And I think the concern  
2 with the Ameren decision is that it does presume regulatory  
3 failure. And that states somehow can't make these  
4 decisions. That's the generic concern we have. There is a  
5 presumption of regulatory failure, that underlies that  
6 decision. It gives a lot of states concern going forward.  
7 I mean, we tried the mandatory competitive bidding process.  
8 It did work, to the extent it produced more peakers. And we  
9 can go back to the that.

10 Our order says, you can do that, or you can do  
11 something else. But the burden is on the applicants to  
12 demonstrate a fair and transparent process. I so, I guess,  
13 I'm urging as a state regulator, give us, as state  
14 commissions, particularly those that have not gone to retail  
15 choice, the most flexibility in terms of how we are going to  
16 deal with generation procurement. I mean, removals are a  
17 great example, where everyone in our state is doing that  
18 competitively. Everything is being bid out, and affiliates,  
19 non-affiliates, anyone can bid on that.

20 When it comes to base-load, we want the  
21 flexibility to consider IPPs, traditional rate-base, or for  
22 example, states like ours, where Wisconsin is unique in that  
23 respect, where if you are a state regulator and you are  
24 looking at barriers to entry, we have a state law that says  
25 if you're a load serving entity and you want to build

1 through an affiliate, the load serving entity is compelled  
2 as a matter of state law to give over that real property,  
3 which are the valuable ground filled sites at both value.

4 Now, however you look at competition as a  
5 state regulator, we're charged with carrying out state law.  
6 However, an IPP representative may say that at the outset is  
7 a huge barrier entry, if you want to compete for that base-  
8 load resource. If you are competing for that, if the  
9 incumbent utility can transfer that asset, or that real  
10 property, that is a perceived barrier to entry, but that is  
11 a state law. I'm trying to explain why --

12 MS. PERL: Let's say we have our four principals  
13 both in Allegheny and in Ameren, is this transparency  
14 definition evaluation oversight. Have an RFP, say what you  
15 want, have an independent oversight, and I think the state  
16 is acceptable. I think we left that flexibility in there.  
17 I just think laying out things up front. I don't see how  
18 what you are saying and what I'm saying is incompatible.

19 MR. GARVIN: I'm just saying --

20 MS. PERL: Other than there's you just don't have  
21 people wanting to use base-load?

22 MR. GARVIN: For example, Wisconsin Public  
23 Service Commission, not including Entergy, sought approval  
24 for three-quarters of billion dollar plant last year, and we  
25 didn't see anything. It was a rate-based facility. There

1 was no interest from any wholesale merchant plant to try to  
2 compete for that demonstrable need. No one is debating that  
3 that is a needed base-load resource in 2009, 2010.

4 The point I'm trying to make is, that in a pure  
5 academic environment, no one is going to dispute that if  
6 you're replacing widgets, that there should be a transparent  
7 competitive bidding process. We hold that out in our state.  
8 We can do that. Or you can do where the burden is on the  
9 applicant to show, if you're not going to go through a two  
10 stage competitive bidding process, how do you evaluate the  
11 proposals? And then we through a case proceeding evaluate  
12 whether or not that was a fair and transparent process, and  
13 whether wholesale merchants had an opportunity to  
14 participate.

15 Now, I can tell you, for base-load resources, it  
16 is not a pretty process in terms of the different factors  
17 that you're going to consider. Because like I said, you're  
18 frequently pushes to -- just look at 2007, do not look at  
19 the GS cost model that we use. So, then you would think,  
20 well, will be get other competing coal applications? And we  
21 haven't seen that in our state. And this is a state that's  
22 in a load doc. So, that's why I know my colleague from  
23 Maryland may have a different view. They have a different  
24 market structure.

25 I'm just trying to argue as the state regulator,

1 we would like as much flexibility as possible in coming up  
2 with generation resource decisions to serve need of load.  
3 And we think the Ameren decision, and the criticism we had  
4 of as state regulators is the presumption of state  
5 regulatory failure.

6 MR. RODGERS: Let me ask you a question about  
7 your procurement process.

8 MR. GARVIN: Sure.

9 MR. RODGERS: How do you treat contracts for  
10 power? Do you just flow them through to the customers?

11 MR. GARVIN: Yeah, I mean, we review the prudence  
12 of long term, short term PPAs in our annual in our in --

13 MR. RODGERS: So, the utility gets no reward for  
14 finishing the contract. It simply take that power and  
15 passes through. Whereas, if it builds a rate-based plant  
16 and puts it in its rate-base, earns a return on it?

17 MR. GARVIN: Yeah. I mean, it's part of the  
18 revenue requirement. But when they enter into a purchase  
19 power agreement, and Alliance is a good example, Wisconsin  
20 Power and Light. And there's where they entered into a  
21 purchase power agreement with an intermediate resource. And  
22 we deemed a large portion of purchase power agreement  
23 imprudent and denied recovery.

24 So, I mean, our auditors, and us as regulators do  
25 sharpen our pencils, and not just let them, you know, well

1 that's a purchase power agreement.

2 MR. RODGERS: Everything else being equal,  
3 suppose the utility had purchased the IPP or whatever, they  
4 build the plant and sell it into a long term contract.  
5 Everything else being equal, the utility would prefer to put  
6 that in rate-base, because it can earn a return on that.  
7 And it can't earn a return on insufficient contract.

8 MR. GARVIN: Right. And we have denied that.  
9 They've applied, a couple of utilities a few years ago,  
10 wanted to earn a premium on purchase power agreements. And  
11 I know different states may vary, but in that opportunity we  
12 didn't think that was --

13 MR. RODGERS: So, that creates a natural bias,  
14 building rate-base plants for the incumbent utility.

15 I had a follow up question, Commissioner, if I  
16 could. I think where Kelly was going, or a point she was  
17 raising. And I'm just wondering in light of our statement  
18 to apply the four principles of solicitation guidelines in  
19 the Ameren order, transparent to the definition, evaluation  
20 and oversight. I'm wondering why that would adversely  
21 affect your ability to protect retail customers. I mean, it  
22 would just seem that having those kinds of things  
23 transparency and oversight, shining the light of day on  
24 what's going on in the solicitation process could very well  
25 serve to support what you all were doing at the state level.

1 But I'm not clear why that would cause a problem of what  
2 you're trying to do?

3 MR. GARVIN: Well, I don't think it's a problem  
4 at all. I know our lane. If it's a wholesale sale, that's  
5 FERC jurisdictional. I don't perceive a conflict there.  
6 I'm just saying where there are gaps, which is where there  
7 are concerns that this agency has, whether states are  
8 adequately policing affiliate transactions. I think we need  
9 to work together to address any perceived gaps. Which is  
10 apparent in last month's testimony. That there are concerns  
11 by some of the witnesses on the December panel, that are  
12 states doing the job?

13 MR. RODGERS: Right.

14 MR. GARVIN: And I think that's where, I hope  
15 this is just the opening (coughing, unintelligible) an  
16 opportunity for us to work constructively together to  
17 provide some clarity as to what the rules are.

18 So, I think with respect to sales, whatever  
19 prong, you guys have a number of market power tests in the  
20 last two or three years. Whatever you develop, that's sort  
21 of your lane. But I do think with respect to, you know,  
22 affiliate generation acquisition, I think we need to work  
23 together closely, to find out what your role is going to be  
24 in the future. And the more difficult challenge is, how can  
25 we work together to get more investment.

1 MR. RODGERS: Right.

2 MR. GARVIN: That's where I think on the TDUs,  
3 and I think everyone agrees, rather than tweaking with all  
4 these market rules, I think to have a healthy wholesale  
5 market, the answer is to have more transmission access, and  
6 those infrastructure issues. I mean, we're a state to show  
7 you the diversity level of the regions. We have a stand  
8 alone company that's only purpose is to build transmission.  
9 And that has worked well for Wisconsin. Whether that's the  
10 right model for Louisiana, I'm not here to give Louisiana  
11 advice. But I do think that it has worked well for us. And  
12 those are the type of things that we can work constructively  
13 together to try, whether it's citing, or day-through pricing.  
14 I would promote greater investment. It's how those costs  
15 are going to be allocated. That's something that FERC and  
16 the states can continue our dialogue on.

17 MR. RODGERS: I think that sounds like a  
18 wonderful idea, to have that dialogue, and continue to try  
19 and work those matters. I had a related question about how  
20 do you think the state review process on acquisitions of  
21 generation needed for base-load, (paper shuffling,  
22 unintelligible). How do you think that state review process  
23 will protect FERC's jurisdictional wholesale customers or  
24 competition in the wholesale market, particularly, when, as  
25 you know, if I understood you correctly, that not all states

1 are as engaged in these kind of review of these kinds of  
2 issues, as say Wisconsin is?

3 MR. GARVIN: You're asking me whether --

4 MR. RODGERS: I understand and appreciate that  
5 the states have a very legitimate interest to make sure that  
6 their utilities that they regulate are able to procure the  
7 power they need to meet their retail load obligations going  
8 forward. So, that's understood.

9 From our perspective, we need to make sure that  
10 wholesale customers are protected, and that wholesale  
11 competition will be protected. And it may be that some  
12 states have a very thorough and elaborate review process  
13 that may be very similar to what FERC would do. So, there  
14 may not be much of gap or lag there. But there's other  
15 states, as you have acknowledged, that don't really focus on  
16 these issues as much. So, how can FERC that its customers  
17 and competition are going to be protected?

18 MR. GARVIN: I think your ultimate hammer is the  
19 revocation market-based rates, if you feel like -- for  
20 example, you have an affiliate -- we have an affiliate in  
21 our state, if there are base-load resources just being used  
22 to serve native load. All those sales are going to native  
23 load customers. If they make opportunity sales, that's  
24 where they are making above power transactions, those sale  
25 arrangements are reviewed by this agency. And I think there

1 is a safe (unintelligible.)

2 We have the -- for purposes of argument we have  
3 the regulatory hammer of denying recovery of those costs if  
4 we think they are above market. You have a variety of  
5 tools, and I think that's what this forum is about, on what  
6 the proper test is, in terms of whether or not you should  
7 allow, or continue to allow entities that have market power  
8 to continue to sell on opportunities wholesale power at  
9 market-based rates. And that's where I will defer to you on  
10 whether it should be a three-prong, four-prong, or five-  
11 prong test.

12 MR. RODGERS: So, you would agree that if the  
13 utility built the generating unit for the purpose of serving  
14 retail native load, nonetheless, at certain times of the  
15 year, that plant was being used to make off system wholesale  
16 sales, that would be something that FERC should take into  
17 account as it goes about conducting its market power review?

18 MR. GARVIN: Absolutely.

19 MR. RODGERS: Debbie, I think you had your card  
20 up?

21 MS. LEAHY: I have. I was going to change the  
22 conversation slightly. So, if anyone else's cards are up,  
23 or want to talk on this particular issue, I'll give them the  
24 opportunity before I move --

25 MR. FRANKLIN: I'll follow up on Steve's

1 question, if that's okay.

2 Commissioner, I understand the PUC on the state's  
3 desire to maintain flexibility, and maintain authority over  
4 these transactions. My question kind of relates to that.  
5 And I think that's a good idea, to give as much flexibility  
6 as possible. The problem that I potentially see, is that  
7 when there is an affiliate acquisition, there may be  
8 criteria in which bids are thrown out. Like I might be a  
9 utility, I've got an AAA rating. And somebody's affiliate  
10 has an AA minus. So, they're not as good as me, so they're  
11 gone. Where is the bright line? How do states -- and what  
12 I'm leading up to is that in order for -- which FERC has  
13 jurisdiction over, the wholesale, interstate commerce of  
14 bulk power. In order for that market to stay viable,  
15 there's got to be some kind of criteria, or at least  
16 reasonable assurance if they build 330 megawatt plant, it's  
17 going to be treated equally, or reasonably in markets, in  
18 selling, and liquidating assets. So, the criteria for  
19 bouncing people off of the bidders list, transmission can  
20 get into some really obscure issues, which you can argue  
21 either way. I mean, I've seen cases I could argue on either  
22 side. And argue fairly passionately on it.

23 But you know, my concern is that NARUC has not  
24 developed clear guidelines as to what constitutes, or at  
25 least would qualify as acceptable reasons to throw out

1 bidders, based on their economics, or transmission access.  
2 And to go further with that, just real quick, is that the  
3 wholesale market, in order for people to build merchant  
4 plants, need to be able to be assured that their investment  
5 is going to be viable for a long duration. So, what kind of  
6 standards has NARUC come up with to assure that -- to give  
7 commissions some kind of reasonable consistency from state  
8 to state in saying that this is not a proper reason to throw  
9 bids out?

10 MR. GARVIN: That's extremely difficult for a  
11 national association to come up with uniform standards  
12 without knowing what your power generation needs are. I  
13 mean, a state like Wisconsin, when we look at a construction  
14 application, particularly for base-loads, we look at  
15 everything from credit quality to O&M, all of those  
16 different criteria how you are going to finance the  
17 facility. It's a number that is run through a variety of  
18 different assumptions. So, if you look at the reams of  
19 testimony that I've looked at in terms of trying to find out  
20 what's in the public interest for your state to build what  
21 unit, we go through hundreds of assumptions.

22 I mean, it's hard to try to quantify seven or  
23 eight things that state regulators look at in terms of a  
24 procurement decision. And that's why -- again, that's an  
25 argument for (unintelligible) with the states. I mean, if

1       there's a concern that somehow we are not adequately  
2       reviewing affiliate transactions, cite the examples and we  
3       can address them.

4               MR. FRANKLIN: I don't think it's a concern that  
5       you're not adequately doing it. I think it's a concern that  
6       it's a hard task. I mean, BB plus adequate, is BBB  
7       adequate. You know, what kind of -- it would be hard for us  
8       to do, I would think to make those judgments, but it's  
9       absolutely no standard, no general philosophy. The way the  
10      boom and bust goes. This happens every fifteen years, it  
11      will probably boom -- bust or boom in another fifteen years  
12      from now. It has done it for the last sixty years. So,  
13      people will over bill, and there will be distressed assets.  
14      And something that might help a company, if they offer it at  
15      a lower cost. They may only be BBB, but if it would make  
16      their company viable, if they could recover the initial cost  
17      of that transaction. And I don't know, it's such a hard  
18      question. The tendency might be to just defer to the  
19      applicant.

20             MR. GARVIN: I think it get more complicated. In  
21      the perfect world, if you're looking at generation  
22      procurement, depending on what hat you're wearing, you might  
23      want to just rate base it, or IPP. But in states like  
24      Wisconsin there's specific statutory measure that  
25      contemplate affiliate generation. So, that makes our job

1 harder. So, I don't think I can give you the clarity that  
2 you are --

3 MR. FRANKLIN: I want to say it's not an  
4 inadequate job. You say it's a difficult job without  
5 standards.

6 MR. GARVIN: Right, if you're dealing with a  
7 peaking resource, that is not rocket science, in terms of  
8 what are the rates, what is the transmission tie in, and  
9 there's a number. But when you are competing with gas  
10 versus coal, it gets a lot more difficult. Then you throw  
11 in -- and we got our -- we are planning for how do we get  
12 through ten percent removal portfolio standard. Those are  
13 all things that we have to consider, depending on what state  
14 you're in. You might be at a state where there is 2.2  
15 percent. We may be going to ten. That is going to have a  
16 definite effect on how future procurement decisions are  
17 made. As gas gets more expensive, in certain models, we  
18 will buy substitute, as a fuel substitute. I don't know the  
19 answer today.

20 MR. WOOD: Let me jump in here, because I think  
21 what Bert raises, because I've sat in Bert's seat before  
22 down in another state and we had the same issues prior to  
23 retail competition. There's three ways to get new  
24 (unintelligible). But at any rate, buy a plant that's  
25 already there. That triggers our 203 review for most cases,

1 and our 205 if you do a contract with somebody. The non-  
2 affiliate contracts we hear about in the quarterly -- the  
3 electric quarterly report, affiliate issues, if the  
4 incentives are right you get adjusted to a reasonable rate.  
5 The affiliate deals, 205, and I think you acknowledge, Bert,  
6 those come through here. We've got some pending from  
7 different utilities all the time. We look at those.

8           What we said is, if you want the utility, and  
9 Ameren was one of the first ones that came through. And we  
10 started getting some discomfort with these, because we  
11 didn't have the transparency we needed to really make our  
12 statutory finding. The solicitation requirement, which was  
13 one of the things offered in Edgar, we just said, look, if  
14 you want to through here quick, you need something from us,  
15 whether it's 203, or it's affiliated related 205, here's the  
16 quick way out, do a criteria -- do a solicitation that meets  
17 these criteria. We spoke favorably about the Maryland test,  
18 and I think we have seen some others.

19           What happens, and I will just say looking forward  
20 as a general matter, because we looked at the Ameren case,  
21 there were some frustrated competitors that lost. If you  
22 have a solicitation, you have an organized process, and  
23 nobody shows up, to me that seems to be a pretty quick  
24 process through here as well. One of a number of others.  
25 We will the future Commission a chance to wiggle on that.

1 But by and large, I think if you throw a party and nobody  
2 comes, let's give the party favors out and keep moving. But  
3 if you have one and people come and don't like what's on the  
4 table, we've got to look at that.

5 We did in Ameren. We worked through the issues  
6 there. We made the determinations that showed up in the  
7 order. We approved the transaction. So, I mean, it's kind  
8 of a fundamental question. We've got a job to do under two  
9 of those three avenues. The third avenue is purely yours.  
10 We don't have anything to do with that.

11 We do look at market concentration as a  
12 consequence of rate-base of plan, as we should do. But  
13 that's not really what you are concerned about. We look at  
14 half of 205, and all of 203. We want to see a solicitation.  
15 Not because that's what you have to do, that's the quick way  
16 to do it. There have been ones, and Joe has been very  
17 articulate about it. There have been ones that come through  
18 where you didn't do a solicitation. And we've said yes  
19 anyway. But we have to work through it just to get  
20 comfortable in some pace.

21 I think our goals are really the same, but we've  
22 got a statutory duty to say, is this a just and reasonable  
23 transaction? Or in the case of 203, is it in the public  
24 interest? If so, check -- we've said check to a lot of  
25 those. The states should actually be happy that we're

1 working with them because our interest are aligned in making  
2 sure that if the affiliate relationship, and I think as Dick  
3 O'Neill's question pointed out, the incentives, which aren't  
4 necessarily pro-customer in that relationship, don't work to  
5 the detriment of what the retail and wholesale customer  
6 gets.

7 So, let's keep talking on this subject. It was  
8 very helpful for me to hear. You were saying that we heard  
9 about Ameren EEI. The other day, I got there a little too  
10 late to hear it. And I just think that we need to engage,  
11 because we're on the same side of this issue.

12 We have no intentions of stepping on your turf.  
13 We've got plenty on our turf to do. But there is a lot here  
14 that can impact the competitive market. And it also impacts  
15 our statutory obligations. We've got to do that. But we  
16 are trying to find efficient, effective ways to do that that  
17 we haven't had before, mostly because we haven't had these  
18 types of transactions before. It's not a new role for us.  
19 It's one that goes back to the '30s. But it has just shown  
20 up a lot in the past few years that you have distressed  
21 generation, and you have load growth, and these things are  
22 coming together in affiliate 203 positions.

23 So, hey, I'm glad you're here. We want to stay  
24 engaged with your guys. I think, quite frankly, when I look  
25 across the landscape, there are a lot of states that go way

1 beyond those four kind of gentle criteria we laid down, that  
2 are much more sophisticated that FERC has had to deal with,  
3 because of the stuff you deal with on a day-to-day basis.

4 On Ameren, I just wanted to quell a concern  
5 there, I don't think we have ever, and I'm not going to  
6 speak for Joe, Sudeen, or Nora, but I don't think we've ever  
7 had a vision, in fact, this is what we wanted. We never  
8 have had a vision that we wanted to prohibit Ameren's  
9 affiliates from participating in a bid auction. In fact, we  
10 want that. We want for more competition. I think, Mr.  
11 Kelley, an issue that you raised at your comments. But that  
12 is far from what the Commission is concerned about.

13 In fact, we want a way in which all parties can  
14 participate in competitive market place, particularly  
15 through transparent mechanisms like this. So, that was a  
16 big part of, I think, of the alignment of incentives for  
17 Ameren in making the MISO market work. Because you guys  
18 have to live in it, both as a generator and as a load  
19 serving entity. You guys want a good market. You want  
20 everything in that to be liquid, transparent, and  
21 competitive. So, that alignment of incentives is very  
22 compatible to what this Commission is trying to achieve all  
23 over. So, don't waste any weekend time worrying about that.  
24 We do not want to prohibit affiliates from participating in  
25 bid auctions, and open auctions, and a lot of other

1 transactions as well.

2 And I think, for example, pushing reciprocity.  
3 If you don't open your market, you can't play in that  
4 market. Now, that may be one way to get all the markets  
5 open. And certainly one people have asked us, why don't you  
6 do that more. But it is because we want to make sure that  
7 the people that are in the markets have as many people  
8 playing in them as we can, because that benefits them.

9 So, we love the transparent options. We  
10 appreciate advocacy for that in front of the Illinois  
11 Commission. And we want to see that working in the next  
12 couple years really well you all.

13 MR. KELLEY: That's good hear. I appreciate  
14 that. I will take back the message that I was very  
15 compelling in my arguments.

16 MR. RODGERS: Debbie, did you have questions.

17 MS. LEAHY: I did. Thanks. Going back to Mr.  
18 DeRamus' written statement, "the issue of affiliate abuse  
19 arises most obviously in Section 205 proceedings involving  
20 transactions between vertically integrated utilities and  
21 their wholesale generation and marketing affiliates."

22 I wanted to ask you and the other panelists,  
23 should the Commission also be concerned about transactions  
24 where the vertically integrated utility is not on the one  
25 side of the transaction, but it's a transaction between a

1 generation affiliate and market affiliate?

2 MR. DERAMUS: I think that is one of the reasons  
3 why I was trying to lay out what I considered to be an  
4 affiliate transaction. And basically, any related party  
5 transaction in which there is the potential, and this gets  
6 back to some of Mr. Garvin's statements, regulatory failure.

7  
8 That term is thrown out a lot, but I think with a  
9 lot of misperceptions about what it really means. From an  
10 economists perspective, it doesn't mean that the state  
11 regulators are falling down at their job. It just means  
12 that whenever you have a regulated industry, that's where  
13 regulatory failure comes up, because there are the  
14 incentives for the participant to use the regulated monopoly  
15 position from one area and extend that into a more  
16 competitive area, and to earn extra profits in that area; or  
17 somehow gain that particular regulatory protection in order  
18 to increase their profits.

19 That's why I always go to the structural  
20 (coughing, unintelligible) because that's where you need to,  
21 ultimately, address these issues. And I also think --  
22 yesterday Dick O'Neill said something about perhaps needing  
23 standards for different locations. Obviously, there is not  
24 one single market out there. There are very different  
25 market rules, and very different circumstances in Wisconsin,

1 in California, in Pennsylvania, and Louisiana. And I do  
2 think each of each of those jurisdictions presents very  
3 different issues in terms of the incentives that are  
4 provided to the various participants to engage in affiliate  
5 abuse.

6 So, for example, if there is retail choice, or if  
7 there is retail price gaps, then certainly you don't have  
8 the same -- you have much reduced incentives to engage in  
9 affiliate abuse. And if you have the incentives that Dick  
10 O'Neill was referring to, where you have the incentives to  
11 maximize your -- for rate-base in order to increase your  
12 profits. And you are prevented from profiting on  
13 transactions with non-affiliates.

14 One other point that also brings up, not to go  
15 off base. But something that Chairman Wood suggested that  
16 the competitive solicitation process, what happens when no  
17 one shows up, should simply be a bright line test of the  
18 fact that there's no problem? That's my concern. My  
19 concern is that you have these competitive solicitations in  
20 which -- they are defined in such a way that the winner is  
21 predetermined. And it is predetermined to be an affiliate.  
22 So, then why would an independent market participant have  
23 any incentive to go through a very costly process of  
24 participating in those kinds of procurements?

25 And it can be if the perception of affiliate

1 abuse is there, through whatever means, then that is further  
2 disincentive for independent parties to participate in those  
3 solicitations. And I'm all in favor of greater  
4 participation in those types of solicitations, because I  
5 think that's what will get you more competitive offers.

6 MR. RODGERS: Bryan, do you have a question?

7 MR. CRAIG: Yeah. Other than taking away a  
8 company's market-based rates when they violate our rules,  
9 what other remedies do you think would effective for  
10 companies -- for us to initiate against companies? That's  
11 for anybody on the panel.

12 MR. DERAMUS: I'll try and take that one. It's a  
13 fairly broad question, so I'm trying to figure out how best  
14 to answer it. I think of it -- most of my thoughts on  
15 affiliate abuse have recently have been with the context of  
16 market-based rate applications. And in thinking about that,  
17 I have thought to look at past instances of affiliate abuse  
18 in lots of different context where intervenors have raised  
19 concerns.

20 There have been proceedings before the  
21 Commission. There have been findings of affiliate abuse.  
22 Then are continued unresolved issues of affiliate abuse. I  
23 think all of those issues -- those are facts that, I think,  
24 economists, especially, and policy makers as well, should  
25 take into consideration when trying to figure out whether in

1 fact, someone should be granted market-based rate authority.  
2 There is a pattern of behavior, and therefore that reflects  
3 that there is underlying incentives. And getting back to  
4 Mr. Huval's argument in terms of the DNA, to my mind that is  
5 a reflection of what the incentives actually produce in that  
6 particular location. And that's why I think that these are  
7 very -- and I may be again, going back to my earlier  
8 statement, it may be very regional specific issues. One  
9 region would be very different from another one.

10 MR. CRAIG: I would like to hear from the  
11 gentleman from the state, what type of remedies did you-all  
12 have when you found a company violated your affiliate  
13 rules?

14 MR. GARVIN: You're testing my memory here in  
15 terms of a specific instance where --

16 MR. CRAIG: It could be generic. It doesn't have  
17 to be a specific instance.

18 MR. GARVIN: Well, for violations, in my  
19 experience, I mean, I can't tell you the specific remedy  
20 where you find affiliate abuse, other than we always have  
21 the obligation, if you violate our state statute, you are  
22 referred to the attorney general. That's the obvious answer  
23 of the state regulator.

24 In terms of addressing the issues you, behavioral  
25 remedies, and there are structural. And we are an example

1 of the state that, again, a matter of state law set out, you  
2 could call it a structural remedy, by setting up a stand  
3 alone transmission company. That was designed to foster my  
4 transmission.

5 I can't -- there's no specific remedy we enforce.  
6 We have affiliate transaction statutes. We have the  
7 Wisconsin Holding Company Act. There are numerous instances  
8 there wherein the -- for example, there have been cases  
9 where we've asked that transactions, in the event that there  
10 is a guarantee. We've had a couple of issues while I've  
11 been on the Commission, where that's come up, where we just  
12 enforce our statute, and we order equitable relief on the  
13 underlying transaction, or you could be referred to the  
14 attorney general.

15 So, from a state regulatory perspective that's  
16 the normal SOP, if there is an issue that comes up.

17 MR. KELLEY: Mr. Craig, I would respond to that  
18 this way, that affiliate abuse doesn't always come up in the  
19 context that somebody knew something was wrong, and they did  
20 it. A lot of times it has to do with unclear expectations  
21 laid out at the beginning. I would suggest the best that  
22 FERC could do, of taking and expanding on that within the  
23 last year, to lay out that clear expectations of what the  
24 requirements are going to be. And I think that will  
25 address, to the extent that people understand those and

1 follow them, that will address much of the concern. Case in  
2 point, again, is the Illinois Solicitation for power that  
3 will be taking place next year for supplies beginning in  
4 2007. There have been, probably, 15 parties meeting, 20 to  
5 30 meetings over the last year, to lay out what the game is  
6 for what the contract is, what the product is, how the  
7 auction will be conducted. And the frankly, you will find  
8 those following very closely to what FERC has come out with  
9 in the summer 2004, on what Edgar and the requirements  
10 should be.

11 MR. RODGERS: Commissioner Kelliher, do you have  
12 some questions?

13 MR. KELLIHER: A question for either Dr. DeRamus  
14 or (people laughing and talking, unintelligible.) And in  
15 response to your testimony. Normally when the Commission  
16 looks at market-based rate context, there are fundamental  
17 questions, can the applicant exercise generation market  
18 power, of whatever forms, in their role as a seller. Can  
19 they charge an unjust and unreasonable rate when they sell  
20 wholesale power? You and the others have proposed that we  
21 look, really -- as part of the equity, we look at their role  
22 as a buying power. And to me there has to be some  
23 connection between the two for us to really expand the  
24 market power test.

25 And if you are looking at a pretty sweeping

1 expansion. Because under your testimony when a utility  
2 sells to an (unintelligible) with the approval of the state  
3 regulator, that is an affiliate transaction from your point  
4 of view, in your testimony. And would be difficult for us  
5 to do, because I can see how -- let's put self-help aside  
6 for a minute. Let's say the utility prefers to operate its  
7 more expensive generation in lieu of buying lower cost power  
8 in the wholesale market. Concede the impact on retail  
9 consumers. Maybe they end paying 25 percent more than they  
10 otherwise would have if they bought lower cost power. But I  
11 don't see how that necessarily in unjust and unreasonable  
12 rates which impact the retail consumers. And we would have  
13 state regulators bombarding us with that fact. But I don't  
14 see how that kind of behavior by the utility advantages them  
15 when they make a wholesale sale. Can you help me understand  
16 that?

17 MR. DERAMUS: I would be happy to. I do think  
18 that some of the misperceptions about the issue have to do  
19 with, first all, an overly narrow perception about what the  
20 exercise market power relieves. It is sufficiently  
21 designed, both with the ability to increase prices, and the  
22 ability to foreclose competition. You are concerned,  
23 obviously, about competition in the wholesale markets. To  
24 the extent that a participant is able to limit the number of  
25 participants in that market, as a result of their

1 unilateral actions, that to me, is an even more egregious  
2 form of exercise of the market power, than if they simply  
3 make their own unilateral decisions about their own pricing  
4 out issues.

5 So, if you want inter-market -- if you're -- I'm  
6 a public utility, and you're concerned about my ability to  
7 raise prices, that's still a question about unilateral  
8 actions with regard to my output and pricing decisions.

9 Now, if you are independent power producer that  
10 wants to come into a particular location, and I can effect  
11 the amount of power you put on the system through my  
12 unilateral decisions, that is important. In my view, a more  
13 egregious example of the exercise of market power. And  
14 that's why I wrap it all up into the issue of foreclosure,  
15 that the Commission has long been concerned, with regard to  
16 transmission market power. It's just foreclosure achieved  
17 through a different means. A foreclosure in the wholesale  
18 market.

19 If one wants to look to -- and ultimately it is a  
20 fundamental axiom economics, the fewer number of competitors  
21 in the market, the greater the prices will be in retail.  
22 Wholesale prices are going to be up as well.

23 So, I think, in discussion the issue with the  
24 individual market participants, and particularly power  
25 producers -- independent power producers who have been

1 foreclosed. And qualifying utilities as who have been  
2 foreclosed from participating in the wholesale market by the  
3 actions of the utility. It affects their ability to also  
4 offer competitively priced power zoned to the utility, but  
5 also to other smaller wholesale customers.

6           If I have a large plant, and I'm foreclosed from  
7 access that broader market, I can't offer power at the  
8 competitive rates I otherwise would be able to, to a small  
9 co-op that wants 80 megawatts of power. That co-op is going  
10 to be stuck with the -- going to the incumbent utility.  
11 That's direct impact on wholesale rates. That's just an  
12 example. I can go on, but I'm hoping -- that to me shows  
13 some of linkage in this.

14           And with regard to jurisdictional issues,  
15 ultimately, I think a lot of these questions keep coming  
16 back to jurisdictional issues.

17           The problem is, there legal distinctions between  
18 who has authority, and how different authorities -- what  
19 different authorities have. What different jurisdictions  
20 have authority types of transactions and such, and the types  
21 of decisions that utilities make. The problem is the  
22 economics of the industry is such that the economic  
23 distinctions don't necessarily jive with the jurisdictional  
24 distinctions. It's a challenge. I will fully admit that it  
25 is a challenge for regulators, both federal regulators and

1 state regulators to figure out how to work through those  
2 issues. But I still think that if the ultimate concern and  
3 the ultimately responsibility of the Commission is with  
4 respect to wholesale rates, that you can't not address those  
5 fundamental conditions.

6 MR. CRAIG: Your position seems to be that we,  
7 through the market-based rate policy should almost require a  
8 vertically integrated utility to provide lowest price cost  
9 of electricity to their retail consumers. When they build,  
10 they should buy cheaper power in lieu of building. They  
11 should buy cheaper power in lieu of dispatching higher cost  
12 generation. That seems to be the rationale, the lowest cost  
13 electricity. But sometimes states have growing concerns  
14 about fuel diversity. They may want a coal plant, and it  
15 may prove a coal plant, higher priced than other wholesale  
16 power costs option. It just seems that if we were to follow  
17 your course, we would inevitably be clashing with the  
18 states, where they, in some respects have fairly clear  
19 jurisdiction.

20 MR. DERAMUS: I don't think the clash is  
21 inevitable. And I think that is one reason why advocate a  
22 rule of reason approach to this. I think if you see a  
23 persistent divergence between economic path -- the dispatch  
24 decisions of a utility, and supply options that actual  
25 available to them, that should raise the question of whether

1 foreclosure is the (unintelligible) to the market. That's  
2 why I said, I think the DPT analysis, you can't do the DPT  
3 analysis without considering such issues. Otherwise, it is  
4 this meaningless theoretical exercise that looks at  
5 theoretical capacity -- theoretical market participation.  
6 You look at the capacity share of the independents that are  
7 in the market. But that doesn't reflect anything about the  
8 reality of what is actually happening in that market, and  
9 supply choice is available to wholesale customers in that  
10 market, and the ability of all of that theoretical capacity  
11 could discipline the pricing behavior of the utility. So, I  
12 think you are there. You are faced with the fundamental  
13 issues of whether foreclosure is occurring in particular  
14 markets. And this is not something that I think necessarily  
15 is rampant in a lots of your market. I think it's very  
16 problematic in certain markets. And I think you use a rule  
17 of reason approach to figure out when there is a serious  
18 problem. And that's why I said I prefer this kind of  
19 rebuttable presumption approach that I thought the  
20 Commission was right to use in another context, to say, is  
21 this something that we really need to look at? But we need  
22 to take foreclosure as a very serious issue. And we can't  
23 drop the buyer market power, because it's the same set as  
24 transmission market power.

25 MR. CRAIG: Thank you.



1 transmission upgrades and investing in that. I guess the  
2 question it get to is participants funding kind of issue.  
3 You know, we might well invest in transmission upgrades  
4 that's going to benefit the entire system, and still may not  
5 get us what we wanted to get out of it. I mean, we might  
6 get part of it, but we're going to making a significant  
7 investment on our own, that we're not going to enjoy the  
8 full benefits of that investment. And so that whole concept  
9 to use seemed one that would be very difficult to justify  
10 spending the community's money doing that. And felt that if  
11 we're going to spend money on something, let's spend it on  
12 something we can be sure is going to benefit our consumers  
13 directly, as opposed to, perhaps not doing so.

14 MS. PERL: I seem to recall that it was either in  
15 TAP's paper or APPA's paper, that one of the solutions or  
16 incentives that were being advocated to increase  
17 transmission investment was to allow more participation,  
18 public power in transmission projects. which I find very  
19 interesting. I was wondering if you had thoughts on  
20 specifically how you accomplish that.

21 I would like to ask Bert how it was accomplished  
22 in Wisconsin, because I hear it was accomplished in  
23 Wisconsin. But if you had any thoughts on specifically how  
24 that could be accomplished or incentivized.

25 MR. HUVAL: I think if you are talking about some

1 sort of joint project, if you're looking at something,  
2 you're looking at a transmission grid as whole. And you are  
3 looking at what are the things that best benefit the  
4 transmission grid, and how do all participants have a pro-  
5 rata share of funding that does make some sense to do. It's  
6 just the idea that you need a transmission upgrade to  
7 accommodate project A, and you put the entire burden on one  
8 entity to pay for that, when everybody is going to benefit  
9 from it, doesn't make any sense to me. But I do think the  
10 idea, if you are looking at this as a joint type of effort,  
11 kind of looking at it as a single system, not worrying about  
12 who owns it per se, from that perspective, and looking at a  
13 project that gives the greatest system as a whole, then I do  
14 think, and I do think it is appropriate that you have us  
15 have the ability to participate in that funding so we can  
16 get the pro-rata benefit of it.

17 MS. PERL: Sort of joint ownership, and then  
18 rolled in --

19 MR. HUVAL: Right, that's correct.

20 MR. GARVIN: I think that's one of the critical  
21 challenges we face in the MISO market as a funding and cost  
22 process. That's been a big issue in OMS, in terms of as we  
23 go through that issue. In Wisconsin, as you know, we are on  
24 one of the constricted interfaces in the Continental United  
25 States, and the response to that was to set up a stand alone

1 company who has been aggressively tasked with that. We have  
2 added the biggest line in four years in our state. And  
3 that's primarily looked for reliability and preserving the  
4 unit's load, as well as a whole bevy of little fixes. So,  
5 we're going to be actively participating with our colleagues  
6 in the upper Midwest on how we get some agreement on that.  
7 Because I think that is a concern on going forward with some  
8 of these RTOs, is how are you going to pay for future  
9 transmission that's going to lock in future transmission  
10 rights on a longer term. And I don't have the answer today.  
11 I can just tell you that we've seen in our state, through  
12 stand alone companies, very aggressive construction  
13 transmission. And it's in response to, you know,  
14 (unintelligible) that we have had for years, as well as some  
15 of your bigger loads that are in an electric island. We  
16 sort of have been on the same page in our state to get the  
17 transmission built.

18 But as MISO matures those questions are going to  
19 be a lot tougher to get into. Who is going to be paying for  
20 that (coughing, unintelligible) running from our state to  
21 serve Chicago, and other markets? Then it gets a lot more  
22 complicated, because then it is not being used for local  
23 load serving, it's being used for facilitate bulk power  
24 transfers. That's where there is going to be a lot of  
25 tension between state regulators (coughing, unintelligible)

1 state region on how are you going to allocate those costs.

2 MS. PERL: I guess it's going to be how you  
3 define the units. If you see yourself as part of region it  
4 might make it a little easier than you think of it as a  
5 state. I did want to mention that the Commission's decision  
6 in Ameren wasn't a statement of regulatory failure. In  
7 fact, we ultimately agreed with the Commission's decision in  
8 that case.

9 Sometimes our jurisdiction overlaps, but our  
10 focus is on carrying on our 203 and our 205  
11 responsibilities. And we understand that the state has  
12 different responsibilities. Just because the states have to  
13 carry out their responsibilities doesn't mean that we can  
14 defer to the states. We have to carry on ours as well.

15 It does seem to that our goals are not  
16 inconsistent. We're looking to ensure that there is no  
17 ulterior preference. I understand from time to time there  
18 are state laws that are perhaps enshrined with affiliate  
19 preference. But certainly, to the extent that there aren't  
20 any of those, our job is to ensure that there is no  
21 affiliate preference. I had heard that states were having  
22 difficulty with that as a concept. I would assume that  
23 Wisconsin doesn't.

24 Alan, I just wanted to add to what  
25 Pat said, that I have no thoughts whatsoever along the lines

1       that affiliates shouldn't be permitted to bid. I think they  
2       should. Thank you.

3               MR. RODGERS: I had just another question I  
4       wanted to ask Mr. DeRamus. One of the areas of affiliate  
5       dealings, I'm not sure the Commission has focused much  
6       attention on, is the whole area of holding arrangements.  
7       And I'm wondering if you feel that there is a potential for  
8       affiliate abuse when utilities engage in such holding  
9       arrangements, such as a tolling arrangement for gas, and if  
10      so, do you think this is a very significant problem? And if  
11      so, what do you think the Commission should do about it?

12             MR. DERAMUS: I generally like to -- if it's a  
13      question I haven't thought about too much in depth, which is  
14      the case for those specific tolling arrangements, to me,  
15      it's something I haven't thought about. I think I can make  
16      some comments, though, in terms of general principles.  
17      Obviously, it is kind of a unique aspect of the tolling  
18      arrangement, is it is typically more of a cost plus type of  
19      arrangement. And I do think that there is the potential for  
20      affiliate abuse in even cost plus arrangements, which is why  
21      the Edgar standards were applied to cost plus type --  
22      partial service type contracts between affiliates. So,  
23      would certainly think that they should be looked at with the  
24      same certainty as any other affiliate transaction. That's  
25      it. I would also emphasize that I think there are lots of

1 affiliate transactions that are perfectly justified, that  
2 is, if it is a least cost alternative, then certainly it  
3 makes economic sense from the bottom line costs. Then  
4 obviously, those were perfect exceptions. My concern is  
5 simply when those transactions are really -- and  
6 particularly involved with affiliates where you have the  
7 ability to leverage your monopoly position in one side of  
8 the market or the other.

9 MR. RODGERS: Mr. Kelley, did you want to comment  
10 on that whole issue of tolling arrangements, and whether  
11 that is something that the Commission should be concerned  
12 about?

13 MR. KELLEY: I wouldn't see it any different than  
14 any other arrangement. Frankly, our sales agreements that  
15 involved, for example, gas through a site facility, those  
16 costs as our contract, are usually passed on costs, which  
17 essentially the situation. You have a tolling arrangement,  
18 somebody else is buying the gas for you and you are selling  
19 power back to them. Because of the facility itself, you're  
20 able to establish a rate of return. I've seen it pretty  
21 much the same way.

22 MR. DERAMUS: Actually, if I could follow up on  
23 my response. That just triggered a thought. I think one of  
24 the criteria should be how liquid the underlying market is.  
25 The thinner the liquidity, the biggest problems that you

1 have with having a lack of market signals, is when you have  
2 very thin market. If you don't have very many procurement  
3 markets -- but if there are lots and lots of gas type  
4 transactions, then you have lots of competitive bench marks,  
5 and lots of ways to -- lots of opportunities for different  
6 market participants to be involved in that market. But in  
7 the absence of foreclosure, then I obviously be less  
8 concerned when you have that kind of liquidity.

9 MR. RODGERS: Are there any questions from those  
10 in audience, or any comments from those in the audience?  
11 Please, come forward and, please, identify yourself.

12 MS. DESPERAUX: Kim Desperaux with Entergy. I  
13 just wanted to respond and maybe clear up a little confusion  
14 earlier regarding Mr. Huval's comments about the Acadia  
15 facility. Entergy does not own Acadia and did not build  
16 that facility. Acadia did come to us and request to  
17 interconnect to our system. And at the time they were not  
18 requesting transmission service. So, consistent with this  
19 Commission's policies, we identified the upgrades that would  
20 be necessary to reliably let them interconnect to our  
21 system. We advised them of those, and we entered into an  
22 interconnection agreement that was filed with this  
23 Commission. At the time that we were advised that a load  
24 serving entity within the region was requesting network  
25 service from that facility, they were not requesting to

1 cross our transmission system, but another transmission  
2 provided. We alerted that transmission provider that loads  
3 from that facility may create issues for our system, and we  
4 have been working the Louisiana Commission, Mr. Cumeway,  
5 (ph) SPP, and CLECO over the past several months to try and  
6 reach some resolution of this issue, and address it. And it  
7 is a very complicated situation where the three utilities  
8 interconnect. And there may be some details -- the  
9 Commission may prevented it from having some additional  
10 information about. So, we would like to have the  
11 opportunity to submit regarding this.

12 MR. RODGERS: I'm sure there will be an  
13 opportunity for any interested parties that wishes to file  
14 comments at the end of this. Rich, did you also have a  
15 question?

16 MR. O'NEILL: No.

17 MR. RODGERS: You're okay?

18 MR. O'NEILL: Yes.

19 MR. RODGERS: Any other folks from the audience  
20 that would like to make a comment, or ask a question?

21 (No response.)

22 MR. RODGERS: I have a personal matter I need to  
23 mention. I accidentally knocked my name card off awhile ago  
24 in the middle, and there's not a clear opening in here. But  
25 I am prepared at this time to offer a full hour of panelist

1 time to anybody in the audience that would like to come a  
2 get it. In seriousness, we will adjourn now for about  
3 fifteen minutes and reconvene for our next half.

4 Thank you very much, panelists, you did a great  
5 job.

6 (Brief break.)

7 MR. RODGERS: We want to thank our panelists for  
8 appearing this afternoon. We're going to again be talking  
9 about affiliate abuse issue, and in particular, what can the  
10 Commission do to lessen the prospect of affiliate abuse and  
11 reciprocal dealing.

12 Leading off our panel late this morning is Steve  
13 Corneli, who is the Vice President of Regulatory Affairs  
14 with NRG Energy. And he is here today representing the  
15 Electrical Power Supply Association. Welcome.

16 MR. CORNELI: Thank you very much, Steve. It's  
17 an honor to be here and I appreciate the opportunity to help  
18 look at these complicated difficult issues about how do we  
19 sync up the Federal Power Act requirements with just and  
20 reasonable rates with a viable positive market.

21 (Interruption from knock on door)

22 I'll just keep moving on. The focus of the  
23 Commission in dealing with market-based rates, and the  
24 decisions about whether to grant them is focused on  
25 identifying market conditions that could deviate from the

1 workable competition. And thereby to prevent market prices  
2 from being unjust and unreasonable when those conditions  
3 exist.

4 My remarks here are intended to focus not only  
5 problems associated with affiliate abuse in market-based  
6 rates solutions. But at the very beginning, I'd like to  
7 start by just talking for a minute about what we should see  
8 when workably competitive market are out there as supply and  
9 demand interact with each other. When supplies get short,  
10 workably competitive markets produce high prices. Prices  
11 that get higher than the cost of entry. Higher than the  
12 marginal costs of production on the average plant.

13 These high prices attract entry. And then prices  
14 get lower. So workably competitive markets sees swings of  
15 prices that are above the cost of entry, and full cost  
16 recovery levels, the prices that are below cost of entry and  
17 full cost recovery levels. And over time, these cycles  
18 should balance around price that reflects the cost of  
19 recovering all the costs of investment, and efficient new  
20 technology.

21 As a result, over time efficient suppliers should  
22 expect to earn money and inefficient suppliers should be  
23 weeded out from the market process. So when we think about  
24 market-based rate authority, we should be thinking about if  
25 conditions deviate from that workably competitive pattern,

1 or if they can be expected to deviate, there should be some  
2 conditions on market-based rate authority to try to remedy  
3 those underlining flaws that could lead to the deviations  
4 from workably competitive prices.

5 For example, if markets produce consistently  
6 profitable prices when there's an over supply, it would look  
7 like there's something that's not workably competitive in  
8 the marketplace, and then market-based rates may not be  
9 warranted.

10 Similarly, if there is a shortage in the market  
11 and there's consistent, persistent under recovery of costs,  
12 it looks like there's some problem in marketplace, and  
13 market-based rates do not request the reasonable prices.

14 So what we're trying to do here, as I see it, is  
15 to define broad indicators that will signal the likelihood  
16 of those kinds of problems occurring and then as the  
17 Commission considers market-based rate authority decisions,  
18 it can attach conditions to remedy those underlying  
19 problems, or to prevent them from happening.

20 We salute that effort. We particularly salute  
21 the Commission's activities to extend their review of these  
22 conditions beyond the single method of concentration of  
23 generation ownership. After all, real markets really are  
24 afflicted by other problems like bottlenecks, control of key  
25 bottlenecks that are necessary for getting goods to

1 consumers, by tying one product to another, by refusals to  
2 deal, and by self-dealing among affiliates. Thus, it's  
3 appropriate that the Commission should continue to extend  
4 and refine the focus of its market-based rate authority  
5 standards on the other three prongs of transmission market  
6 power, barriers to entry, and affiliate abuse.

7 Now, I want to talk about three broad areas where  
8 affiliate relations have the potential to cause prices to  
9 deviate from competitive levels; to identify potential  
10 solutions to those problems; and to link those solutions to  
11 your decision regarding market-based rates.

12 First, and probably most important, is this  
13 Commission has observed for years. Control and transmission  
14 system by entities who are affiliated with market  
15 participants create the high potential for undue  
16 discrimination that favors the controlling entity or  
17 affiliates. Preferential access to transmission  
18 information; to reservations in transmission capacity, to  
19 long-term investment advantages, or cost advantages. And  
20 access to customers are all highly likely to enhance the  
21 market events of transmission providers and their  
22 affiliates, and to prejudice independent firms who would  
23 like to compete to serve the same customers.

24 This will quench entry in their competition, and  
25 harm customers. The Commission has long recognized the

1 cures for this problem, independent control and management  
2 of transmissions. We salute the emerging efforts to  
3 consider additional standards and provisions for the  
4 Performa OATT that will allow all competitors equal access  
5 to transmission services, to markets, and to customers.

6 In the meantime, you should certainly use the  
7 lack of independent transmission oversight and management as  
8 a factor to consider in granting market-based rate authority  
9 to transmission owners and their affiliates.

10 The second big problem facing the industry is the  
11 acquisition of assets and of long-term supply contracts from  
12 affiliates. It's continued to be a significant challenge.  
13 We've discussed this quite a bit on the earlier panel. I'd  
14 like to point out that your Ameren order, in our view,  
15 rightly underscored that affiliate acquisition -- affiliate  
16 preference and acquisitions can actually increase market  
17 power, increase market efficiency, and act as a powerful  
18 barrier to entry.

19 In that order, you established a safe harbor for  
20 203 filings that the Chairman spoke about in the last panel.  
21 Conditioning the safe harbor on the existence of an  
22 objective arm's length, open and independent process to  
23 identify the most competitive alternative, whoever is  
24 (unintelligible). This safe harbor approach is a really  
25 good idea. And if the applicants in the states take it to

1 heart and use it consistently, and if you're able to enforce  
2 it consistently, it should help go a long way and start  
3 solving the problem about procurement.

4           You also rightly observed in the Ameren order  
5 that a dominant regulating utility can have significant  
6 market power, which it can exercise through affiliate  
7 purchases. And that this market power can act as a barrier  
8 to entry to competitive providers. To prevent unjust and  
9 unreasonable -- unreasonable prices that would result from  
10 this kind of market power, you should condition market-based  
11 rates on the existence of the kind of arm's length  
12 independent procurement process that's identified in the  
13 Ameren order, that will force solicitation guidelines, and  
14 the existence of similar Edgar Standards for the selection  
15 of contracts when affiliates can bid.

16           And I'd just like to interject that there's some  
17 back and forth about states and state jurisdiction and  
18 federal jurisdiction on this issue. I've worked for many  
19 years as a state consumer advocate in Minnesota. And one of  
20 the things I did as a consumer advocate was help the Public  
21 Utilities Commission set up a competitive bidding review  
22 process for procurement situations where they were competing  
23 on a QS, independent power producers, and utility  
24 affiliates. And it worked very well. The Commission  
25 embraced this. And I'm left with the question in my mind why

1 any Commission would not embrace something that was help  
2 identify the lowest cost alternative for their customers.  
3 So I think that -- I think they will and I think that that's  
4 a very promising avenue to go down.

5           These two steps -- both conditioning -- I should  
6 add, that given that you should also consider conditioning  
7 market-based rate authority for vertically integrated  
8 utilities on whether or not there is the existence of such  
9 an arm's length Edgar consistent solicitation process.

10           These two steps will integrate your tariff and  
11 your public interest concerns with the interest in  
12 competitive markets and competitive market-based rate  
13 authority process focuses. There is, however, a deeper and  
14 more troubling problem that relates to rate regulated  
15 utilities and their affiliates. As I mentioned above,  
16 workably competitive markets allow efficient suppliers to  
17 expect over time to recover their fixed costs. And it's  
18 that expectation of fixed cost recovery that attracts entry,  
19 and creates efficient investment. Markets that don't  
20 produce these results are not workably competitive. Yet,  
21 today, in large parts of the country, we see the opposite of  
22 workably competitive markets. This creates a challenge not  
23 only for market-based rate determinations, but for the  
24 industry as a whole.

25           Let me explain what I'm talking about by

1 comparing the southeast and northeast United States. Both  
2 markets have substantial excess supplies. According to  
3 NERCs 2004 summer reliability assessment the Northeast Power  
4 Coordinating Council, in the New England and New York area,  
5 has a 27 percent reserve margin while SERC, Southeast  
6 Reliability Council has a whopping 46 percent reserve  
7 market.

8 Now, any workably competitive market facing these  
9 kinds of overage supplies will produce low prices. And  
10 investors in capital assets will have to take some tough  
11 knocks. Consumers would benefit in those markets by lower  
12 prices. And this is happening in the northeast, where  
13 except in certain areas where additional investment is still  
14 needed for reliability, market prices are far below the  
15 level that allows for full cost recovery; to the great  
16 benefit of consumers; and that to the longer efficiency of  
17 the supply sector.

18 By contrast, due to pervasive costs and service  
19 regulations throughout SERC, consumers are still taking the  
20 owners of capital assets a full return of, and on their  
21 investment. Now, to put the magnitude of this in  
22 perspective, if the Commission's approve capacity demand for  
23 the New York control area when it sets capacity prices,  
24 prices fall to zero, and there's a reserve margin of 32  
25 percent. If SERC's 46 percent surplus were subject to the

1 same market discipline, cost recovery by investors, and  
2 prices paid by consumers would fall dramatically.

3 For example, I estimate that the New York control  
4 area's current demand curve, if applied to SERC, would  
5 produce capacity payments of about \$12 billion per year if  
6 the market were imbalanced, just enough capacity to be SERC  
7 reserve requirements, peak load and reserve response. But  
8 facing a 46 percent reserve margin, the same demand curve  
9 would reduce capacity prices near zero. There is a  
10 potential \$12 billion difference between a market that's  
11 imbalanced, the prices it charges, and the prices it charges  
12 when it has an oversupply. It represents one quarter of the  
13 \$40 billion or more dollars that SERC consumers pay for  
14 electricity each year.

15 Now, I don't know what SERC customers are  
16 actually paying for capital assets, cost recovery in SERC,  
17 but I suspect it's more than zero. If we're going -- this  
18 presents a fundamental challenge for competitive markets.  
19 If workably competitive markets in the regime might have  
20 something on the order of \$12 billion lower price for  
21 consumers than regulated markets, it's hard to call that  
22 market competitive, you know, to perhaps warrant market-  
23 based rates. This is really, in my view, a much broader  
24 version of the safety net problem that you raised in the  
25 Synergy order. There's no bigger barrier to entry than the

1 threat of not recovering your fixed costs, unless perhaps  
2 it's the guarantee that your competitor will recover their  
3 fixed costs while you don't recover yours.

4 And this raises a very troubling question. If  
5 this differential ability to recover fixed costs impairs  
6 competition by acting as a barrier to entry, what's the  
7 remedy? It certainly can't be imposing average cost-based  
8 rates. That's the cause of the problem, not the cure. In  
9 requiring marginal cost-based rates for wholesale sales in  
10 an overbuilt region, would simply further disadvantage  
11 competitors while continuing to allow regulated entities to  
12 recover their full fixed costs and return.

13 So, let me try to offer a solution about how a  
14 competitive evaluation of market-based rate authority might  
15 take place in such an environment. And this is a glimmer of  
16 hope, from of all places, California. Of course, we'll have  
17 a real optimist from California speaking in a few minutes.

18 MR. COMER: We'll see about that.

19 MR. CORNELI: But the State of California  
20 recently developed its own resource adequacy requirement, as  
21 you all know. And this resource adequacy requirement has  
22 the potential to begin to establish market prices in  
23 California that will attract and sustain the resources they  
24 desperately need. But, the same state jurisdictional  
25 resource adequacy approach that California has enacted as a

1 state, could be used in other states with surplus  
2 generation as well, if not for evaluating rate-based  
3 investments, at least for the purpose of considering the  
4 value of affiliate additions to rate-based, affiliate  
5 contracts, and the desirability of going out and buying or  
6 building needs investments and generating capacity.

7 There's one additional factor you may wish to  
8 add to your market-based rate determination, is whether the  
9 applicant has a fair and a competitively neutral state or  
10 regional approach to resource adequacy, and one that allows  
11 resources -- all resources that are needed for reliability,  
12 comparable access to serving reliability and energy needs of  
13 a region.

14 Thank you and with that, I'll pause and look  
15 forward to your questions.

16 MR. RODGERS: Thank you very much, Mr. Corneli.  
17 Next, we're going to have Ed Comer who is the general  
18 counsel with the Edison Electric Institute. Welcome, Ed.

19 MR. COMER: Thank you. I apologize at the  
20 front for a bit of hoarseness, but please bear with me. I  
21 appreciate being invited here today and my comments will  
22 follow up on Steve's, and on some of the discussion from  
23 this morning. I think a -- to begin with, I think a  
24 critical theme of my comments will be to urge the Commission  
25 to recognize that an effective regulatory framework consists

1 at the state level to prevent affiliate abuse, relating both  
2 to asset and purchase power transactions.

3 State regulations should figure prominently  
4 in the Commission's deliberations as you address these  
5 issues. And I encourage the Commission to develop a state  
6 and federal dialogue process. To the extent that you think  
7 states can do better and develop best practices. And to  
8 create the kind of regulatory stability that we need, to  
9 address these issues in a fair manner, so that business can  
10 attract capital from the facilities which we need to serve  
11 our customers.

12 EEI recently published our framework for --  
13 framework for continuing development of competitive  
14 framework of competitive and wholesale market. And we have  
15 clearly said that we support wholesale competition. We  
16 believe, however, that the benefits of robust wholesale  
17 competitive market can be achieved only if there is a strong  
18 effective state/federal working relationship. And that is  
19 clearly because, as we've discussed today, there are areas  
20 of the market that are exclusively within FERC jurisdiction.  
21 There are areas that are exclusively state jurisdictional,  
22 and there are some overlaps.

23 I think it's significant that a recent survey of  
24 utility executives, this Roger Gail's survey, showed that  
25 currently lack of regulatory certainty is one of the

1 greatest concerns right now. And I'll get back to that  
2 later, because I think this is really critical of this whole  
3 issue of what FERC and the states do on addressing  
4 affiliated abuse and other market issues.

5 First, what I'd like to do is briefly talk about  
6 transmission. Steve mentioned and it has come elsewhere.  
7 With respect to transmission, FERC's open access rules  
8 standards of conduct, the behavioral rules, and all the  
9 other rules that you have in place, we believe have been  
10 very effective in preventing affiliate abuse. However, we  
11 recognize there are additional measures that can be  
12 implemented that could provide more certainty so that such  
13 abuses cannot occur in the future. Therefore, where RTOs  
14 are not formed, fair and non-discriminatory transmission  
15 access is being enhanced by state and FERC endorsed  
16 mechanisms, which might include independent transmission  
17 administrators, Transco's or similar organizations.  
18 Market monitors should also provide oversight, as well, for  
19 matters such as, the behavior of market participants, so  
20 they can also help assure independent, transparency and fair  
21 open access.

22 These kinds of measures should dispel any  
23 remaining concerns about affiliate abuse in transmission.

24 I'd like to talk about resource procurement  
25 issues, and actual address the same three points that

1 Chairman Wood talked about in one of his questions a little  
2 while ago, in a slightly different context.

3 When we look at resource procurement issues, we  
4 are facing a major challenge in the industry. There is a  
5 widespread consensus among our members at least, that there  
6 will soon be a need for substantial new investment in large  
7 base-load, coal, and nuclear generating plants. Now, when  
8 we talk about retail competitive markets, and this actually,  
9 I think, gets to the whole point that Steve was talking  
10 about.

11 The most pressing need in retail competitive  
12 markets today is to decide how to facilitate investments in  
13 new base-load plants. Regional market structures should  
14 provide accurate price signals to promote efficient  
15 investment and ensure long-term resource adequacy. You  
16 have to reflect the regulatory and market structures adopted  
17 by the states within the region. Now, competitive retail  
18 markets, this may require market mechanisms to ensure long-  
19 term resource adequacy.

20 The resource adequacy rules in most RTOs are now  
21 in a state of flux. Many believe that three and even five  
22 year auctions are not likely to lead to major base-load,  
23 coal or even nuclear generation investments. And as the  
24 recent Edison Emission decision highlights, the importance  
25 of wholesale market rules, they should unnecessarily curtail

1 price levels where there is no market power.

2 We urge FERC cooperating with the states to  
3 devote more attention in making this critical aspect of the  
4 competitive market work. Unless there are effective market  
5 mechanisms to achieve to research adequacy in competitive  
6 retail markets new base-load generation capacity may have to  
7 be built under conditional regulation. So, it is important  
8 to have a viable, feasible alternative.

9 Now, I'll turn to affiliate issues. Obviously,  
10 we believe affiliate should be allowed to compete in  
11 competitive procurements. Obviously, transactions with  
12 affiliates have to be conducted in a fair and transparent  
13 manner to protect against bias. But this is a determination  
14 the state commissions are well positioned to make. The  
15 choice of an affiliate may well be the best option in a  
16 given circumstance. Obviously, when a utility chooses an  
17 affiliate, there is a heightened concern about the potential  
18 for self-dealing. States are looking at these issues. Now,  
19 recently several states, California and Wisconsin have  
20 approved affiliate transactions. And this, as I think it  
21 was Wisconsin has suggested, this could be an important  
22 financing mechanism in the future for new base-load plants.

23

24 But state commissions have a direct interest in  
25 scrutinizing affiliate transactions to protect their retail

1 customers. Virtually, all states have the authority to  
2 assure that such transactions are fair, do not result in  
3 cross (unintelligible), and do not harm customers. And I  
4 have attached to my written statement (coughing,  
5 unintelligible) this report on authority of state  
6 commissions. It's not something we did, but it is an  
7 exhaustive survey of state commission authority looking at  
8 affiliate transactions and related issues.

9 State procedures are open to both competitors and  
10 consumers to raise any concerns. And states have a proven  
11 track record. We agree with much in the FERC guidelines on  
12 competitive procurement, as they apply to transactions  
13 involving affiliates which fall under FERC jurisdiction.  
14 The competitive solicitation process should be open and  
15 fair. Products sought should be precisely defined.  
16 Evaluation criteria should be standardized and applied  
17 equally to all.

18 However, the independent standard is too vague.  
19 And we urge the Commission to confirm the state commissions  
20 qualify as an independent entity under those standards. All  
21 the reasons I've said, what states have done, in fact, if  
22 the states have jurisdiction over retail service, planning,  
23 resource adequacy, fuel supply choices, environmental  
24 issues, and retail cost-recovery issues. They offer due  
25 process to all interested parties.

1           There is no reason to conclude that some other  
2           so-called "independent" reviewer is better qualified, better  
3           able to assure due process, better able to protect retail  
4           customers or, in the end, would do a better job than state  
5           commissions.

6           If FERC has a concern that state commissions can  
7           do better in reviewing affiliate transactions, then we can  
8           all do better. We urge you to work with NARUC, and hold  
9           best practices workshops.

10          We would also urge the Commission to apply the  
11          guidelines with flexibility. Short-term and spot market  
12          transactions are different from longer-term transactions and  
13          may not require formal solicitations, particularly, in more  
14          (unintelligible) markets.

15          In addition, uncontested proceedings require a  
16          lower degree of scrutiny than contested ones. FERC has a  
17          legitimate interest for ensuring that the utility does not  
18          exercise market power, or improperly favor its affiliate in  
19          wholesale transactions. However, Edison -- just as Edison  
20          (coughing, unintelligible) it's wrong to regulate rates  
21          where there is no market power and competitive markets.  
22          It's just as wrong to restrict beneficial affiliate  
23          transactions where there has been abuse.

24          Most -- many, if not most states believe that  
25          there is a lull to vertically integrated model and

1 traditional relations. If there is too much uncertainty or  
2 inconsistency between federal and state regulations, many  
3 utilities and states will end up constructing new base-load  
4 clean hold facilities in rate-base. The Federal Power Act  
5 reserves these decisions to the states. Therefore, if FERC  
6 finds that market power exists as a result of building such  
7 new facilities, we urge it apply flexible mitigation tools,  
8 like those it uses for load pockets and RTOs.

9 Much has been said about the safety net theory,  
10 and we don't agree that it is valid. We think it presumes  
11 the state commissions are not doing their job. We think it  
12 ignores the fact that the state commissions have authority  
13 over retail issues, and to decide whether or not they want  
14 vertically integrated utilities.

15 The proper way for FERC to address the concerns  
16 and has underlying safety net theory, is to assure that  
17 competitive markets, competitive retail markets provide  
18 appropriate pricing and sufficient certainty to stimulate  
19 the construction of needed new generation facilities.

20 The challenge and I think it's a challenge for  
21 all of us, is to do so as effectively as what occurred with  
22 construction finance through traditional rate regulation,  
23 without imposing uncompensated costs on the balance sheets  
24 purchasers signing long-term contracts.

25 With that, thank you.



1       circumstances of specific undue discrimination of  
2       preference. I think it's pretty well recognized that the  
3       potential for market power abuse does exist. And the way I  
4       approached this and, I think, giving the punch line away  
5       here, is, I really think you need to take -- you need to  
6       create structural rules on the front end. That, obviously,  
7       when you're talking about affiliate abuse; it's not the fact  
8       that someone is an affiliate that's the problem, it's the  
9       relationship with -- it's actually the utility that creates  
10      the potential problem. So having structural rules up front,  
11      I think, creates the sort of clear expectations that we've  
12      heard, from a previous speaker on a previous panel, of  
13      knowing what the rules are going forward. And there should  
14      be a rebuttable presumption that if there is a utility and a  
15      utility affiliate engaged in a transaction that there is  
16      market power. And it's a rebuttable presumption and it  
17      should be up front.

18                 Since I'm a relatively simple guy, I like to  
19      think of things -- I like to use simple analogies. And I  
20      sort of view this as the tradition of how we play cards.  
21      The dealer is required to, basically, shuffle the cards and  
22      then hand it to one of the other players to cut the cards.  
23      Now, why do we do that? It's not because we know that that  
24      specific dealer was going to cheat in that specific hand.  
25      But there is a wide, you know, a tradition of recognizing

1 the fact that the dealer is in a unique position to affect  
2 the outcome of that game, and that it, basically, mitigates  
3 that problem. And it establishes some integrity to moving  
4 forward.

5 And while it may sound like a simple analogy, I  
6 think it's applicable here. These are -- in a place where  
7 you have resources that are needed you can be highly  
8 contentious. And the affect of market power could have,  
9 obviously, adverse affects on not only the outcome of those  
10 -- of those resource additions, but also the perception of  
11 the integrity of the overall wholesale market.

12 Obviously, affiliate abuse is, basically, likely  
13 to occur within the context of market power. We've seen  
14 somewhat of an uncommon success rate among affiliates  
15 winning RFPs conducted by the utility affiliates. Although,  
16 there are some notable exceptions which I will get to in a  
17 second. And this is because you often find situations where  
18 the contracts can be awarded to an affiliate without  
19 customers being able to go anywhere. It may be a condition  
20 to where the RFP is structured in a way that favor an  
21 affiliate. And these are not so subtle types of  
22 occurrences.

23 You also may have, and I think it was referenced  
24 earlier today, a somewhat troubling development where, at  
25 least in my mind, we are creating distressed assets by

1       having rules that will limit the level of, you know. In my  
2       state right now, the utilities are not contracting for  
3       resources over three years. This has an interesting affect  
4       when it affects their own resources, which can go well  
5       beyond that three years. So, it's that sort of discrepancy  
6       that, I think, creates with some problems.

7                 One of the issues that has arisen today is the --  
8       you know, why is this your problem? Why isn't this the  
9       problem with the individual state? Well, it wouldn't be the  
10      problem with the individual state if the electrons stopped  
11      at political borders. And the simple fact is, they don't.  
12      Resource decisions that are made in California, obviously,  
13      affect the California wholesale market, and the wholesale  
14      markets throughout the western region. And I don't think  
15      that's different in really any other part of this country.  
16      So if we figure out a way of stopping electrons at the  
17      border, if there's an easy solution here, I don't see that  
18      occurring.

19                Obviously, a lot of the affiliate abuse problems  
20      can take place with respect to the transmission system where  
21      it's less detected. And with respect to the types of  
22      assumptions that go into determining transmission and  
23      availability, these sometimes can be very subtle or very  
24      complex. And there has been, and I reviewed some of the  
25      transcript from the last meeting that, you know, why isn't

1       it that we see more complaints here? Well, believe it or  
2       not, the IPP industry is actually in the generation, not the  
3       litigation business. And there really is very little upside  
4       about it. When you loose an RFP that you believe was less  
5       than kosher, there's very little incentives to carry on.  
6       What, first of all, you end up expending a significant sum  
7       of money, and at the end of the day, what's the remedy  
8       Added to that, you've got the question that has been raised  
9       in the Trade Press, why would you go out there and  
10      deliberately incite your potential future customers. And I  
11      think, a represent from the public power industry  
12      characterized it the last time here, you don't really want  
13      to be pulling the tail of the tiger if you're in the cage  
14      with the tiger.

15                So I don't think that these expectations that  
16      people are going to bring these individual litigation here  
17      is one that -- that's very useful and I think, argues for  
18      having a more structural approach to this.

19                Other parts of the country or in  
20      various parts of the country, you do have what has been  
21      characterized by some as sort of this fortress utility  
22      approach where, in fact, there is a refusal to interact with  
23      IPP providers. And yet, the utility seems to be able to run  
24      its resources even, notwithstanding the fact of the rates of  
25      those resources may be significantly higher than the IPPS.

1       And, I think, Chairman Wood referenced an interesting part  
2       of the Federal Power Act 205(F), which may be something that  
3       the Commission wants to look at as this debate unfolds over  
4       the next year, as a potential remedy to make sure that our  
5       wholesale markets are actually performing efficiently; and  
6       that we are using fuel, and the environmental resources in  
7       this county effectively. Because I think that's the way it  
8       was put in place back in 1978.

9               Obviously, there's a potential for market power  
10       through transmission markets. I know you had another panel  
11       on that. I think that in the RTO world and I think there --  
12       part of the rebuttable presumption should be, if the  
13       utility is handed their transmission assets over to the  
14       control of another, that's a huge step in the right  
15       direction.

16               Notwithstanding, I've been at this for about 17  
17       years. And when I started, there was no question that the  
18       transmission system in California was used to discriminate  
19       against independent power producers, municipal utilities and  
20       other transmission dependent utilities. Notwithstanding the  
21       fact that we spent lots of time here arguing about Cal ISO  
22       issues, the simple fact of the matter is that the ability of  
23       the transmission owners to utilize that transmission system  
24       directly discriminate against other market participants has  
25       been dramatically, if not completely, reduced. I won't say

1 completely, because of (unintelligible) conception. But the  
2 fact of the matter is that we moved in the right direction.  
3 But a lot of this, of course, is -- so it's a huge  
4 mitigating factor. But a lot of this is dependent upon the  
5 transparency of the process, that people know what goes into  
6 all the calculations, equal access to that information and a  
7 common set of rules. And that we need to be sure that as  
8 those rules move forward, and, you know, people are allowed  
9 to opt out of scheduling, for example, that resource  
10 decisions that are currently being made, those are decisions  
11 that aren't determined by their pre-existing hydro-  
12 requirements, or contract requirements, but new resource  
13 additions aren't done in such a way they could affect the  
14 wholesale market.

15 So, in closing here, I think that we should --  
16 what do we suggest we do here? Obviously, there's no  
17 birthright to market-based rate authorities. I think the  
18 fact that the IOUs that have joined RTOs that should be a  
19 key piece of the rebuttable presumption that they have moved  
20 in the right direction. I think it -- continuing on with  
21 the structural rules, the burden should be on the party  
22 seeking market-based rate authority to show that it doesn't  
23 possess any form of market power. And we should also  
24 include, from an affiliate side, obviously, structural  
25 separation from the utility, from the affiliate to the

1 utility, maintain separate chains of command, and,  
2 basically, ensuring that whatever information has been made  
3 available to the affiliate is also made available to its  
4 competitors. I think that goes a long way towards opening  
5 those markets up.

6 Secondly, I think the requirement for a  
7 competitive process removes, once again, is very helpful  
8 with respect to rebuttable presumption. These obviously  
9 need to be open transparent and fair. I think, auction and  
10 fee bids are a good direction to go with this. There's  
11 mixed reviews. I've heard very good things from a number of  
12 my members about various markets in the Northeast, New  
13 Jersey and Maryland. My understanding, however, these are  
14 somewhat shorter types of transactions, and how they might  
15 be applicable to longer term contracts, I think is  
16 interesting. I think as Mr. Corneli indicated earlier,  
17 California has had the checkered -- we got a checkered star  
18 here. There are a couple of proceedings that predated the  
19 current Commission's decisions that we, obviously, were very  
20 troubled with. The California Commission did last month,  
21 issue a procurement order, and it did, prior to that issue,  
22 the resource adequacy requirement, which I do think will go  
23 a long way in establishing some sense of what -- what  
24 California's capacity needs are in the future, or resource  
25 adequacy needs are in the future and may provide the

1 opportunity to have a more rational approach to adding  
2 resources. Obviously, the Commission's expansion of Edgar  
3 is helpful. Obviously, I have issues with timing. But that  
4 being said, it's moving in the right direction. Independent  
5 monitors are a good thing. But it's important that they  
6 actually have some teeth, that it isn't just sort of a  
7 reporting mechanism that everyone showed up on time and  
8 actually were civil to one another. But actually,  
9 something a little beyond that.

10 And, you know, finally, recognize that in the  
11 markets in the United States that you have to interact with,  
12 because that's your mandate with respect to interstate  
13 markets. It may have IOU's that continue to operate on a  
14 regulated -- a fully regulated route, that do have other  
15 impacts on the wholesale market. And you might want to  
16 consider looking at, you know, what 205 actually means in a  
17 modern context. I think that might be very, very useful.

18 So in closing, we have not taken the position  
19 that utilities ordered affiliates should not be allowed to  
20 participate in the processes. But we do believe that those  
21 processes need to have sort of common sense of expectations  
22 and risks. And again, that this is not competition for the  
23 sake of competition. Rather competition sort of as the  
24 basis of our free enterprise system recognizing the fact  
25 that it's designed to drive prices down over time, and

1 create innovation. And that should be benefiting customers  
2 whether FERC jurisdictional or state jurisdictional.

3 So with that, I look forward to your questions.  
4 Thank you.

5 MR. RODGERS: Thank you Mr. Smutney-Jones.  
6 Next, let's turn to Dennis Eicher who is the President of  
7 Power Systems Engineering.

8 MR. EICHER: My name is Dennis Eicher. I am  
9 President of Power System Engineering. We are an  
10 engineering economic consulting firm servicing the electric  
11 utility industry. While we serve clients in all sectors of  
12 the industry, we have historically specialized in providing  
13 service to small electric utilities, primarily, rural  
14 electric cooperatives and municipal electric systems and  
15 it's their interests that I hope to represent today.

16 I'd like to say at the beginning, that I  
17 appreciated comments that Terry made this morning and I  
18 suspect that we share many of the same perspectives on these  
19 issues. There's one issue, however, that we probably do not  
20 share the same perspective on. I'm from Minnesota and I  
21 greatly appreciate the opportunity to come here to  
22 Washington in late January and enjoy this balmy spring-like  
23 weather.

24 Since time is limited, I will focus my remarks on  
25 one aspect of the subject of this session, namely whether or

1 not the Commission should continue to be concerned with  
2 improper affiliate relationships between utilities. My  
3 simple answer, for reasons I will explain later, is a  
4 resounding "Yes." I intend to further focus my remarks on  
5 some recent experience in the Upper Peninsula of Michigan  
6 where I represent a number of small municipal and electric  
7 cooperative clients, generally referred to as the Upper  
8 Peninsula Transmission Dependent Utilities or affectionately  
9 known as WPPTDU. The majority of these utilities depend  
10 entirely on wholesale purchases from others to supply their  
11 retail load requirements. A few of them do have some  
12 generation but primarily they are purchasers of wholesale  
13 power from other utilities.

14 Before discussing market power and affiliate  
15 abuse issues in the Upper Peninsula, it is necessary to  
16 understand the electrical supply resources and transmission  
17 network that are currently used to serve the U.P. The U.P.,  
18 for all intents and purposes, is divided into two distinct  
19 areas. The eastern half of the Upper Peninsula is served by  
20 Edison Sault Electric Company, Cloverland Electric  
21 Cooperative and the Village of Newberry. It is connected to  
22 the Lower Peninsula of Michigan via two 138 kv transmission  
23 lines across the Straits of Mackinac. Generation in the  
24 eastern U.P. consists of roughly 60 megawatts of hydro-  
25 electric capacity and 20 megawatts of oil-fired diesel

1 engines. The load is substantially greater than that and  
2 so the eastern U.P. is a net purchaser of power.

3 The western side of the U.P. is served by the  
4 Upper Peninsula Power Company, Wisconsin Public Service and  
5 Wisconsin Electric along with eight municipal electric  
6 systems and two rural electric cooperatives. The Western  
7 U.P. is connected to Wisconsin via a 345 kb line and two 138  
8 kv lines.

9 Prior to 2000, there was no effective  
10 transmission interconnection between the east and the west.  
11 In 2000, a 138 kv line that connects to a 69 kv line which  
12 sort of acts as a big fuse connected the two parts of the  
13 U.P. There's about 70 megawatts of capacity on that line  
14 but unfortunately, a significant portion of the capability  
15 is often used up by loop flow around Lake Michigan.

16 In the late 1990s, the four investor-owned  
17 utilities in the U.P. consolidated their positions through  
18 two mergers. Wisconsin Electric merged with Edison Sault  
19 and Wisconsin Public Service merged with UPPCO. As part of  
20 the approval process HHI analyses were prepared for each of  
21 those proposed mergers. Those analyses were alleged to show  
22 that market power did not exist in the U.P., or at least  
23 that the proposed mergers would not aggravate any market  
24 power that already exists.

25 In my opinion, the results of both those analyses

1        were misleading at best. It seems to me that if one stands  
2        back and takes a rational, unbiased look at the power supply  
3        situation in the U.P. you come to any other conclusion but  
4        that significant market power does exist. The simple facts  
5        are these. Excluding generation owned by the cities of  
6        Marquette and Escanaba, two municipal electric systems on  
7        the western side whose generating facilities are dedicated  
8        solely to supplying their own municipal load, there is  
9        approximately 785 megawatts of base-load capacity that is  
10       either hydro-electric or coal-fired generation in the U.P.  
11       Wisconsin Electric owns or controls 735 megawatts, or 94  
12       percent of that capacity.

13                        Furthermore, as I have indicated, there are  
14       currently only two transmission paths into the U.P., one on  
15       the east side, one on the west side, both are highly  
16       constrained. Wisconsin Electric and/or its affiliate Edison  
17       Sault controls roughly 80 percent of the transmission  
18       capacity into or out of the U.P. Wisconsin Public Service  
19       controls virtually all of the remaining capacity and I  
20       should point out that the capacity that Wisconsin Public  
21       Service has in the facilities leading from Wisconsin into  
22       the U.P. was part of a settlement in the Wisconsin Electric  
23       Edison Sault merger. I might also note that Wisconsin  
24       Electric also controls the majority of the capacity in the  
25       east-west tie. When I look at those facts, I can only

1 conclude that Wisconsin Electric, and to a lesser extent,  
2 Wisconsin Public Service, have significant market power in  
3 the U.P., regardless of what the HHI analyses or any other  
4 analyses might conclude.

5 In fact, it seems to me intuitive that if such  
6 analyses do not conclude that there is market power in the  
7 U.P., then there's something wrong with the analyses  
8 itself, either the methodology assumptions, definition of  
9 market area, treatment of long-term contracts or some other  
10 factor. The potential for abuse of that market power is  
11 aggravated by the fact that the two utilities that are  
12 native to the U.P. have merged with the two Wisconsin  
13 utilities, which raises the possibility of affiliate abuse.  
14 Simply put, there is no viable market in the U.P. that can  
15 function in light of that market power that the two  
16 utilities and their affiliates have.

17 Some practical examples, this is not merely  
18 theoretical. There are some very real practical  
19 consequences to this concentration of power supply and  
20 transmission capacity and the potential for affiliate abuse  
21 in the U.P. Here are a couple of examples.

22 In the fall of 1999, I assisted Alger Delta  
23 Cooperative Electric Association and Ontonagon in issuing a  
24 request for proposal to seek alternatives to contract  
25 extension prices quoted by UPPCO and Wisconsin Electric.

1 RFPs were sent to approximately twenty-five potential  
2 suppliers in the Upper Midwest. No responses were received.

3 The lack of available transmission capacity into the U.P.  
4 from Wisconsin or from the Lower Peninsula of Michigan was  
5 undoubtedly a major factor and I would say it was  
6 undoubtedly the major factor.

7 As a result, Alger Delta and Ontonagon were  
8 forced to extend their contracts with UPPCO for another five  
9 years, even though this represented a substantial increase  
10 in cost. They simply had no choice. We continued to pursue  
11 a replacement of approximately 1 megawatt that Wisconsin  
12 Electric had been supplying to Ontonagon because of a huge  
13 rate increase that would have occurred had Ontonagon  
14 accepted the Wisconsin Electric proposal. Ultimately, we  
15 were able to negotiate a deal with Wisconsin Public Power,  
16 Inc., or WPPI a joint action agency of municipal electric  
17 systems in Wisconsin. Even though the WPPI proposal would  
18 have represented an increase of approximately 22 to 33  
19 percent over the current cost from Wisconsin Electric, that  
20 was still substantially less than the 65 to 91 percent  
21 increase that Wisconsin Electric originally proposed.

22 However, when we attempted to consummate the deal  
23 with WPPI, we were informed by Wisconsin Electric that all  
24 of the available transmission capacity between Wisconsin and  
25 the U.P. was reserved by its marketing affiliate, and thus,

1 WPPI would not be permitted to deliver firm power and energy  
2 to Ontonagon. I found this response to be incredible in  
3 light of the fact that first, we were only asking for 1  
4 megawatt of transmission capacity and second, Wisconsin  
5 Electric was already serving the load in question. Even if  
6 Wisconsin Electric were to claim that it presently served  
7 the Ontonagon load from U.P. resources, transferring the  
8 load to Wisconsin Electric to WPPI should have relieved  
9 roughly 1 megawatt of WE's generating resources in the U.P.,  
10 thereby freeing U.P. an equivalent 1 megawatt of  
11 transmission capacity. In other words, it shouldn't have  
12 made much difference to Wisconsin Electric whether it served  
13 the load from Wisconsin or Upper Peninsula resources. The  
14 impact should have been roughly the same.

15 After seeking assistance from the stage  
16 legislature, we were ultimately able to strike a deal with  
17 Wisconsin Electric based on Wisconsin Electric's FERC-  
18 approved cost-based wholesale rate rather than its proposed  
19 contract rate. While this rate did represent an increase of  
20 approximately 23 percent over the current price, roughly the  
21 same as the WPPI proposal, it was still substantially lower  
22 than what Wisconsin Electric had originally proposed.

23 A more recent situation, very similar, has  
24 occurred just recently with respect to the City of Crystal  
25 Falls, Michigan. Crystal Falls is supplied partly from a

1 small hydro electric facility which it owns, with the  
2 remainder supplied by Wisconsin Electric. With the expected  
3 expiration of the existing contract with Wisconsin Electric,  
4 the City sought proposals from Wisconsin Electric and  
5 Wisconsin Public Service to supply its supplemental  
6 requirements, roughly 4 megawatts on peak. The City chose  
7 Wisconsin Public Service as its preferred supplier.  
8 However, when the City and Wisconsin Public Service applied  
9 for a transmission path, it was told by MISO that capacity  
10 was not available.

11 Now, some might argue that this result was not  
12 unexpected, since the City was attempting to change its  
13 supplier from Wisconsin Electric, who would have supplied  
14 the load from its Upper Peninsula generation resources, to  
15 Wisconsin Public Service, which would supply the load  
16 presumably from its generating resources in Wisconsin. Yet,  
17 there seems to be sufficient transmission capacity and  
18 generating resources for Wisconsin Electric to supply its  
19 affiliate company, Edison Sault and for Wisconsin Public  
20 Service to supply its affiliate company, UPPCO. Why isn't  
21 there sufficient capacity to supply this small a load to a  
22 non-affiliate?

23 Furthermore, I would note that both Wisconsin  
24 Public Service and Wisconsin Electric have been able to work  
25 out a transfer of load responsibility arrangement wherein

1       Wisconsin Electric supplies Wisconsin Public Service  
2       affiliate UPPCO from U.P. resources, while Wisconsin Public  
3       Service reciprocates and supplies WE load in Wisconsin from  
4       Wisconsin resources. Yet, a similar arrangement has not  
5       been offered to Crystal Falls or other UPTDU members.

6               While there may be many areas of the country  
7       where the wholesale power supply market has matured to the  
8       point that affiliate abuse is no longer a major issue, there  
9       are other parts of the country where this is not true. The  
10       Upper Peninsula of Michigan is one such poster child of an  
11       area where, due to geography and limited transmission  
12       capacity connecting the U.P. to the rest of the world, a  
13       truly competitive market does not exist, and probably will  
14       not exist for many years to come. The fact that this  
15       isolated area is dominated by two large Wisconsin utilities  
16       and their U.P. affiliates, who together have control of  
17       almost all of the generating and transmission resources,  
18       means that the potential for affiliate abuse is all too  
19       real. The Commission should remain diligent in monitoring  
20       the situation to avoid putting the small cooperative and  
21       municipals in the U.P. at a further disadvantage. The only  
22       realistic alternative I see is for the Commission to enforce  
23       an obligation on the dominant utilities to continue to serve  
24       the transmission dependent utilities at cost-based rates.

25               MR. RODGERS: Thank you, Mr. Eicher. Our last

1 panelist today will be Allen Freifeld. Mr. Freifeld is a  
2 Commission with Maryland Public Service commission.

3 MR. FREIFELD: Thank you, Mr. Rodgers. As he  
4 said, my name is Allen Freifeld and I am a member of the  
5 Maryland Public Service Commission, and as the last speaker  
6 this morning before lunch, I know what my assignment is so  
7 let me get right to it.

8 I'd like to thank the Staff and the Commission  
9 for the opportunity to address the issue of affiliate abuse  
10 this morning. The Maryland Commission has some experience  
11 with designing competitive solicitation processes that  
12 successfully prevent affiliate abuse and I'd like to share  
13 some of the details of those processes with you.

14 The Commission has commented favorably on our  
15 processes in your Allegheny Order and various market  
16 participants have commented favorably on our processes as  
17 well. So I thought it might be a good idea to describe them  
18 in a little bit more detail than is probably commonly  
19 understood.

20 Maryland's investor owned utilities have engaged  
21 in several rounds of successful competitive procurement now  
22 in which affiliates participated with the complete agreement  
23 of all parties, including the Commission, but in which  
24 there's been absolutely no hint obtained of the affiliate  
25 abuse, no allegations, no evidence of any affiliate

1 favoritism. And the results have generally been very  
2 acceptable to all our participants. There are three  
3 features of our process that have probably contributed to  
4 this successful result. First, our process minimized the  
5 utilities' ability to exercise any discretion at the end of  
6 the process when a contract was awarded. Under a Commission  
7 supervised collaborative process standardized contract terms  
8 were developed prior to the actual solicitation. The  
9 collaborative process was very open, very public and very  
10 well attended. All segments of the industry were  
11 represented. All forms of suppliers and various customer  
12 classes and, of course, the Commission Staff was involved.

13 The collaborative process resulted in a  
14 standardized contract agreed to by all parties which set  
15 forth such terms as the duration of contracts to be awarded,  
16 the collateral requirements to be imposed, the credit  
17 quality expectations of the buyers such that at the end of  
18 the day, none of these items could be used as an excuse to  
19 award the contract for one party or another. These things  
20 were worked out prior to the actual bids coming in.

21 The collaborative process also called for a  
22 standardized product which was full requirement service.  
23 This feature meant that at the end of the day when a  
24 contract was awarded there could be no form of abuse or  
25 favoritism based on small differences in what was being

1 offered. A very specific product was requested and all  
2 bidders offered precisely that product. Because all of  
3 these non-price terms were developed prior to the bids being  
4 received, the evaluation bids was performed solely on the  
5 basis of the offered price. Bids were submitted on standard  
6 bid forms which were approved through this collaborative  
7 process and bids were electronically transmitted to the  
8 utilities' bid rooms and at the end of the day a very  
9 straightforward mathematical analysis was determined -- was  
10 used to determine the low cost bidders and the winners.

11 The second feature of our process which has  
12 minimized the controversy which might otherwise occur after  
13 a process is the fact that our bids occurred against the  
14 backdrop of the PJM interconnection. Because Maryland is  
15 within the PJM footprint, there is an independent assessment  
16 of transmission availability by any bidders. That is, any  
17 bidder who is a member of PJM is able to deliver their power  
18 into Maryland, so there's no potential of abuse by utilities  
19 who own transmission assets.

20 Our participation in PJM also contributed to the  
21 successful result in that it attracted a diverse and very  
22 large number of bidders. Eighteen or twenty bidders have  
23 occurred in traunch of our bidding. In fact, seven or eight  
24 megawatts has been offered for each megawatt that we sought  
25 for through the bids. And there have been multiple winners

1 in each traunch that we have gone through. So by all  
2 accounts, the bidding process has been very successful and  
3 it has been conducted within a very competitive and robust  
4 wholesale market.

5 The third feature of our solicitation process, a  
6 very crucial one, is that we employed an independent third  
7 party monitor to really oversee the entire process almost  
8 from beginning to end. The monitor reviewed communications  
9 between the utility and all bidders prior to a bid to ensure  
10 that all bidders had access to the same information. And on  
11 bid day the independent monitor ensured a high degree of  
12 security.

13 Specifically, the monitor was on site in the bid  
14 rooms as bids were received to ensure that no inappropriate  
15 communications occurred between the utility and any bidders,  
16 most particularly, its affiliate. Once bidding closed, the  
17 independent monitor independently reviewed and ranked the  
18 bids just as the utility was doing at the same time and in  
19 all cases, the independent monitor of the utility reached  
20 the same conclusion as to what the winning bidders were.

21 Finally, we have a post-bid process which we  
22 refer to as the procuring of improvement process which  
23 allows any party to propose changes in the procurement  
24 process in advance of the next round of bidding and we made  
25 several changes to the initial process pursuant to that

1 procurement improvement process and those changes that  
2 worked well in the second round bidding that we're engaged  
3 in currently.

4           So in the context of this Commission's rulemaking  
5 -- in the context of wholesale procurement, I would suggest  
6 that you may want to memorialize in some fashion, your  
7 approval of a process similar to that used in Maryland such  
8 that any applicant from market-based rates authority who  
9 went through a similar process would be granted their  
10 market-based rates authority fairly expeditiously. On the  
11 other hand, an applicant who did not go through a process  
12 like this or who went through a process that lacked key  
13 features, that application would be subject to a more  
14 searching inquiry of the federal level.

15           Affiliate abuse also, of course, can occur in the  
16 context of transmission system control. As I know, you've  
17 observed recently in regards to transactions in the  
18 southwest. In an RTO such as PJM, this form of abuse does  
19 not occur but in an area which is not governed by an RTO,  
20 some form of perhaps second best solution is required to  
21 adjust this form of affiliate abuse. And I suggest,  
22 perhaps, some form of independent monitor to review in  
23 realtime the operations of those transmission owners might  
24 constitute a chill on that sort of abuse. I suggest some  
25 sort of -- some form of realtime monitoring because after-

1 the-fact audits do not represent much of a remedy for the  
2 agreed parties and as Mr. Smutney-Jones indicated, the  
3 agreed parties simply won't pursue their remedies if the  
4 only remedy is an after-the-fact audit.

5 So I thank you all for your attention and I wish  
6 the Commission the best of luck as you and the states raffle  
7 with these difficult issues going forward.

8 MR. RODGERS: Thank you very much Commissioner.  
9 I have just a couple of

10

11 MR. RODGERS: Thank you very much. I have just a  
12 couple of questions for you, if I could.

13 MR. FREIFIELD: Thanks.

14 MR. RODGERS: It is pretty obvious that the  
15 Maryland Commission has put a lot of time and attention into  
16 the issue of competitive procurement. I was wondering if it  
17 is your belief, your perception that maybe not all states  
18 have put in as much time to give attention to this issue as  
19 Maryland has?

20 MR. FREIFIELD: I don't have any specific  
21 knowledge of what happens in other states, but I think it's  
22 reasonable to assume with 50 states, and diverse interests,  
23 and diverse personality, you will see a range of scrutiny in  
24 all the states.

25 MR. RODGERS: And if there were states out there

1 that had less scrutiny than say, the Maryland Commissions  
2 has, then that might be all the more justification for there  
3 to be a federal role in making sure that the affiliate  
4 transactions were on the up and up, is that correct?

5 MR. FREIFIELD: I say this, every state has an  
6 obligation and it has authority in the area of its utilities  
7 procurement practice. Commissions have a role to play  
8 there, and they will play their role as they see fit.

9 The Federal Energy Regulatory Commission has a  
10 responsibility and authority with respect to sales for  
11 resale. And the state of the law is both Commissions have  
12 this fear of responsibility, and both Commissions will have  
13 to do their jobs consistent with the statutes they operate  
14 under.

15 MR. RODGERS: Under the solicitation guidelines  
16 the Commission, FERC recently enunciated, that we all have a  
17 desire for transparency, definition, evaluation, oversight  
18 in part of a competitive procurement process. Is there  
19 anything in those guidelines that you see a problematic from  
20 the Maryland Commission's perspective?

21 MR. FREIFIELD: No. I think, we adopted all of  
22 those criteria, in fact, before you did. We think they are  
23 appropriate. And I suspect as time goes on, more and more  
24 states will, in fact, migrate to a process that contains  
25 those features, regardless of the ultimate details. I think

1 those features will become more widespread over time.

2 MR. RODGERS: Thank you. Also, I have a question  
3 for Mr. Smutney-Jones. You mentioned, if I understood you  
4 correctly, that there should be a burden on the holder of  
5 market-based rate authorization that it has to meet in order  
6 to keep it market-based rate authorization. Is that  
7 correct, something to that effect?

8 MR. SMUTNEY-JONES: As I said, and actually  
9 applying for it, yes, they do. But your question?

10 MR. RODGERS: For an initial market-base rate  
11 applicant, they have that burden today under Section 205 of  
12 the Federal Power Act. That perhaps is not the case for  
13 someone who is back in FERC for a triennial update filing,  
14 which is what we see more often today, than initial filings  
15 for major players in the market.

16 Staff has talked among itself about the  
17 possibility of perhaps changing the protocol, or consider  
18 changing the protocol to where it would be a subset  
19 associated with a market-based rate authorization that would  
20 expire, say, after three years. So, that at then end of the  
21 three years the holder of the authorization would have to  
22 come back in and re-apply under Section 205 of the Power  
23 Act, which would mean that they would then have the burden  
24 proof. When the Commission initiates a 206 investigation,  
25 it has the proof.

1           So, is that the kind of thing that you're talking  
2 about here, or if not, what's your reaction to FERC --

3           MR. SMUTNEY-JONES: I think that -- what I  
4 thought I heard on a previous panel was the issue of  
5 maintaining your market-based authority, and that it could  
6 be removed if, in fact, you have breached it in certain  
7 respects. I think that's where I would address it.

8           MR. RODGERS: The Commission, I believe, could  
9 impose such a condition on an initial market-base rate  
10 applicant, who is here under 205. But if the Commission  
11 wished to place some kind of requirement, along the lines  
12 that you suggested on someone who already has market-based  
13 rate authorization, presumably they can only do so after a  
14 206 investigation. I just mention that for what it's worth.

15

16           Mr. Comer, I had a couple of questions for you,  
17 if I could. You mentioned on page three of your testimony  
18 that, "the most pressing issue in competitive markets today  
19 is to decide how to facilitate investments in new base-load  
20 plants." I think it's a pretty well known fact, and I think  
21 Mr. Corneli mentioned this as well, but in the Northeast and  
22 the Southeast there's actually a lot of overbuilt  
23 generation, an excess supply. So, I'm wondering why, Mr.  
24 Comer, that you feel that it is such a pressing need that we  
25 have more generation in what are already overbuilt markets.

1           MR. COMER: Well, eventually that overbuilding,  
2 we'll presume overbuilding; will end in terms of the  
3 community growth, among other factors. And people who are  
4 planning -- the two coal plants, and there are a factors,  
5 reasons why people are looking at coal plants there. They  
6 are fuel supply factors, concerns about price, and  
7 availability of natural gas. They need a very long term  
8 period to plan and build. And this is the time now, to make  
9 sure that we have the regulatory structure in place, so that  
10 we can do that.

11           So, we are not thinking in the next year or two.  
12 We're talking five or ten years out. But this is the very  
13 time to start planning.

14           MR. RODGERS: Let me ask you a few things.  
15 There's a more pressing need for transmission infrastructure  
16 to be built to try to hook up the existing generation that's  
17 underground in places like the Southeast, and in particular,  
18 since I think there is a lot of evidence out there that the  
19 growth of transmission infrastructure has not kept pace  
20 nearly with the growth and generation infrastructure.

21           MR. COMER: Well, that's a whole other subject.  
22 We could spend hours on that. There probably is a need for  
23 more transmission. Transmission is being built. We  
24 certainly recommend it to the Commission. (Unintelligible)  
25 to help facilitate that. We are certainly looking forward

1 to having an Energy Bill passed that so that we can give the  
2 Commission some more citing authority. That might help.  
3 But that's a whole other issue.

4 The important thing to remember is transmission  
5 is a way of delivering energy. But when you need base-load  
6 capacity, you have to have that capacity to supply the  
7 peoples' needs. And they are both true.

8 MR. RODGERS: Just one other question I had for  
9 you, Mr. Comer. You mentioned, again, this is on page three  
10 of your testimony. What a market monitor should also  
11 provide for oversight of matters, such as the behavior of  
12 market participants, and assurance of independent  
13 transparency, and clear open access. That was  
14 (unintelligible) where RTOs are not formed. You mentioned,  
15 jumping over to page five, you said, again, a competitive  
16 solicitation process should be open and clear.

17 What should the Commission do, in your view, if  
18 it finds that there was not adequate transparency or clear  
19 open access, competitive solicitation processes are not open  
20 and fair?

21 MR. COMER: In terms of transactions that are  
22 before the Commission --

23 MR. RODGER: I guess --

24 MR. COMER: I mean, the Commission's ultimate  
25 responsibility is to determine whether or the rates are just

1 and reasonable. So, I think it would have go -- if the  
2 guidelines as indicated are sort of the easy way to get  
3 through the process. If you don't comply with those  
4 guidelines then the Commission is going to take a much  
5 harder look at transactions and what resulted from those  
6 transactions.

7 MR. RODGER: In the context of a market-based  
8 rate filing applicant has, if the Commission found that  
9 these factors that you point out were not existent, should  
10 the Commission consider revoking the applicant's market-  
11 based rate authority, and or undertake other mitigation,  
12 structural mitigation, such as some panelists have  
13 suggested?

14 MR. COMER: I think it ultimately depends on  
15 whether or not, looking at all the factors, the applicants  
16 are market power. If the applicant has market power, I  
17 think you have (unintelligible). If not, I don't think you  
18 should. That's the ultimate question before you.

19 MR. RODGERS: Jerry, did you have questions?

20 MR. PEDERSON: I have a few questions for the  
21 Commissioner. In the Maryland competitive solicitation  
22 process, did any of the affiliates win any of the contracts?

23 MR. FREIFELD: I have to think for a moment  
24 whether or not I can tell you that based on the  
25 confidentiality agreement. The answer is I can tell you

1 without naming which affiliate. Yes, affiliates won some  
2 bid blocks. Our bid blocks are 50 megawatts, roughly  
3 speaking. So there are many bid blocks. Affiliates won  
4 some, they lost more than they won.

5 MR. PEDERSON: But they did win some?

6 MR. FREIFELD: They did win some, yes.

7 MR. PEDERSON: Would you agree that that then  
8 would demonstrate, at least for the Maryland process anyway,  
9 that an open and competitive process, that includes an  
10 independent monitor would not unfairly disadvantage  
11 affiliates?

12 MR. FREIFELD: I think it is safe to say that in  
13 our process, affiliates are not disadvantaged. They simply  
14 compete on the same terms as everybody else. And if they  
15 submit the best bid, in fact, they do win as they did for  
16 several bid blocks, as I just mentioned. They are not  
17 disadvantaged or advantaged.

18 MR. PEDERSON: In that process, Maryland was  
19 looking at the process, yet, you chose to get an independent  
20 monitor involved. Can you expand upon the reasons for that?  
21 We heard earlier today that if they state is looking at it,  
22 perhaps, no one else needs to look at that process. That  
23 the Commission should just rely on the states review of that  
24 process, yet, Maryland chose to go with an independent  
25 monitor.

1                   MR. FREIFELD: Yeah. The reason for the  
2 independent monitor is just a function of resources and  
3 expertise. What the monitor did requires a fair degree of  
4 industry expertise. And we have a very good staff, but they  
5 may not have had precisely the expertise that we were  
6 looking for this process. And even our internal staff had  
7 the expertise, we only have so many employees. So, as a  
8 matter of getting a monitor who could devote the time, and  
9 knew what to look for. An independent monitor with a great  
10 deal of industry experience was exactly what we needed.

11                   MR. PEDERSON: And lastly, you stated about the  
12 product, and defined the product in such a way that you  
13 essentially got rid of the non-price factors, and dealt with  
14 the little room that can be out there. And that certainly  
15 would work in a Maryland situation where you are sitting in  
16 an RTO.

17                   In a non-RTO market, or a market where there is  
18 non-price factors are part of the solicitation process,  
19 would you agree that a close monitoring of that process is  
20 needed?

21                   MR. FREIFELD: Well, I do agree that the more  
22 discretion the utility has in their choice, if they choose  
23 an affiliate based on some non-price factor, the weight of  
24 which is subject to a great deal of debate, a lot of  
25 scrutiny is going to be called for under that scenario.

1 MR. PEDERSON: Thank you.

2 MR. RODGERS: David, did you have a question?

3 MR. TOBENKIN: Sure. Mr. Smutney-Jones, you had  
4 mentioned the need for structural rules on the front end  
5 with respect to market-based rate authority and resource  
6 procurement involving affiliates. And you also mentioned  
7 the end additions to complaints by losing bidders. Is there  
8 a role for greater enforcement by FERC, and if so, what form  
9 do you think it should take?

10 MR. SMUTNEY-JONES: A lot of that, I think is  
11 probably very dependent upon how that project got here. I  
12 think for example, you have just heard in Maryland where you  
13 have an auction process that works really well. My  
14 organization was, obviously, part of a process in California  
15 we didn't think worked very well, and brought that issue  
16 here. So, I think a lot of that probably depends upon what  
17 that structure looks like coming to you and what the impact  
18 of that solicitation or that addition might have with  
19 respect to the wholesale market. And my hope is, and  
20 certainly within the context of California, within the last  
21 year have made pretty good strides with trying to come up  
22 with rational procurement rules that will, in fact, allow  
23 utilities to recover costs associated with those  
24 procurements. A state-based resource adequacy  
25 determination, that is the state, not the FERC imposing it

1 on the state. So, we assume that that will remain somewhat  
2 uncontroversial.

3 So, I think a lot of it kind of depends on how it  
4 gets here, to the extent that you've got a state process  
5 that's open, transparent, and fair, I don't think you have  
6 really much to do.

7 MR. RODGER: Mary Beth, did you have a question?

8 MS. TIGHE: Yes, thank you. Just to follow on  
9 Jerry's question to Commissioner Freifeld. As I understand  
10 it, in addition to having the independent monitors, the  
11 Commission, as well the staff were also involved to a large  
12 extent throughout the process, is that correct?

13 MR. FREIFELD: That's correct.

14 MS. TIGHE: In your view, was that involvement by  
15 the Commission, one of the factors in this success of the  
16 program? Or do you think that you might have had a similar  
17 outcome if the Commission and the staff had been not as  
18 involved, or not involved at all?

19 MR. FREIFELD: No, I'm fairly certain that the  
20 day-to-day involvement by the staff and the frequent  
21 briefings that the Commission got, and being able to send  
22 messages back to the collaborative, and hence the prospects  
23 for success. And also moved the process along more quickly  
24 than it would have been, had we simply waited to the end to  
25 hear what the parties had brought.

1 MS. TIGHE: To change the topic just a bit, as  
2 you may know, Commissioner Freifeld, one of the factors that  
3 this Commission considers as a way to protect customers from  
4 the cost shifting that may occur among affiliates is to  
5 consider whether the applicant for market-based rate  
6 authority operates in an area where there is a retail rate  
7 freeze, or where there may be retail access.

8 Am I correct that retail rate freezes are  
9 typically not permanent?

10 MR. FREIFELD: All retail rate freezes are  
11 temporary, to the best of my knowledge, typically, five,  
12 six, or seven years. And of course, they have to be  
13 temporary, because to the extent they hold prices below  
14 market-based or actual costs, they are not sustainable  
15 forever. So, they all have a limited life.

16 MS. TIGHE: So, given that, would you think that  
17 we should think about modifying this approach of granting  
18 market-based rate authority, or exemptions from codes of  
19 conduct on the basis of a retail rate freeze being in place  
20 at the time of the application?

21 MR. FREIFELD: I think to the extent that you  
22 grant waivers like that, you may be correct in the short  
23 term that customers are protected from the negative  
24 consequences you're looking at. But in the long term  
25 granting those sorts of waivers just because there is a

1 temporary price freeze in place, the long term consequences  
2 of that exemption is probably harmful to the development of  
3 markets.

4 MS. TIGHE: And similarly with the retail access  
5 consideration, I understand that there are various flavors,  
6 if you will, of retail access in terms of effective choice  
7 for customers. But do you have opinion on whether that is a  
8 adequate basis; for example, giving an exemption from code  
9 of conduct?

10 MR. FREIFELD: I suspect where you have retail  
11 choice, if an affiliate is unduly advantaged because it is -  
12 - and it is, in fact, high cost retail choice, may allow  
13 customers to escape those consequences. But it is not at  
14 all clear, because retail choice programs are just getting  
15 off the ground. And penetration rates are still low. So,  
16 while that form of affiliate abuse may be escapable, it's  
17 not certain that that's the case yet.

18 MS. TIGHE: Thank you. I have a question for Mr.  
19 Corneli, Mr. Smutney-Jones, and Mr. Eicher, I believe.

20 This morning you heard Mr. Kelley talk about a  
21 code of conduct violation as being a clear changing of that  
22 within his company. In your experience, how easy is it for  
23 a market participant to be able to detect code of conduct  
24 violation, such as information sharing, for example between  
25 an affiliate and the utility? And what would your reaction

1 be to Commissioner's Freifeld's realtime auditing suggestion  
2 that he made a little while ago?

3 MR. CORNELI: From our perspective and  
4 experience, especially in the area of say, transmission  
5 information, transmission reservation, reliability. These  
6 are requirements like the ones that Mr. Huval talked about  
7 this morning. It's very hard to know who knows what on the  
8 other side of the Oasis Reservation Center, or the other  
9 side of the control room. It often seems like we are having  
10 a particularly bad day reserving transmission, and it's not  
11 really clear if that is because somebody has shared  
12 information, or they are just smarter, or you're just having  
13 a bad day.

14 So, in that area it is not at all transparent.  
15 And it is very, very hard to know. In terms of the New  
16 Jersey version of the Maryland retail auction, we have had a  
17 very comfortable sense in our participation. And that is  
18 working. There is no question it's a structured process  
19 that works very well.

20 The fundamental problem though is, from a market  
21 participant's perspective, you never know if somebody else  
22 has their thumb on scale, or is sharing information, unless  
23 somebody tells you that. Then you are the last person they  
24 tell. So, it's very hard to know, which is why it is so  
25 important to have the codes of conduct. Which are important

1 to have, essentially, to structure some incentives that  
2 align people's interest with just trying to produce a  
3 competitive result. That's what we are all trying to get  
4 to.

5 MR. SMUTNEY-JONES: Yeah, I think that we did a  
6 good job of covering the opaqueness and trying to find out  
7 why something has happened. I think two things. One of the  
8 ways to get around that, of course, is having, you know,  
9 transparent data available to all parties. That it isn't --  
10 shouldn't be kept it a state secret, and subject to only  
11 two transmission owners, for example, knowing it. And I'm  
12 not quite familiar with how the realtime auditor process  
13 works, but obviously, if you've got someone watching  
14 people's behavior in realtime or close to realtime, and can  
15 draw some conclusions about what's going on, and throw the  
16 flag when it needs to be thrown. I think that's better than  
17 waiting a couple of years for it to, you know, come out and  
18 then, you know, you try to unravel, you know, a sweater  
19 that's already been knitted. So, to the extent that -- you  
20 know, it can be more, you know, up front more realtime and I  
21 think as Mr. Kelley indicated this morning, he made it clear  
22 that it is a career limiting opportunity, if you engage in  
23 that kind of behavior, I think that, you know, that's --  
24 that's a pretty good incentive.

25 MR. EICHER: I'm not sure that that question

1 relates to our issues in the Upper Peninsula. The Upper  
2 Peninsula, along with Wisconsin, is part of the American  
3 Transmission Company. And so there isn't the affiliate  
4 abuse that might have existed historically between -- on a  
5 vertically integrated utility. And yet the transmission  
6 reservations were made back at the time that the utilities  
7 were vertically integrated. And the mergers occurred back  
8 at a time when the utilities were vertically integrated.  
9 That's also part of MISO, so I'm not as concerned about the  
10 day-to-day operating situation, as I am about the inability  
11 to be able to sign five year contracts, for example, with an  
12 entity that's outside of U.P., because there isn't any  
13 entity in the U.P. that has any resources except for  
14 Wisconsin Electric.

15 I'm also concerned about the fact that the two  
16 Wisconsin utilities and their affiliates have the ability of  
17 negotiating power swaps where one will supply power of the  
18 other utility in the U.P., and the other will exchange that  
19 in Wisconsin. But those opportunities don't appear to be  
20 available to the small municipals and cooperatives in the  
21 Upper Peninsula, so that they're left with virtually no  
22 options. And they even don't have an option to build their  
23 own capacity, because since the capacity both into and out  
24 of the U.P. is tied up. Any excess capacity would not be  
25 able to get to market. So, we're really caught between a

1 rock and a hard place again. And I'm not sure that the  
2 affiliate rules even address situations like that. The  
3 bottom line is that the real problem is transmission. And  
4 it's a wires problem ultimately. But that problem is not --  
5 you see, the APC is working on resolving that problem. And  
6 I think that may be resolved at sometime, but that's many,  
7 many years down the road. And our problem is, what do we do  
8 in the meantime, where contracts are up. What we're being  
9 offered at very, very high rates and we have no options.

10 MR. RODGERS: Dick, did you have some questions.

11

12 MR. O'NEILL: First of all, on behalf of myself  
13 and several Maryland ratepayers here at the Commission,  
14 thanks. You said that the contracts were full requirement.  
15 And as a former contract, it's sort of hard to estimate just  
16 exactly how much you need. So, I was wondering if you could  
17 discuss the importance of the role of realtime and day-ahead  
18 market and PJM in fulfilling the full requirements of that  
19 contract.

20 MR. FREIFELD: I'm fairly certain that PJM's  
21 markets are critical to the bidders who are winning the  
22 solicitation. My understanding is they are -- once a bidder  
23 wins, they go out and establish a portfolio of resources  
24 through which they meet their commitments. But at the end  
25 of the day, they may be engaging in PJM and short-term

1 transactions to balance, or to fill out whatever their needs  
2 are. I'm fairly certain the bidders, and indeed Maryland-  
3 end users, are very dependent on a robust viable and healthy  
4 PJM.

5 MR. O'NEILL: Ed, I thought I heard you say that  
6 we're thinking about embarking on another round of nuclear  
7 plants.

8 MR. COMER: I think there are people looking at  
9 nuclear plants. And obviously, we all know the difficulties  
10 there. But the point is that they are -- people are looking  
11 at alternative fuels to gas. Coal is certainly the most  
12 like. Whatever the plants are they will be large and  
13 complex, and therefore, more difficult to finance than gas  
14 has been recently. And that just goes to the complexity of  
15 all of it, and the need for regulatory certainty.

16 MR. O'NEILL: I couldn't agree with more and  
17 since I haven't been around here for a while. I was here in  
18 '88 debate year and you folks came in and told us it was  
19 either a hundred billion or two hundred billion in straining  
20 costs in late '88. And most of those were nuclear costs.  
21 And some people have argued that one of the reasons why  
22 those costs are so large is because we ended up with fifty  
23 different franchised utilities as owner/operators of nuclear  
24 plants. And some of those who probably shouldn't have been  
25 in the business of operating nuclear plants. How are we

1 going to avoid that? Well, maybe it wasn't a mistake. But  
2 if it was a mistake, how are we going to avoid that the next  
3 time around?

4 MR. COMER: I don't know whether or not it was a  
5 mistake either. Obviously, the markets will tell you that.

6  
7 MR. O'NEILL: Not if you don't open up the  
8 process?

9 MR. COMER: Well, I think, what you can do with  
10 the authority that you have at FERC is to have good market  
11 rules for competitive markets. And they can work. We all  
12 live with division of authority and responsibility over  
13 electric regulations. And the states have a lot of control.  
14 And we may not like what the states do, but I was -- and we  
15 all live with it.

16 MR. O'NEIL: No, I wasn't talking about federal  
17 jurisdiction versus state jurisdiction.

18 MR. COMER: But you are.

19 MR. O'NEILL: I'm -- well, I mean, we had a  
20 filing here that we had to deal with a hundred billion  
21 dollars in straining costs. So, it does sort of affect us.

22 MR. COMER: I think what we have seen is the  
23 merger of the position process. I think, you know, what  
24 we've seen in the nuclear industry is the industry has  
25 become far more efficient, it's consolidated, it has become

1 far more successful. They're making a lot of money these  
2 days. And, I think, they're --

3 MR. O'NEILL: Due to consolidation?

4 MR. COMER: I think in consolidation and  
5 consistent controls has been one of the elements that's made  
6 it.

7 MR. O'NEILL: Stellar performance of the nuclear  
8 heads.

9 MR. CORNELI: If I could jump onto that. If  
10 there aren't something like nuclear ifs and nuclear IGCC  
11 providers, as many of us have suspected, it's not really  
12 going to be anything that independent of nuclear power  
13 production for much longer. The next wave of technology  
14 needs to come from some place. Just like Ed's saying, it  
15 needs to be financed somehow. If it can't be financed  
16 competitively, it's going to be financed on the back,  
17 captive customers with 30 year lifetimes, and we'll be right  
18 back where we started.

19 MR. O'NEILL: Long term contracts probably  
20 haven't disappeared as a way of lowering risks of a large  
21 base-load utility.

22 MR. COMER: But without end market -- what he  
23 says, is without market rules that will make that contract  
24 happen spontaneously between buyers and sellers, there's  
25 only one other place it can happen.

1                   MR. O'NEILL: And the munies, the APPA and NRECA,  
2 desperately want to be in those long-term contracts.

3                   MR. CORNELI: There's a funny thing about your  
4 market power rules and long-term contract. There are two  
5 things about long-term contract. One, I spoke to mentions  
6 it's a high-end issue, and it is an important issue, and how  
7 it's treated. The other is for market power purposes.  
8 Under a long-term contract your market power position is the  
9 same as if you have a long-term contract to buy power, as if  
10 you owned the plant. If you have you have a lot of control  
11 under that long term contract.

12                   MR. O'NEILL: If' you have a long-term contract,  
13 it gives you control of the power. It doesn't matter who  
14 owns the --

15                   MR. CORNELI: Right. So for market power  
16 purposes, you're in the same situation. So, it doesn't  
17 solve your market. What I'm trying to say is long-term  
18 contracts don't necessarily solve your market power issue.  
19 It might solve some other issues but not market power  
20 issues.

21                   MR. O'NEILL: Yeah, it solves the affiliate abuse  
22 issues, which is a market power issue.

23                   MR. SMUTNEY-JONES: If I can jump in the other  
24 plank here. I don't think there's anything that's been said  
25 that doesn't apply to long-term contracts. I think that was

1 the point. I mean, if what utility needs to take thirty  
2 year base-load plant and it is the determination of the  
3 regulators that what that ought to be is something other  
4 than gas, then say that and put it out there and see what  
5 happens. The benefit is from my perspective in the IPP  
6 industry, is that it shifted the risk of those investment  
7 decisions onto the shareholders of companies building those  
8 plants and the banking community. If they made good  
9 decisions, great. And if they made poor decisions, it's  
10 their problem not the ratepayers problem. You don't run  
11 into these unless you have two hundred dollar number, not a  
12 hundred billion, it was a two hundred billion dollar number.  
13 Going forward again, I said at the opening of my  
14 presentation, we have a long past a discussion that we need  
15 to be a vertically integrated utility to build -- you know,  
16 to build generation in this country. And I say that  
17 representing the entire coal fleet in California, all 300  
18 megawatts. So, you know, if that's what the goal is and  
19 there is a goal to add resources for long-term, you know,  
20 I'll be on long-term coal product -- power plants, then put  
21 it out there and see what happens. And if it -- and if the  
22 final analysis nobody shows up because they can't, then by  
23 all means, have the utility build it and let them rate-base  
24 the recovery.

25 MR. COMER: And I think I agree with that. But,

1 put it out with fair rules, and so you know what the rules  
2 are at the state level and the FERC levels. And there are  
3 paths that you know how you can do it and you have fair  
4 options. The worst thing is to not know what the rules are  
5 and not have the federal and state regulators talk to each  
6 other, so that we can understand what the big picture will  
7 be. And this is the time to do it, because we've got the  
8 time to get it right now in a way that is fair, you know.  
9 So that there are viable paths, whether it's, you know, IPPs  
10 or fully competitive -- it's an affiliated transaction or a  
11 base-load, they should all be variations. You know, the  
12 state will decide if it's base-load or not. But you need to  
13 have those paths out there so people know how they can do  
14 it, and understand it. And I too as a Maryland customer --  
15 - a lot of the Maryland customers, I think people are  
16 concerned that three year traunches aren't going to get us  
17 there. And I don't have the answer, but there's a lot of  
18 thinking to do to get it.

19 MR. RODGER: We'll take one more question from  
20 Jerry, then I'm going to open it up to the open microphone  
21 if there's any of the folks in the audience that want to  
22 come make a comment, or ask a question. Jerry.

23 MR. PEDERSON: I'm going to direct this question  
24 to Mr. Corneli, but I encourage any who handle this to offer  
25 an opinion if you have one. We've talked a lot about the

1 resource planning and long-term contracts. I'd like to  
2 shift the focus for a moment to short-term opportunity sales  
3 between affiliates. We've got a lot of utilities out there  
4 that have tariff provisions that allow affiliate sales under  
5 certain conditions. Conditions such as, tying the price to  
6 an index price, tying the price to some published price.  
7 There's also this -- what we refer to as the Detroit Edison  
8 provisions that would allow an IOU to sell to an affiliated  
9 power marketer, provided it makes the same offer at the same  
10 time to non-affiliates. It sells it no lower than it would  
11 sell it to non-affiliates, and the results are posted. And  
12 I'm curious on what your opinion is as to whether --  
13 regarding those policies and allowing them opportunity  
14 sales?

15 MR. CORNELI: I think you're going in the right  
16 direction in terms of the fundamental concern which is an  
17 affiliate -- a sale from a regulated entity to an affiliate  
18 can be profitable with a very low energy margin, because the  
19 fixed costs are already a recovery rate. So, the concern  
20 should be, I think, properly -- our price is going to be  
21 depressed in the wholesale market by this kind of  
22 transaction.

23 The bad news is I don't think there's anyway  
24 really to avoid some kind of potential for suppression of  
25 prices, precisely because the fixed costs are recovered in

1 the rate-base. And any sale of incremental costs --  
2 anything below that of incremental costs won't happen. And  
3 each sale at incremental costs cannot possibly increase  
4 prices unless there's a shortage. So, this is really a  
5 problem, you know, unless it's high up in the regional bid  
6 stack so to speak. I'm sure this is a problem I think  
7 associated with the fact that half of our industry is  
8 recovering its fixed costs from half of the customers and  
9 the other half is recovering from market dynamics.

10 MR. PEDERSON: Should there just be an outright  
11 prohibition on that type of sale?

12 MR. KLEIN: I'm willing to go that far. I think  
13 what there needs to be is a harder look at what it means to  
14 have competitive parity between assets that are in rate-base  
15 and assets that are commercial.

16 MR. EICHER: I'm perfectly happy to say, no, I  
17 don't think you should prohibit it. I think if you have  
18 transactions like that, that are, basically, the way you  
19 describe it as a formula rates, they are tied to market  
20 based indices. As long as it's a market-based rate, I think  
21 that's what you want. I think that that's desirable. You  
22 want to encourage market based rates. So there's not reason  
23 to take on a competitor out of the market if they are  
24 working at the market level.

25 MR. RODGERS: We have some questions from the

1 audience. Please, identify yourself and who you're  
2 representing.

3 MR. LIVELY: I'm Mark Lively, I'm Utility  
4 Economic Engineers. I represent myself. When -- a month  
5 ago I provided comments in this proceeding suggesting that  
6 one way to mitigate market power is to have those utilities  
7 that have control areas to put into place a market -- an  
8 automatic -- automated market for unscheduled flows of  
9 electricity. I know that when India has put into place such  
10 a market for their generation that they have improved their  
11 reliability indices by a factor of about hundred. It would  
12 also help with Commissioner Kelley's [sic] issue earlier of  
13 when she asked the gentleman from the City of Lafayette, why  
14 not build your own transmission? Well, if you have a way to  
15 pay for unscheduled use of the transmission lines, then if  
16 they had made that investment, then they would have -- then  
17 they would have been able to reap all the benefits of that  
18 investment. It would also handle the issue of the gentleman  
19 from the Upper Peninsula, about how much of the transmission  
20 lines are being loaded by loop flow if you are having to pay  
21 for loop flow, you can get paid for loop flow then you have  
22 incentives to correct those loop flows.

23 Again, I filed my comments electronically a month  
24 ago. They're available on the Commission website. Okay.

25 MR. RODGERS: Thank you, Mr. Lively. We have

1 time for one more question from the audience.

2 MR. KLEIN: My name is Carl Klein. I work for  
3 South Carolina Electric and Gas. And I have an observation  
4 for Mr. Corneli. You drew a contrast between markets in the  
5 Northeast and Southeast looking at a large amount of  
6 capacity that was available in the Southeast and describing  
7 it as a reserve margin and speculating that range of  
8 customers was probably high in the Southeast because of this  
9 large rate based source. And I find myself wondering, what  
10 is the source of distress for the distressed assets we hear  
11 about in the Southeast?

12 MR. CORNELI: I'd be happy to answer that  
13 question. The source of the distress is that the  
14 oversupply, the financial impact of an oversupply situation  
15 are only being borne by some generators and not by all  
16 generators. And therefore, the savings that should flow to  
17 the customers in a competitively work related competitive  
18 market, are not fully going to the customers.

19 MR. KLEIN: Well, then I wonder whether it isn't  
20 a sign in a market where supply has grown significantly  
21 ahead of demand. If some suppliers feel distressed, whether  
22 that might not be a sign of a workably competitive wholesale  
23 market working

24 MR. CORNELI: Again, the inefficient supplier  
25 should mop all their plans and get out of the market, for

1       sure.

2                   MR. RODGERS: All right. I do want to mention  
3 something in closing about the comments. Commission will  
4 provide an opportunity for final written comments about  
5 issues covered in this technical conference. And I think  
6 what we're going to do is a slight departure from what we  
7 normally do. The transcript from this conference will  
8 probably be available to the public about seven to ten days.  
9 And around that time the Commission will issue a notice  
10 providing, I guess, thirty day comment period from that time  
11 to file comments, so that interested persons would have the  
12 benefit of a the transcripts from this conference available  
13 when they're preparing their comments. So, I thank you very  
14 much to the panelists. We very much appreciate all your  
15 thoughts.

16                   (Whereupon, at 1:30 p.m., the technical  
17 conference in the above-entitled matter was concluded.)

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