

BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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IN THE MATTER OF: :

CONSENT MARKETS, TARIFFS AND RATES - ELECTRIC :

CONSENT MISCELLANEOUS ITEMS :

CONSENT MARKETS, TARIFFS AND RATES - GAS :

CONSENT ENERGY PROJECTS - HYDRO :

CONSENT ENERGY PROJECTS - CERTIFICATES :

DISCUSSION ITEMS :

STRUCK ITEMS :

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832ND COMMISSION MEETING

OPEN MEETING

Commission Meeting Room

Federal Energy Regulatory

Commission

888 First Street, N.E.

Washington, D.C.

Wednesday, June 25, 2003

10:45 a.m.

APPEARANCES:

COMMISSIONERS PRESENT:

CHAIRMAN PAT WOOD, III, Presiding

COMMISSIONER NORA MEAD BROWNELL

COMMISSIONER WILLIAM L. MASSEY

SECRETARY MAGALIE R. SALAS

ATTENDEES:

JASON STANEK

JOHN CARLSON

SANDRA DELUDE

SANDRA ELLIOT

KATHERINE GENSLER

MICHAEL GOLDENBERG

ROBERT SHELDON

FRANK SPARBER

MICHAEL McGEHEE

CECILIA DESMOND

ELIZAABETH ZERBY

ROBERT PETROCELLI

RAYMOND JAMES

SHEILA HERNANDEZ

AMY HEYMAN

ALSO PRESENT:

DAVID L. HOFFMAN, Court Reporter

P R O C E E D I N G S

(10:45 a.m.)

CHAIRMAN WOOD: Good morning. This open meeting of the Federal Energy Regulatory Commission will come to order to consider the matters which have been duly posted in accordance with the Government in the Sunshine Act for this time and place.

Please join us in the Pledge to the Flag.

(Pledge of Allegiance recited.)

CHAIRMAN WOOD: Madam Secretary?

SECRETARY SALAS: Good morning, Mr. Chairman, and good morning, Commissioners. The following items have been struck since the issuance of the Sunshine Notice on June 19: E-19, E-23, E-27, E-47, E-51, E-58, and H-1.

Your consent agenda for this morning is as follows: Electric Items - E-11, 12, 13, 14, 15, 16, 17, 18, 20, 21, 22, 26, 29, 31, 34, 35, 36, 37, 43, 46, 48, 50, 52, 55, 56, and 57.

Gas Items: G-1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 18, 19, 20, 22, 23, 25, 26, 27, 29, and 30.

Hydro Items: H-2 and 3.

Certificates: C-1, 2, 3, and 4.

And with respect to G-10, Commissioner Brownell is concurring with a separate statement. Commissioner Brownell votes first this morning.

COMMISSIONER BROWNELL: Aye, noting my concurrence on G-10.

COMMISSIONER MASSEY: Aye.

CHAIRMAN WOOD: Aye.

I'd like to add that these items that were struck from today's agenda, except for the one that goes out notationally, we will deal with those in the first two weeks in July.

Today, I'd like to take a few moments to introduce formally, our Commission's Summer 2003 intern class and to welcome them to FERC. If they're in here, if they could just stand up?

(Applause.)

CHAIRMAN WOOD: Everybody found a coat and tie today, despite the summer dress code. This summer's class represents 16 schools from 11 different states, including Texas.

(Laughter.)

CHAIRMAN WOOD: This program provides career experience into the world of energy, the issues and challenges that face the industry, and appreciation of the rewards of public service.

We're extremely proud of your accomplishments. Your resumes were impressive, but what's neat is that the people behind them are, too.

We had a nice social event last week, and we look forward to many more this summer, getting to know you all. We appreciate your dedication and enthusiasm, and the new life that you bring to our Agency restores us, and we're glad you're here.

We should acknowledge that we have among our current cadre of FERC Staff and family, people who started in the internship program, so we know that the used that for good summer experience for some of the nation's best and brightest, but also as a recruiting tool for our Agency, so it's a very valuable tool. And we appreciate both the current and future benefits of the internship program.

We look forward to seeing more of you folks, and appreciate our Staff management and leadership for the training and the time that you commit, above and beyond your normal duties to making sure that our summer interns' experience is useful and productive.

Today, on the remaining items on our agenda, we will turn to a major priority for the Commission over the past couple of years. That is setting the matters right in the aftermath of the 2001-2002 energy market problems in the West.

We began to resolve many of these issues back in March. They represent complex, multifaceted, and novel matters of first impression for our Commission.

This has required a very careful review of the facts and several voluminous records, as well as a thorough deliberation among us and among our staffs on these many, many issues.

We need to put these issues behind us and provide the regulatory certainty that our competitive energy markets clearly require. But these are issues where views and interests differ widely, and compromise is rare.

So, today we act to resolve those conflicts, formally, while providing the due process that market participants deserve. We must decide these issues carefully and fairly, in a manner that will satisfy judicial review.

The issues before us today will address the main issues pending from the March 2003 Staff task force final report on the Western market investigation.

We have carefully examined that report, as well as the evidence and arguments offered by all sides in the 100 days discovery process that we initiated last November. We also take up a number of requests to reform long-term contracts in various parts of the country.

These remarks for me today will give us all an overview of what we're going to cover here today. First, on our Item E-1, we will consider an order to address the market misbehavior of Enron Corporation, by revoking the Company's authority to sell electricity at market-based

rates, and, similarly, to sell natural gas under a blanket certificate.

We send a clear signal that competitive markets must work in the interests of customers and the public interest. This is the first time that the Commission has imposed the so-called death penalty.

Second, the March 26th Staff task force investigation report recommended certain actions in response to Enron's strategies and other questionable market behaviors that were turned up in the pendency of that investigation.

A study by the California Independent System Operator identified a number of market participants as having engaged in these strategies and entering into business relationships with Enron that raise concerns.

Additionally, a number of parties in the 100-days discovery process identified many of these same concerns, while raising other matters. The law allows the Commission to order disgorgement of profits in these instances, provided that the represent a violation of the then-existing tariff.

In Item E-3, we consider specific market practices that violated the market monitoring and information protocol provisions of the tariffs of the California ISO and the California Power Exchange.

Based on the Staff, the ISO's and the 100-day evidence, parties' information, we consider today, formally initiating enforcement proceedings for some 60 companies regarding apparent violations of the California Independent System Operator and California PX tariff provisions which prohibit gaming and anomalous market behavior.

The evidence will be considered by a FERC judge in a formal hearing with the base remedy being disgorgement of unjust profits associated with any proven violations.

We also clarify which market's gains constitute prohibitive gaming and other which represent legitimate arbitrage or will otherwise not be prosecuted.

By definition, a prohibited gaming behavior is driven largely by the use of false information and deception to make a profit. Not every behavior identified in the Enron memos of last year was wrong.

For example, selling power outside California to receive an uncapped price in a non-California state is legitimate. Furthermore, we recognize that transactions may have the appearance of gaming, but may have occurred for a solid, non-manipulative purpose, so we offer some direction to the parties and the judge for how to winnow thoroughly, but expeditiously, through the transactions.

The first Show-Cause Order which we look at in E-3, addresses gaming behavior practiced by individual

companies, but the Staff task force's final report also explained that Enron and two other companies apparently practiced gaming and market manipulation by working in concert with other utilities in the West.

In the second Show-Cause Order, Item E-4, we will consider formal enforcement hearings in which Enron and the other two alleged partnership organizers and their business partners will be asked to submit evidence and proceed to hearings on the issue of jointly engaging in these gaming practices that violated Commission regulations and relevant tariffs, which disadvantaged customers and the marketplace.

As with the individual gaming practices, the base penalty for these issues would be disgorgement of unjust profits from the tariff violations.

The Staff task force final report also addressed the issue of economic withholding. In Item E-5 today, we will consider an Order accepting the Staff's recommended level of \$250 per megawatt hour as the threshold of review for anomalous bidding as defined in the MMIP and the tariffs.

The Order publicly would direct the Office of Market Oversight and Investigation to continue its investigation of bidding behaviors in the ISO and PX markets, to determine whether they represent economic withholding in violation of the tariff's prohibitions

against gaming.

They will report back to us before year end regarding those responsible for economic withholding and the amount of profits potentially subject to disgorgement. This is perhaps our most difficult remaining issue, but we must and will conclude our review of economic withholding soon.

This will affect sales from May through October of 2002. October 2nd marked the beginning of the applicable refund period in our California refund proceeding.

That refund proceeding is on a different track here and will proceed as we directed in our March 26th Order. We have essentially bifurcated the process for October 2nd 2000 through June 21st, 2001, the refund period, and the soon to be determined market mitigated clearing price will be the floor for establishing refunds and will be the benchmark for establishing refunds.

For the prior period, beginning in May of 2000, companies will be subject to disgorgement of unjust profits associated with tariff violations.

The Staff task force final report and the 100-day evidence also alleged that some generators may have engaged in physical withholding. Today we will receive a brief public update on Staff's ongoing investigation of these matters.

What I've just described is a backward-looking

remedial issue concerning past market behavior, but in Items E-54 and G-24, we consider responses to the Staff task force's report recommendations to add clear market rules at the Commission level, and to add some bit to our electric market-based rate authorization and to our gas marketing certificates.

In those items today, we have proposed rules that will add new behavioral constraints and reporting requirements to electric market-based rate authorizations and natural gas blanket certificates. We also touch upon solutions to some of the index and reporting issues we heard about yesterday at the well-focused gas and electric price reporting issues conference that we held with the Commodities Futures Trading Commission.

We look forward to comments on these proposals. Also looking forward, we consider in Items M-1 and M-2, a final rule on cash management practices, the subject of the Staff audit last summer and a new NOPR on regulated company reporting requirements.

These actions, our first following the Sarbanes-Oxley Act last year, are intended to enhance transparency and public disclosure to our regulated entities. This serves not the only the interest of the Commission in our duties, but also the interest of customers, state regulators, investors, and counterparties.

Finally today, we consider Orders in a number of different cases regarding some aspect of power contract reformation. Acting on the evidence and analysis compiled by our Administrative Law Judges in four western cases, we find that the records do not support requests to modify or abrogate contracts entered into during the western energy crisis.

We also act today on a contract dispute arising in Connecticut. I acknowledge that we do not rule with unanimity among us on these contract issues.

One of the challenges of these Orders has been that we each have strongly-held and different approaches to the standard of review and the weighing of the evidence in these various cases.

These are difficult and complex issues, as we will discuss later today, but while we may not agree on every conclusion, we do continue to work on these hard issues collegially, with a mindful eye toward the inevitable court reviews of these decisions. So, today on our second anniversary at FERC, Nora and Bill, your 10th anniversary with the company, we should be able to move significantly down the road on the numerous western dockets and issues before us.

After today's meeting, we will have the bulk of the decisionmaking on the California cleanup behind us.

Going forward, it is absolutely imperative that we have clear market rules in place to assure that this sort of severe dysfunction can never again victimize electricity customers.

I look forward to our continued dialogue on the road, around the country, with market participants, with RTO and ISO staff and leadership and state officials to accelerate the development of fair and robust power markets that bring benefits to customers, not pain.

In closing, I want to thank all the Staff whose hard work, long hours, weekend hours, too, and the dedication, made today's actions possible a full month earlier than I had promised.

So, with that, why don't we hop into the cases?

COMMISSIONER MASSEY: May I make a short statement, please?

CHAIRMAN WOOD: Yes.

COMMISSIONER MASSEY: On some of the matters we will deal with today, I will be dissenting, and I will lay out the reasons for my dissent, here at the table and in written statements.

But I wanted to say for the record that I have huge respect for the manner in which my colleagues and the Commission Staff are addressing these issues. The fact that I disagree on some of these points should not be construed

as a lack of respect for the general policy direction in which we are headed.

I have no lack of respect whatsoever, and I have huge respect for the manner in which the Commission is now addressing some very, very challenging issues that have been before us now for quite some time.

I want to say that publicly, even though we will be disagreeing on some of these matters, for the most part, I agree with our policy direction and I agree with 95 percent of what we're doing today as a Commission.

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COMMISSIONER WOOD: Thank you for saying that. I appreciate that. Madam Secretary?

SECRETARY SALAS: Mr. Chairman, Commissioners, your first item for discussion this morning is E-1, Enron Power Marketing Inc., with a presentation by Giuseppe Fina.

MR. FINA: Good morning, Mr. Chairman and Commissioners. On March 26th, 2003, the Commission released the final staff report on price manipulation in Western markets. Based on this report, the Commission issued an order that directed two Enron power marketers to show cause to the Commission in a paper hearing why their authority to sell power at market-based rates should not be revoked.

In addition, that order directed several Enron gas marketers to show cause to the Commission in a paper hearing why the Commission should not terminate their blanket marketing certificates. The draft order finds that the Enron power marketers, one, engaged in gaming in the form of inappropriate trading strategies, and number two, failed to inform the Commission as required by the Commission when it granted them market-based rate authority of changes in their market shares that resulted from their gaining influence or control over others' facilities.

With regard to the Enron gas marketers, the draft order finds that they manipulated prices by engaging in wash trading on Enron Online. In view of these findings, the

draft order revokes the Enron power marketers' market-based rate authorities and terminates the Enron gas marketers' natural gas blanket marketing certificates.

Given Enron's bankruptcy proceedings, and to minimize further harm to third parties from Enron's actions, the draft order allows Enron to unwind its current natural gas positions. That is, the draft order limits Enron's authority to market natural gas to only what is needed for such unwinding, and revokes those authorizations entirely once unwinding ends.

Furthermore, any companies that emerge from the bankruptcy are required to apply at that time for authorization to sell electricity and natural gas at wholesale.

Thank you.

COMMISSIONER BROWNELL: I think as we look at the suite of orders here today in dealing with both past and future, this case perhaps more than any other makes it clear that when you have as an integral part of your business plan systemic manipulation of markets in order to succeed, that you have not earned the privilege of a market-based rate.

I think the record in this case was very clear, as it is not as clear in other cases that we'll be dealing with where we've had to parse through the impact of scarcity, ineffective market structure, rules that depending

on your view, are clear and unclear. And so I think we ought to look at these side by side as we make those distinctions, because people may walk away wondering why we've done one thing in one case and something different in yet another.

The difference is that in this case, sadly, the business was all about manipulation. That was pervasive throughout the organization. It wasn't a misinterpretation of any rules.

I think as we put the past in context, it's important to understand some of those distinctions that we have had to struggle with, as well as the marketplace has had to struggle with. I think it's why in this and all of the other cases we have and have been criticized for taking so much time in building a complete record and allowing the 100 days' evidence and allowing the oral arguments, which I feel were critically important as we evaluated additional information along the way.

I think this is an important beginning of the clean-up, but everyone is not similarly positioned. But I'm glad that this case is finally getting resolved, and I would of course vote to support this order.

COMMISSIONER MASSEY: I want to commend our staff for what I consider to be an excellent order. The order details some very serious behavior, and we remedy that

behavior with a very serious remedy. Profit maximization is not an excuse for market manipulation. I think this order shouts that loudly and clearly, and we will address that same issue in a number of orders today. This order has my full support.

CHAIRMAN WOOD: As it does for me as well. Go ahead, Nora? We're ready to vote.

COMMISSIONER BROWNELL: Aye.

COMMISSIONER MASSEY: Aye.

CHAIRMAN WOOD: Aye.

SECRETARY SALAS: The next item for discussion is E-3, American Electric Power Service Corporation and other companies with a presentation by Andre Goodson.

MR. GOODSON: Good morning. The draft order finds that over 50 market participants appear to have engaged in certain conduct that constituted gaming practices that violated the ISO and PX tariffs. The order directs those market participants in a trial type evidentiary proceeding to be held before an administrative law judge to show cause why their behavior during the period January 1, 2000 to June 20th, 2001 does not constitute gaming practices that violated the ISO and PX tariffs.

The transporter further directs the ALJ to hear evidence and render findings and conclusions on defining the extent of the identified entities' conduct and provides that

the ALJ may recommend a monetary remedy of disgorgement of unjust profits, and any other additional appropriate nonmonetary remedies.

The show cause respondents will have an opportunity to submit evidence to the ALJ that may demonstrate that any or all of the transactions in questions were not gaming practices.

The alleged gaming practices for which the show cause order institutes a show cause proceeding involve market participants taking unfair advantage of the ISO's rules by making false representations to the ISO in order to obtain unjust profits. The draft order identifies four such gaming practices. The first type is false import, sometimes referred to as ricochet or megawatt laundering. The second type is congestion-related practices, which include cutting nonfirm, also known as nonfirm export; circular scheduling, sometimes referred to as Death Star; scheduling counterflows on out-of-service lines, sometimes referred to as wheel-out and load shift.

The third type is ancillary services-related practices, such as paper trading and double selling, which are sometimes collectively referred to as Get Shorty.

The fourth type is selling nonfirm energy as firm. The draft order finds that underscheduling load and overscheduling load are gaming practices, but the draft

order finds that disgorgement or other non-monetary remedies are unwarranted in light of the circumstances in which market participants engaged in those practices.

Further, the draft order exercises the Commission's prosecutorial discretion not to proceed against market participants whose revenues were less than \$10,000 for particular gaming practices, because the burden and cost of litigation may exceed any unjust profits on such revenues.

The draft order also finds that certain practices referred to in the order as California practices, such as sales of power outside California, do not constitute tariff violations. Instead, they were legitimate transactions and not manipulative.

Thank you.

COMMISSIONER BROWNELL: I appreciate all the work the staff has done in the analysis. This was probably one of the most challenging orders to conclude I think that we've had in a while, and speaks to the importance of something we'll do later, which is clarify the rules. I wish someone had done that three years ago. I think we wouldn't have been in this position.

I look forward to really getting a full understanding as people come in during this process to describe why and when they engaged in these business

practices.

I think it's important, one, because we obviously have to recognize due process. Two, because I think we will all be in a better understanding of the dynamics that went on in this marketplace so we're better equipped to deal with the future, as Bill has often said. Perhaps there are many things we could have done so that we wouldn't be in this position.

I would encourage all of the participants to quickly develop the information that we seek and get in here so that we can in fact complete the closure but also inform the process in a way that will make us all better prepared as we develop and restructure the marketplaces in more effective ways.

And I think it will be particularly helpful as our colleagues in California work towards developing their plans for the future, as they I think have made great strides in doing in the last couple of months.

So I'm encouraged by this. It's difficult. I wish that there were more clarity, frankly, in many places. But I'm willing, as I know my colleagues are, to evaluate the situations and the explanations of what we seek. So thank you.

COMMISSIONER MASSEY: This is a very complex order. Our staff spent many, many hours looking at the

California ISO and PX tariffs, looking at the behaviors that were prohibited by those tariffs, comparing those behaviors to the conduct alleged here, sifting through the kinds of behaviors that had a legitimate business purpose and taking them off the table and focusing our efforts on behavior that may very well be manipulation or anomalous trading behavior that violated these provisions and that certainly ought to be barred.

I think this order is a major step toward addressing the manipulation that contributed to the extraordinary Western power crisis, and I want to applaud my colleagues and our staff for taking the steps to grapple with these issues, and I particularly applaud Chairman Wood's leadership on this matter.

I write separately, however, to express my disagreement with two aspects of this order. I think you will find that I'm in agreement with virtually all of this order, but there are two points I want to raise.

First, I would not limit the monetary penalty for tariff violations to disgorgement of unjust profits. Market manipulation can raise the single market clearing price paid by all market participants and collected by all sellers. The Federal Power Act requires that all charges and rates be just and reasonable.

Where the market has been manipulated so as to

affect the market clearing price, that price is not just and reasonable and is therefore unlawful. Simply requiring that bad actors disgorge their individual profits does not make the market whole, because all sellers received the unlawful price caused by the manipulation.

The narrow remedy of profit disgorgement is not an adequate remedy for the adverse effect of the bad behavior on the market price and may not be an adequate deterrent to future behavior.

The appropriate remedy may be in certain circumstances that the manipulating seller makes the market whole. I read today's order as taking that remedy off the table, and I disagree with that conclusion. I would prefer to wait to see the harm that specific behaviors actually caused before addressing the remedy issue, and I would not at this point take any remedies off of the table.

Second, I would not apply the show cause order to nonpublic utilities that are otherwise not jurisdictional. Today's order uses the same rationale for doing so as was used to extent a refund obligation to nonpublic utilities in our July 25, 2001 refund order.

I disagreed with the rationale at that time and wrote separately with the dissent. I still do not believe the Commission has that authority. I would not belabor that point now. I've written separately on that point more than

once.

But for these reasons, although I agree with the bulk of this order, I agree with the direction which it heads, I would be dissenting in part.

CHAIRMAN WOOD: Thank you, Bill and Nora. I just want to add only one thought about where we go from here with these cases, because there are a number of them, and I think it's important to get these to closure.

I do want to encourage, as the order does, early settlement of these claims with our Trial Staff in whose court they will now move to be before the law judges. I do think that although our remedies I think are on firmer legal ground, and I'm thinking about your issue, Bill. I mean, certainly that make the market whole approach is one we did use I think in the context of a settlement with Reliant on the physical withholding issue from the spring of 2000, and I think that's certainly always available.

I do think we're clearly on firm legal ground when we do focus on disgorgement of profits. What we have here attached to this order is the revenues that parties obtained from this activity, which may include costs plus profit. I think certainly for me, in settlements without admissions of guilt that writing a check along the amounts put in the appendix there are probably in excess of disgorgement of profits but do allow parties to conclude a

case and get on beyond it.

So I do not disagree with your sentiment on that, but I think as far as where we're on legal grounds as to what to put in the order, I do want to kind of stick close until hopefully Congress gives us some more robust enforcement tools, as I think both the Senate and the House drafts of the bill have proposed to do.

So I do think in the capable hands of the OAL Staff and our judges, these can come up to settlement. I would hope that we could get some money back to customers. I think we've set a precedent for that in earlier settlements we actually have not take up yet.

But those issues as far as the DWR accounts or what have you are probably appropriate places to look to make those kinds of settlements.

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For those who don't settle, we go through the normal process, and it takes however long it takes. But I do say -- you all said it better, but I hope that's a way to resolve a number, if not all of these captioned cases here, because they're getting old.

So, let's vote.

COMMISSIONER BROWNELL: Aye.

COMMISSIONER MASSEY: No, in part for the reasons laid out in my separate statement.

CHAIRMAN WOOD: I vote aye.

SECRETARY SALAS: The next item for discussion this morning is E-4, Enron Power Marketing and other Companies, with a presentation also by Andre Goodson.

MR. GOODSON: Good morning again. The draft Order finds that based on the Staff's final report released in March 2003 and evidence and comments submitted by market participants, there is evidence that approximately two dozen entities referred to in the Order as partnership entities, may have worked in concert through partnerships, alliances, or other arrangements, to engage in gaming practices that violated the ISO and PX tariffs during the period of January 2000 to June 20th, 2001.

Consequently, the draft Orders directs those partnership entities, in a trial type evidentiary proceeding to be held before an Administrative Law Judge, to show cause

why their behavior during the relevant period, does not constitute gaming and/or anomalous market behavior prohibited by the ISO and PX tariffs.

In addition, the draft Order directs the Judge to hear evidence and render findings and conclusions, quantifying the extent to which the partnership entities may have been unjustly enriched as a result of their conduct.

The Judge may recommend a monetary remedy of disgorgement of unjust profits, and any other additional, appropriate, non-monetary remedies that the Judge finds appropriate. Thank you.

CHAIRMAN WOOD: Thank you, Andre. Any thoughts?

COMMISSIONER MASSEY: Again, for the most part, I believe that this an excellent Order, and I commend our Staff and our colleagues for tackling these very complex issues.

I will be dissenting, in part, for the same two reasons that I raised in the Order that we just voted on. I would not limit the monetary penalty at this point to disgorgement of profits, and I question whether we have jurisdiction over the non-public utilities, but I won't belabor those two points since I just raised them. But that will be the basis for my vote on this Order, as well.

CHAIRMAN WOOD: The only thing I would add on this one is that I understand from looking at this, from

reading the report, and from just what we've learned on the road with RTO development, that there are business strategies that can be taken by a non-control area operator.

One of them is called parking, for example, where a company such as an Enron or others, can partner with people with hardware on the ground, to, in effect, try to level the playing field that would make up for the structural advantages that control area operators have in dispatching real-time power across the grid.

I think our Order kind of throws these all together. It says explain them. Those could perhaps be explained.

I think our issue could be a very narrow one of all you have to do is come tell us, or it could be a much broader one of you were actually using this to do subterfuge over the operations of the market.

And I do think we can, even in the context of settlement, get some understanding of this, because these strategies, some of which may be gaming -- this Order is not as crisp as the last one, for the reasons that we just don't know. We know a lot about the Enron memo strategies and practices because we spent a lot of time looking at those over the past nine or 12 months, but the business relationships memo or order, which is this, is a slightly different deal, and I do want to make sure that as we're

developing our record on really why the case to be made for RTOs, that record isn't full enough yet.

There are yet other reasons that would come out of these cases, but I do understand the parking issue is certainly one that has troubled me for quite a few years. It's really a structural impediment to fully efficient, competitive markets. I know that some of that was going on here, so this is an issue that we need to come in and update the records. But I want to understand this better, so I would hope, in the context of settlement, if that is, in fact, how most of these are resolved -- and I hope they are -- that we do get a good understanding of exactly what is going on here.

So I will vote to support the Order, too.

COMMISSIONER BROWNELL: I think it's important that we get a better understanding of not only what those business relationships were, but the extent of knowledge by the participants. Were they willing participants who fully understood the impact of the way that they were being used?

Were they unwilling participants who were unaware of it? One could argue, of course, that when you engage in a business relationship, you should understand fully, the implications of what's going on, but I think it's important for us to examine that as well.

Having said that, I think people need to come in

with real facts and information, and not simply come in and say, well, I didn't know I was being a victim. That won't do it.

I do want to explore that fully, as we move forward with this, once again, in the interest of making sure we and the marketplace have taken steps to ensure that this type of opportunity isn't available again.

COMMISSIONER MASSEY: Let me ask a question: You may have laid this out, but how many business entities are involved in this case?

MR. GOODSON: Approximately two dozen.

COMMISSIONER MASSEY: Thank you.

COMMISSIONER BROWNELL: Aye.

COMMISSIONER MASSEY: No, in part, for the reasons laid out in a separate statement to follow.

CHAIRMAN WOOD: I vote aye.

SECRETARY SALAS: Next for discussion is E-5, Investigation of Anomalous Bidding Behavior and Practices in the Western Markets, with a presentation by Kent Carter.

MR. CARTER: Good morning. In Agenda Item 5, the Commission responds to the findings made by Staff in its March 2003 final report on the Western energy markets concerning, specifically, Staff's recommendations regarding bidding behavior and bidding practices engaged in by participants in the short-term energy markets by the Cal ISO

and Cal PX for the periods May 1, 2000, to October 2, 2000.

The timeframe addressed in the draft Order predates the refund effective date established by the Commission in the California refund proceeding.

The draft Order finds that the Cal ISO and Cal PX's market monitoring and information protocols, the MMIPs, prohibit the bidding practices and behavior identified by Staff in its final report as a prima facie matter.

The draft Order adopts the marketwide screen recommended by Staff, that is that all bids in the Cal ISO and Cal PX markets above \$250 per megawatt, be considered excessive as a prima facie matter.

The draft Order directs the Commission's Office of Market Oversight and Investigation to investigate this matter at the individual market participant level.

The draft Order instructs the Office of Market Oversight and Investigation to investigate all parties who bid in the Cal ISO and the Cal PX markets above the level of \$250 per megawatt, to determine whether these parties may have violated the MMIP's prohibition against anomalous market behavior.

Parties identified under this screen will be required to demonstrate to the Commission's Office of Market Oversight and Investigation, why their bidding behavior and bidding practices did not violate the MMIP.

The draft Order instructs the Office of Market Oversight and Investigation to report to the Commission regarding its findings. Thank you.

COMMISSIONER BROWNELL: A couple of questions, process-wise: We need to get the information from the Cal ISO after some period of time, or do we have it, the transactional information?

MR. CARTER: The draft Order finds that at the market-participant level, there may still be some additional information that may be required in order to make specific determinations regarding individual market participants.

COMMISSIONER BROWNELL: In other words, the Cal ISO has updated or amended their information a number of times, I think, during the course of the investigation. Do we have the kind of final runs, so we know what number of transactions we're talking about, and who might have engaged in them? If we don't have that, will we have it soon? Can we rely on it?

MS. MARLETTE: Nora, my understanding is that we do have it. Illinois has it.

MR. ARMSTRONG: Just to clarify, the studies the ISO is updating, that was referring to the Enron strategies. The data we're talking about here is just the bid data that was submitted by the entities.

COMMISSIONER BROWNELL: We're comfortable that

that data is accurate?

MR. ARMSTRONG: Yes.

COMMISSIONER MASSEY: So we have the bid data for every hour in the ISO and PX markets that occurred during the period of time in question, which was roughly May to October of 2000; is that right?

MS. WATSON: If I could just clarify, we have to get it from the California ISO when we're relying on bid data. We will be relying on that in our investigation from the Cal ISO.

We received that a few weeks ago. We will be getting additional information, of course, from each market participant, but we do have Cal ISO's bid data, as well as the Cal PX bid data.

COMMISSIONER BROWNELL: So the market participants are expected to evaluate based on that bid data, transaction-by-transaction, anything over 250, and come in and give us an explanation as to why that was not anomalous behavior or gaming in some ways?

MS. WATSON: Right. We are doing screens now with regard to the bid data, and will be making inquiries of the market participants. They will be individualized in many instances, and many times they will be the same questions, depending on the actual bidding behaviors of the particular participants.

COMMISSIONER BROWNELL: Give me some examples of potential explanations that someone might give for this behavior. Also, maybe you could describe in some greater detail, how the number of 250 was chosen.

MS. WATSON: I would defer to Mr. Gelinas as to the \$250 number. That came from his report.

MR. GELINAS: We picked that number in our report for a number of reasons. The main one was that we are here enforcing a tariff and that was the ceiling in the tariff in August when gas prices skyrocketed.

The draught was in full force, and emission allowance costs ballooned to \$35. It's a number from the tariff. It's a tariff enforcement proceeding, so we picked that number. It was also the lowest of the caps in the summer that was in the tariff. If you recall, we were concerned by the fact that the bidding was inversely related to the rise in the import costs. That's the basic logic.

COMMISSIONER BROWNELL: How many transactions are we talking about? Do we have a number?

MR. GELINAS: It depends on how we look at the transactions. If you look at the ten-minute increment, it's much more. If you look at the average of the increments over an hour, it's much less. There are thousands of transactions.

COMMISSIONER MASSEY: So do we have the data for

every ten-minute increment?

MR. GELINAS: Yes.

COMMISSIONER MASSEY: We do, so essentially what we'll do is, look at any bids that exceeded \$250, and market participants will have an opportunity to come in and tell us why they bid in excess of that price.

MS. WATSON: I think that's correct. I can give a little bit better numbers. It's my understanding that with respect to the Cal PX, for example, there's over 400,000 bids above that price, and I think an equivalent, maybe not quite as large in the real-time Cal ISO market.

COMMISSIONER MASSEY: Four hundred thousand bids above the \$250?

MS. WATSON: Yes, that was a rough cut run.

COMMISSIONER BROWNELL: That's at the ten-minute increment level?

MS. WATSON: I think they're dispatched at the ten-minute intervals, and I think it's actually bid for the hour, so that's at the hourly levels. My understanding is that they're bid for the hour. They don't bid for ten minutes. They can be dispatched for only ten minutes, but they bid at an hourly level.

COMMISSIONER BROWNELL: That's the level at which we'll look at it, and so that's about 70,000 or 800,000 bids?

MS. WATSON: Yes. Again, I know the PX is about 430,000; Cal ISO, I'm not positive of the number. It may be a little less, but in that neighborhood.

MR. GELINAS: In that regard, the ten-minute increment issue is only in the ISO. The PX is an hour. It's strictly an hour.

COMMISSIONER BROWNELL: Describe to me, kind of process-wise -- we provide that information to the market participants. We give them some number of days to come in and describe that behavior. Would kind of several bidding strategies cover a number of bids? I'm not sure how you match up 800,000 bids with 800,000 explanations. How does this work?

MS. WATSON: Hopefully it won't be 800,00 explanations. I think there are a number of parties involved. I believe there are about 59 for the PX and, I think, around 36 or something like that for the Cal ISO.

Many of those would probably be duplicates. The first thing that we're doing, the economists and Alice, we're currently working on it, looking at the bidding behaviors. We'll be looking to see if we see any particular patterns with regard to individual parties.

Then we will be issuing them a series of questions as to their bidding practices and patterns that we see. They won't necessarily be every bid on every

individual day, but hopefully we will be able to categorize the types of bids.

For example, what was happening in terms of the market clearing price? Was this above the \$250, below the market clearing price, or above it? Below it? What else? Patterns like that.

And then the defenses you asked about earlier, there may well be some legitimate defenses in terms of opportunity costs. During the summer, it's a period of time that the cap as at 750, the cap was at 500, so some of those bids may well have taken into consideration, scarcity costs and opportunity costs in terms of environmental restrictions, hydro limitations.

Those types of things are likely to cover a great deal of these bids.

COMMISSIONER BROWNELL: For those who are watching and listening who would walk away and say, what an overwhelming task and the promise of closure is not going to be in my lifetime, in fact, there is a process here. There are patterns here where it is an approach here that we make this focused and disciplined and closure will come in the foreseeable future.

MS. WATSON: I certainly hope so.

(Laughter.)

COMMISSIONER BROWNELL: So do I.

MS. WATSON: We're working on a game plan now,
and we look forward to working on this.

COMMISSIONER BROWNELL: It sounds like you've
actually made tremendous progress in the last week or so. I
emphasize that because we have made a commitment to the
people of California and the people in the marketplace that
we are, in fact, narrowing this funnel, as Pat likes to say,
and bringing this to closure, while examining and fulfilling
our responsibility to examine all of the evidence at hand.

Thanks.

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COMMISSIONER MASSEY: If I were a czar, and I'm not of course.

(Laughter.)

CHAIRMAN WOOD: Pretty darn close.

COMMISSIONER MASSEY: That ought to be a comfort to everyone in the room.

(Laughter.)

COMMISSIONER MASSEY: But I was chairman for three days.

(Laughter.)

COMMISSIONER MASSEY: Boy, those were the days.

(Laughter.)

COMMISSIONER MASSEY: I would probably look at bids somewhat under \$250. That is a quibble of mine with this order. Although I generally agree with the direction in which we are headed. I just recall that when total prices skyrocketed, where the bids were in the range of \$30 to \$40 per megawatt hour, and then all of a sudden, they increased rather dramatically, I know circumstances in the marketplace changed as well. But production costs increased somewhat, although they didn't increase by multiples.

And so I'm very much aware of all that as I look at this order. In a concurring statement, I will lay out my theory for how we ought to look at these bids. I hate to be a Johnny-one-note here, but again, this order raises this

question of limiting the remedy to the disgorgement of unjust profits, and again, my position is the same. I would not so limit what we're doing here, and that has been a consistent theme of mine. So I must issue a very short partial dissent from this order on that basis.

CHAIRMAN WOOD: One of the things that gets obscured when we do a broad screen like 250 is what does economic withholding really mean?. And I think one of the things I've gotten wiser on since the report came up in March is the type of things that really are in violation of the first bullet of the anomalous market behavior strategy, which really is withholding generation, not physically, but in effect doing the same thing, by withholding it through bidding a real high price for it.

And I was intrigued with some of the analysis that Lee Ann and her colleagues on staff had done with the bids in the real time market. And I thought that, while certainly we've got a broader screen here, the things that are particularly of interest to me are the bids that were bid high and not taken. Because that's putting your capacity in effect outside the dispatch curve of the market, and it's admittedly a smaller universe than what we're going to screen here at FERC.

But when we talk about economic withholding, if you bid high and it's taken and everybody's basically

reflecting the same scarcity premium, but if you're taking part of your capacity and holding it out of the market, and you have a lot of other capacity that's getting the elevated signal from your withholding your capacity from the market by bidding way above the market clearing price, that's a different issue.

And I know staff has spent some time focusing on that, and Lee Ann didn't go into that with her discussion about your question or about some of the things that they were looking at. But the ones that were most of interest to me personally, and I hope that as we move forward on the analysis and potentially the settlements here, that the people that are most subject to my scrutiny are going to be the ones who did bid part of their portfolios above the market for a reason that's not explained by, you know, physical needs of the generating facility or, you know, shortage of emissions issues or, you know, some effectively persuasive case about opportunity costs that are a little bit more than just the specious claims that we sometimes hear, but are the things that really were in effect in my mind economic withholding in its purest sense.

So I do look forward to seeing where we go with this one. But I do share Nora's and Bill's sentiment both that this could be very broad but should not be -- but should be for here, and we're going down the funnel,

focusing on it, and then getting money back to customers that paid too much that year, and then moving on.

So this one's hard. This is the hardest one left on the whole book of things we're dealing with this agency. And I do appreciate the lot of analysis and discussion and give-and-take that we've had over the past 90 days since we really started honing in on it.

So I think that this is the right way to move forward, and I will support the order.

COMMISSIONER BROWNELL: Aye.

COMMISSIONER MASSEY: No in part, for the reason I will lay out in a separate statement.

CHAIRMAN WOOD: And I vote aye.

SECRETARY SALAS: The next matter for discussion is a joint presentation of E-54, Investigation of Terms and Conditions of Public Utility Market-based Rate, and G-24, Amendments to Blanket Sales Certificates. And this is a presentation by Dave Perlman.

MR. PERLMAN: Good morning. Items Numbers E-54 and G-24 are proposals to use the Commission's conditioning authority to amend market-based rates tariffs and gas blanket certificates to include certain behavioral rules, including prohibitions on price and market manipulation, require completeness and accuracy in reporting and communication, and require compliance with market rules and

codes of conduct.

Market-based rate authority and blanket certificates are proposed to be conditioned upon adherence to these rules. Many of the proposed rules were identified in the Staff Western Markets report issued in March.

Violations of the proposed rules could result in disgorgement of unjust profits obtained in contravention of the rules or non-monetary penalties, such as suspension or revocation of market-based rate or blanket certificate authority.

Complaints by third parties about such violations must take place within 60 days after the end of the quarter in which the complaint of action took place, unless the Complainant can show that it should not have known of the behavior at that time. In such a case, the complaint must be made within 60 days of actual knowledge. Comments on the proposed rules are to be made 30 days after filing in the Federal Register.

One aspect of these rules relates to reporting to index compilers. The proposal states that to the extent that a seller reports to an index compiler, it must do so accurately and completely. Also each seller must inform the Commission if it is reporting today, and if so, to what extent.

Further, the proposal indicates that the

Commission may take further actions in this area, and if so, compliance with such further orders will become a component of these rules.

In furtherance of the index compilation process, the Commission staff held a public conference yesterday, and Steve Harvey will provide an update on that conference now.

MR. HARVEY: Thank you. Yesterday Staff did hold a conference to discuss price discovery in electric and gas spot markets. As in our April conference, discussion was lively and insightful.

Important in yesterday's discussion was a clear separation between short-term, really through the winter, and longer-term solutions. Two issues proved particularly relevant to the short term. First was the substantial progress made by broad stakeholder groups in sorting out many areas of agreement going forward and clarifying areas of disagreement.

Second was the substantial progress made by the trade press and exchanges in clarifying their methodologies, increasing information about liquidity in markets, and attempting to meet regulatory concerns about access to information in investigations.

The key issue going forward appears to be some form of safe harbor or protection from penalties for simple errors in reporting not committed to manipulate markets.

Bill Hederman announced a quick follow-up workshop now planned for Wednesday, July 2nd, to discuss possible language with anyone from the industry interested in the issue. If such industry protection can be developed, we hope that voluntary participation in price discovery can be encouraged.

As the Commission continues to work on the price reporting issue, it is important to note that these draft orders today to condition blanket certificates and market-based rates regarding trading behavior provide potential platforms for further Commission action regarding report to the extent action is necessary.

COMMISSIONER BROWNELL: I just have a couple of questions. On G-24, what percentage of the players in the marketplace are we picking up here? One of my concerns is that we are giving a set of rules to kind of a narrowly focused group of people over whom we have jurisdiction and a large number of players in the marketplace over whom we do not have jurisdiction.

Does that somehow give those who don't have to play by the rules a competitive advantage? How do we intend to deal with that?

MR. PERLMAN: I don't know the percentage, and I'm not sure that anyone knows with precision what that percentage is. But it is not the complete --

COMMISSIONER BROWNELL: But it's some significant percentage I think.

MR. PERLMAN: I believe that's correct. One aspect of the proposed rule is -- I guess different than say it's an aspect, a question that is asked to the public is to address that precise question. And for us before we would go forward to truly understand whether having behavioral rules addressing a subset of the entire marketplace is a wise action to take, in recognition of the fact that it is only a subset.

COMMISSIONER BROWNELL: As one who's been screaming for the Ten Commandments and sure wish they had been in place in these markets before we got here, because then we could only have to build for the future and not spend all our time on the past, I endorse the idea of having clearly understood rules.

I have a couple of concerns about which I will be interested to hear comments, including the one that I just raised, one of which in the electric marketplace, we seem to be putting an increasing number of rules and restrictions on one segment where we have not yet dealt with the full issue of access to the transmission grid. And we seem to be putting rules on one business model where the others still have not made the transition to the marketplace.

I think I am concerned about endorsing rules with

some expectations that they're implemented in marketplaces that aren't fully developed, that don't have independent operators of the grid, that don't have independent boards kind of looking at the state of the marketplace. So I think we have to deal with that.

I think rules are important, but I think that we need to make sure that everyone is playing by the set of rules that is appropriate to lead to competitive markets.

The other thing that I think we need further discussion is, while we talk about disgorgement of unjust profits and other remedies as we decide, it strikes me that I don't know the difference between a mortal sin and a venial sin here. And I think we need to give some clarification as when you do get the bullet in the head and when you do have other remedies as we decide.

I think that is not bringing the stability that we all seek to the marketplace. So I'll be interested to see comments on that, and of course, it does once again call for greater authority in terms of fining and other things from Congress if they deem to see fit to give us that.

So I really think that these are a great beginning, but I think they need a lot of discussion and development both in terms of their equity, in terms of how we intend to implement them, and in terms of how we define kind of degrees of badness in the marketplace. Because it

isn't clear to me from this, so I daresay it isn't clear to the market players. You may want to comment on any number of those issues.

MR. PERLMAN: I think the way the proposals are written should bring comments in on all of those issues and would help inform us when we move forward and make a recommendation to the Commission on final rules, is how to provide as much clarity as we can while keeping available to the Commission the ability to address unforeseen actions with the rules that we are proposing going forward.

So we are very much open, and we would encourage as you have, anyone who's interested in this to provide us their comments and help us create as much precision and clarity in the ultimate rules of the Commission issues.

COMMISSIONER BROWNELL: Thank you.

COMMISSIONER MASSEY: In your explanation, did you lay out the tariff condition? I think it might be useful if you explained what it is for electric markets and for gas markets.

MR. PERLMAN: I'd be happy to do that. There's actually different conditions for electric markets and gas markets in recognition of the differences among the markets. The desire that we had in putting these proposals together is to maintain a commonality as much as possible, recognizing those distinctions.

In respect to the electric markets, there are several components. They take the form of unit operation, market manipulation, communications reporting, record retention and related tariffs. What those mean are, with respect to unit operation, it gets to the issue most significantly of physical withholding and requires operators of generating units that have obligations to report their outages, forced or otherwise, in accordance with whatever market rules are there applicable. So there is an obligation to do that accurately and completely.

The market manipulation section is more material, and I think is of most interest to the public. We had a lot of difficulty in struggling with the balance that we tried to achieve here, which is to leave open a generic opportunity for there to be enforcement activities to address unforeseen manipulative behavior, but also provide as much clarity as we could with respect to the specific items that we were familiar with that should be prohibited today. An example of a specific item would be wash trades. They are prohibited.

So in order to address the issue of manipulation broadly, we have a generic standard. That generic standard is generally prohibitive of manipulation or other activities that would create prices that are not reflective of supply and demand conditions. We have specific examples that are

the product largely of the Western Markets Report.

We say in the body of the order that because of the evolution of this process and the understanding that the Commission and the market participants are coming to collectively, that as we address these issues through enforcement and other processes, we will be able to bring to the table through a case by case sort of process some further clarity as to how these rules should be applied. And it is not necessarily going to create an outcome where there would be a punitive treatment of a market participant if there was some legitimate ambiguity as to whether this behavior was bad behavior, and the Commission can take steps to clarify what it means by manipulative behavior over time.

So there's a generic standard and specific requirements there.

That manipulative, anti-manipulative section is included in both the gas and electric proposals. There are less examples in the gas proposal. Wash trades is an example of one that is resident in both.

With respect to communications, there is an obligation on sellers to provide complete, accurate and factual information and not omit important information to the Commissions, ISOs, et cetera. That is something that was identified in the Western Markets Report, and it's applicable to the electric market.

In the reporting section, there's an obligation to provide accurate and complete representative data to index compilers if you do so today. There's a requirement also there to tell the Commission whether or not you do so and to what extent.

In addition, as I said earlier, there is a sort of placeholder that says, to the degree that the Commission further addresses this issue, any subsequent order the Commission issues would become applicable to the seller. And that is something that is resident in both gas and electric orders.

There is a requirement for record retention, which is in both orders as well that will allow the Commission and the sellers to assure that the documentation that supports the sales and just and reasonable rates as well as the index information is retained for up to three years. I guess three years, not up to three years. And a section on related tariffs in the electric order that requires adherence to other related tariffs, such as the 889 Code of Conduct, whereas today that is a requirement solely on the transmission entity. This is sort of a corollary obligation that's explicitly placed on the seller, so if they act in concert with the transmission entity and violate that 889 tariff, there would be an obligation on them that would be subject to remedial action.

That's a little more specificity on the individual components of the proposal.

COMMISSIONER MASSEY: That's very helpful. So the general set-up is a more general statement prohibiting market manipulation followed by prohibited actions and transactions that would be considered market manipulation?

MR. PERLMAN: That's correct.

COMMISSIONER MASSEY: And we specify several of those, like wash trades, transactions involving false information, creating artificial congestion and then relieving such congestion; collusion; withholding of generation and so forth.

If I might, because the general standard here is just once sentence, and it reads as follows, quote: "Actions or transactions without a legitimate business purpose which manipulate or attempt to manipulate market prices, market conditions or market rules for electric energy and/or energy products or result in market prices for electric energy and/or electric energy products which do not reflect the legitimate forces of supply and demand are prohibited. Prohibited actions and transactions include but are not limited to" -- and then there's a listing of various kinds of behavior that would be prohibited under these rules.

So thank you for laying that out. I appreciate

it.

CHAIRMAN WOOD: I would only add that on the reporting, as a follow-on to yesterday from both what David and Steve have said, I think in combination with the safe harbor, which Bill brought up at the end of yesterday's discussion, i.e., setting up basically a liability blanket for people acting in good faith and defining what that means and how you can be there, to get back in the reporting business so we get more of the volumes that actually are being transacted reported to the existing price collectors, which should be a no-brainer, but interestingly, a number of involved people hadn't thought a lot about it yesterday, so giving them seven days to think about it was quite prudent.

But adding to that a requirement for those that, you know, in this voluntary world, to tell us if they're not providing that information to trade entities can allow us really to focus our effort on finding out why they're not, and is there some reason that maybe people don't want to talk about publicly that they can't be providing their data.

This may take the old voluntary/mandatory issue off of being a big one if in fact you use the voluntary with the Scarlet Letter approach. And God knows it's working elsewhere in this agency, so let's see how it works here.

But I think that was certainly a contentious issue yesterday that, you know, there's always a third

answer that solves a problem that doesn't get everybody twisted off, but yet those don't ever seem to be on the decision point list that people bring to us, because they're in the mosh pit so long that they don't really think about the win-win scenario.

So thank you all for kind of teeing that up so beautifully yesterday. The longer-term issues about access to data, about the veracity of the platforms and what have you, it certainly appeared that a number of the platforms yesterday were at the point that we were envisioning in preparing these documents, and clearly, at what the industry had come forth with.

I think the industry put forth a good standard, but it's a standard that with some I think clarification and maybe some changes, the existing providers can be at pretty quickly, and new providers will have pretty clear standards that they can shoot at and hopefully exceed.

So I'm open to kind of where that goes next week. Clearly that's the band-aid for the bleeding wound. I think a further discussion about where we go longer term is something we're going to have to have here among the three of us and our staff and with more input from folks from the outside.

But I think we can take some very quick early steps to definitely get the patient out of ER and then

hopefully maybe never see him again. But we might need to have a follow-up visit on some of these issues. So lest I take the medical deal too far and fall off the edge, I think this order on the reporting provides us in both gas and electric a very timely and good platform to address the issues that we talked a lot about yesterday.

I don't have anything new to add to the manipulation, which is clearly an important prong on both. I just should add that we took this up in was it November of '01? Linda was here. And we kind of broke 2/2 on an issue that has kind of swept right past us. I had to go back and actually remember what it was, and it was do you apply these standards on the electric side to people participating in RTO and ISO markets, and I just want to say, Exalted Agent One, that you won.

COMMISSIONER MASSEY: Careful with the agent part.

(Laughter.)

COMMISSIONER MASSEY: But exalted is fine.

(Laughter.)

CHAIRMAN WOOD: I think we agree. I mean, based on what we learned in the West, that that is, you know, organized markets and unorganized markets have some attributes that, you know, they have some dark spots and they need to be fixed regardless of what kind of market

structure you've got.

I appreciate that what we've learned here has informed what I think is a better product than the one we considered 18 months ago. So I will support it going out.

COMMISSIONER BROWNELL: I'd just like to add that I really hope -- we have a short period of comment here -- I really hope people roll up their sleeves and get to work and don't do the kind of typical response to an agency laying on a few more rules, which is oh my God, don't do it.

I think people need to be surgical. I think they need to be disciplined, because there is no question, even though I've raised some issues and I think all of us have, there is no question that this is what it's going to take to build the future and get the confidence back and move forward.

So it's not whether we do it, it's how we do it and how good we are at it that supports the development of the marketplace. So I really hope that people get real about what it's going to take to really effectuate the changes that we need to make to ensure us and others, particularly customers, that these markets are transparent and they are going to work.

COMMISSIONER MASSEY: And I strongly support this order. I appreciate, have huge respect for all the long hours and hard work of our staff on these very complex

issues. We couldn't do this without a lot of extraordinary talent around this table and in this building hashing out some very complicated matters and drafting them up in a readable form so that everyone can understand them. That takes a lot of talent and energy, and I appreciate it very much.

I hope that -- and this is a proposal, so we'll get a lot of comment, and I look forward to that comment, and I also would encourage those out there in radioland to give us their comments on this issue of disgorgement of profits. Should we limit the remedy here to the monetary remedy to disgorgement? Or should it perhaps be broader? And I will not be dissenting on that point, although I think it is a relevant issue for this matter as well, and I look forward to all the comments of market participants on what might be appropriate remedies for violations of this new proposed tariff, and I'll be issuing a concurring statement to underscore that point.

COMMISSIONER BROWNELL: I will vote aye, and I will be issuing a concurring statement in both of these, raising some of the issues that I raised today about how to get it right.

COMMISSIONER MASSEY: Aye, with a concurring statement.

CHAIRMAN WOOD: Aye.

SECRETARY SALAS: Mr. Chairman and Commissioners, the next matter in our discussion agenda is a joint presentation of Items E-7, Nevada Power Company, E-8, California Public Utilities Commission, and E-9, PacifiCorp, with a presentation by Olga Kolotushkina.

MS. KOLOTUSHKINA: Good afternoon, Mr. Chairman, Commissioners. E-7, E-8 and E-9 address three initial decisions on complaints seeking to modify forward bilateral contracts for wholesale power signed during the Western energy crisis of 2000-2001.

The first case is E-7, the Nevada Power case, in which complainants sought to modify over 200 contracts entered into with 10 sellers. The second case is E-8, the California case in which Complainants sought to modify over 30 contracts entered into with 24 sellers. The third case is E-9, the PacifiCorp case, in which the Complainant sought to modify 12 contracts with four sellers.

E-7, E-8 and E-9 were set for hearing to determine whether the dysfunctional markets administered by the California ISO and PX adversely affected forward bilateral markets in the West, and if so, whether modification of the challenged contracts is warranted.

In addition, for those contracts that did not explicitly address the standard of review for modification or reformation of the contract, the Commission set for

hearing the issue of whether the Complainants must meet the Mobil Sierra public interest standard of review or the just and reasonable standard of review in order to reform the contracts.

In the Nevada Power and PacifiCorp cases, the presiding judge has found that the Mobil Sierra public interest standard of review applies to the contracts at issue, and that the Complainants failed to establish that contract modification is justified under the standard of review. The presiding judges therefore concluded that the contracts at issue should not be modified and denied the complaints.

In the California case, the presiding judge found that the Mobil Sierra public interest standard of review applies, and as instructed by the Commission, certified the record of the case directly to the Commission for consideration of all other issues in the case.

E-7, E-8 and E-9 draft orders affirm the presiding judge's findings. Specifically, the orders find that the applicable standard of review for the challenged contract is the public interest standard, and that the Complainants have failed to meet their burden of proof under this standard to justify contract modification.

Those determinations are based on the specific evidence developed in the hearing proceedings before the

presiding judges, at oral arguments in all three proceedings, as well as taking into account the findings of the Commission Staff's final report on price manipulation in Western markets in Docket Number PA022-000, and the evidence submitted in the 100 Day discovery proceeding in Docket Number EL0095 et al.

Thank you very much. This concludes my presentation.

COMMISSIONER BROWNELL: This is probably the most difficult series of decisions I think that we've had to make. I acknowledge and join in Bill's statement in the introduction that while we may not agree on the outcome, I appreciate the thoughtfulness of my colleagues in diving into the issues and really supporting the development of a full record to include the unusual step of the oral arguments.

And I want to acknowledge that the participants in the oral arguments really did a good job at presenting their view of the record, and I appreciate their efforts and acknowledge them, because that's a difficult job when you have a limited period of time.

But I find that given all of the record, which of course we are bound by, that I must support the conclusion that the ALJs came to both in terms of the application of the Mobil Sierra standard, and I think the recognition that

the dysfunctions in the marketplace, the issues of scarcity, the lack of clarity of the rules, the many, many things that influenced the dynamics of that marketplace, do not support overturning these contracts which I believe and have said before would lead to a risk premium and indeed perhaps a scarcity of opportunity for the West in the future.

Furthermore, I think it would deny the investment community the opportunity or the willingness to provide capital to provide much needed infrastructure throughout the West, not limited to California. So I will be supporting this order, although I will acknowledge that very wise people will continue to disagree and debate.

But I appreciate, as I said, not only the work of the staff, who have been just incredibly helpful in diving into the details right up until the last moment I think yesterday when we were still asking questions, but also of my colleagues who respectfully kind of agreed and disagreed and debated. It's been a very meaningful work, the outcome of which I think is difficult for all of us.

COMMISSIONER MASSEY: I will be dissenting from these orders, not because I relish abrogating contracts, because I do not. I'm dissenting because I believe this Commission simply has a higher calling than the sanctification of long-term contracts with prices reaching as high as \$290 per megawatt hour, contract prices that were

multiples of traditional prices, prices that were extraordinarily high, completely unprecedented by historic standards.

Our primary calling is to ensure that prices are just and reasonable all of the time, 24 hours a day, seven days a week, and when prices soar to unprecedented levels, when prices exceed a just and reasonable level by multiples, we have the obligation to make it right.

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That is the way I read the Federal Power Act.

Let me digress here to say that virtually all of what we've been doing today at this meeting has been making it right.

I respect my colleagues for that, and I want to say that the fact that I disagree with them on these cases, should not undermine that in any way.

Many of the contracts challenged here provide for prices that are, in my judgment, not just and reasonable by any measure. There is no persuasive public interest rationale for sanctifying contracts negotiated during the height of the Western electricity crisis where an out-of-control spot market in California with skyrocketing prices, strongly influenced long-term contract prices where there was, according to our Western Markets Report, epidemic market manipulation.

The sanctification of contracts entered into in this tainted environment violates the Federal Power Act's forceful declaration that contracts are absolutely unlawful and must be reformed, if not just and reasonable.

Turning Commission policy on its head, today's Orders will actually encourage wholesale electricity purchasers to ride the spot market, because the Commission has shown a willingness to mitigate and provide refund protection from unjust and unreasonable spot market prices, at least in the California spot markets.

By the same token, buyers will be discouraged from forward contracting, because they will not enjoy protection from astronomical contract prices.

Power buyers, consumers, and retail policymakers will lose faith in the concept of wholesale electricity markets, if they cannot trust the Commission to protect them from unjust and unreasonable contract terms resulting from a wildly dysfunctional market, probable market power and epidemic market manipulation.

Just as a reminder of the events, in May of 2000, prices in the California spot markets spiked to unprecedented levels, stayed high throughout the Fall of 2000 and the Winter of 2001. In November and December of 2000, the Commission found that the market was dysfunctional, that the astronomical prices raged on, natural gas prices spiked to unprecedented levels, wholesale power cost the State of California \$9 billion in 1999, but \$30 billion in the year 2000.

There seems to be no end in sight. As the high prices raged on, the Western economy suffered. An entire industry, the aluminum industry, virtually exited the Pacific Northwest.

Finally, the Commission imposed full-time price controls in June 2001 over the entire 13-state Western Interconnection. That was absolutely unprecedented.

The refunds of unjust and unreasonable California spot prices are being calculated, but may total several billions of dollars, again absolutely unprecedented.

Our Staff investigation that has come to be known as the Wholesale Markets Report, written by Don Gelinis and his excellent staff, details considerable market manipulation, some of which we continue to address today with a number of Orders alleging violations of the California ISO and PX tariffs, possible economic withholding and other matters.

One Order issued today directs over 50 entities to show cause about market manipulation. Another Order directs 23 entities to show cause why their agreements with Enron does not constitute an attempt to game the markets.

Another Order we voted out today directs the Staff to investigate bids in excess of \$250, and there were 400,000 of them. Staff is still investigating whether physical withholding occurred during the crisis. That investigation is, I believe, still underway.

And we have now proposed conditions for all market-based prices and tariffs. This initiative was a direct result of extraordinary events that occurred during this extraordinary, unprecedented crisis.

The Western markets were severely dysfunctional, out of control. The out-of-control spot prices drove prices

throughout California and the Pacific Northwest. It seems clear that the dysfunctional California spot markets had a strong influence in forward contract prices, although I know that there is some disagreement about that in the Orders before us.

That is the firm conclusion of the Western Markets Report issued by Mr. Gelinas and his staff. The California spot prices were not just unreasonable, had to be recalculated, and refunds ordered on an unprecedented nine-month period.

A persuasive case has been made and is in this record and is in the Wholesale Markets Report, that these contract prices were very strongly influenced by the spot prices. The spot prices were not just and reasonable, nor are the prices in these contracts just and reasonable.

These contracts ranged from \$265 a megawatt hour to \$280, up to \$290 per megawatt hour. These prices were historic.

My general overall conclusion in these cases is that these prices were unjust and unreasonable and must be reformed. The Western Markets Report concludes that the influence of the spot markets on the contract prices was the strongest during the first two years and then gradually dissipates over time. I would use this conclusion as a starting point for reforming these contracts to eliminate

the influence of the out-of-control spot markets on contract prices, certainly for the first two years and perhaps longer.

Is the appropriate standard of review, the just and reasonable standard? It is my view that except where the contract has a Mobil-Sierra clause clearly restricting the right of the seller to file a 206 complaint, the standard is just and reasonable.

The law in this area is not the model of clarity.

We made such a statement in our proposed policy statement on Mobil-Sierra that was voted out last Fall. That has not been finalized, but actually in that policy statement, the Commission proposed that the standard, absent a clear Mobil-Sierra clause, that the standard be the just and reasonable standard.

That proposed policy statement set out the statement that the law in this area is simply not the model of clarity. The argument that the public interest standard controls is certainly not without merit. There are good arguments in that direction as well.

Nevertheless, it is my conclusion that the just and reasonable standard should control the review of contracts negotiated in the circumstances of this case where sellers were acting under a market-based pricing authorization granted by the Commission.

Some of this, I will put in a separate statement that I will not read here, in the interest of time, but my main point is that the just and reasonable standard should control. Let me make this point, though:

I believe that the buyers detrimentally relied upon the Commission's admonition in the December 2000 Order, that market participants enter into long-term contracts. In the same Order, the Commission assured buyers that they would be protected from the exercise of market power in negotiating long-term contracts.

The Commission set a \$74 per megawatt hour benchmark to use, quote, "in assessing any complaints" -- and I'm quoting from memory here -- "in assessing any complaints regarding the justness and reasonableness of the pricing of such long-term contracts negotiated under the current market conditions," unquote.

The Commission promised to monitor prices, quote, "To address concerns about potentially unjust and unreasonable rates in the long-term contracts," unquote.

The buyers reasonably relied upon the Commission's declarations that complaints about long-term contracts would be judged according to the just and reasonable standards and that they would be protected.

Given that reliance, it is simply unfair to adopt a standard of review today that gives these buyers

substantially less protection, and after the Commission had declared in December of 2000 that \$74 a megawatt hour was a reasonable rough benchmark for long-term contracts negotiated thereafter.

To me, it seems unconscionable now not to validate contracts that allow sellers to fetch upwards of \$250, \$260, to \$290 per megawatt hour. The Commission said to buyers, get into long-term contracts and \$74 is probably a reasonable benchmark price, and, hey, don't worry, we'll protect you from unjust and unreasonable contract prices.

My view is that that's what we said, and I believe that today's Order fails to keep that commitment.

Even if the majority is correct and the appropriate standard of review is the public interest standard, it is my opinion that these agreements do not withstand scrutiny.

The market conditions and circumstances in which these agreements were negotiated were completely unprecedented, absolutely extraordinary, utterly breathtaking, and those of us who were living through that crisis, those of you in this room who watched all the Commission meetings during that crisis, my colleagues, we all understand that this crisis was absolutely extraordinary.

It was a catastrophe. The impact on the Western

economy was huge. As the crisis raged on during the period in which these contracts were negotiated, consumers and policymakers were losing faith in the whole concept of competitive markets.

If electricity markets could rage out of control with no end in sight, if spot prices of \$500, \$800 or several thousand dollars were okay, what was the point of electricity markets? Where was the market discipline?

The California markets drove prices in the other markets in the West, and the Commission had already declared that conditions in the California markets allowed the exercise of market power. We did that before these contracts were even negotiated.

Those dysfunctional market conditions, in my judgment, certainly tainted any contracts negotiated during this time, and it would simply defy logic to conclude that the negotiation of these contracts was not adversely influenced by market conditions that included the exercise of market power.

We also now know that there was unprecedented manipulation of both the natural gas and electricity markets occurring during this time. The Western Markets Report lays it out in some detail.

There was epidemic false reporting of natural gas trading data, according to the Western Markets Report,

round-trip trades, manipulative bidding strategies, such as "Ricochet," "Get Shorty," and others that we deal with today in an extensive Order aimed at more than 50 different entities.

There was economic withholding to drive up electricity prices and so forth. It's all laid out in some detail in this Western Markets Report that I'm sure all of you have read.

There is simply no persuasive public interest rationale for protecting and sanctifying contracts negotiated in this unprecedented and extraordinary environment, defined by an out-of-control market, the exercise of market power, manipulative bidding, anomalous market behavior, false reporting of trade data, and the like.

If this is a market, who wants one? And who will ever want to negotiate a long-term contract in such an environment where the contract is, without question, a product of the tainted environment in which it was negotiated and where the Commission fails to reform the contracts to protect consumers from prices that are clearly not just and reasonable?

Therefore, Mr. Chairman, I will be dissenting in these cases before us today. Thank you.

CHAIRMAN WOOD: Thank you, Bill. I think the

most challenging thing for me was one that we dealt with quite well by putting the full records of the 100 days' evidence and putting the Staff report in the record of these cases here.

And I have been really waiting for that, and really appreciated the chapter that was in there about the linkage between the spot and the long-term markets, but I'm haunted by the fact that really came to light in my review of the SCWC, Southern California Water Company case, where, in fact, in October of 2000, the record shows that Dynegy, Inc. offered to extend its contract with SCWC on a blend-and-mix rate of between 46.50 -- that's a decimal point after the six -- per megawatt hour, to \$54.50 per megawatt hour, depending on the term.

SCWC got a bid from Enron in November of 2000 to hedge costs at \$55.73, so in the midst of all of this, perhaps raging manipulation of the markets, there were, in fact, in the record of the case before us today, two deals that in today's terminology and in the terminology at the time and the terminology of when we set the benchmark in December, that were relatively low contracts, ones that I would certainly not expect anyone to come in before us today. So datapoints matter.

We look at them, and, yes, there are some odd contracts before us today. I do think it's important, as we

asked when we sent these Orders to hearing, to look at the package in the California cases.

Paragraph 4 -- I just want to read a paragraph here that, for me, was a dispositive paragraph, under, quite frankly, whatever standard we look at.

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I should add here that I do generally share, Bill, your view of the legal requirements for moving from a J&R standard to a Mobil Sierra public interest standard. I do think for that reason, we sent those cases to hearing to find out what the standard was. And I know actually that we were way all over the map on that, including Linda.

But I was really going to be driven by what it looked like the parties intended for the standard to be. And I think in E-7 with the WSPP contracts, there is actually a pretty solid construction of that. That really looks a lot like a Mobil Sierra clause is written in the document.

For some contracts in E-8 and E-9, however, it was required to go to the actual evidence to look at the intent or intention of the parties with regard to what standards should be reviewed. And so for that reason, I will just concur in part on these two orders to indicate that, although I agree with Nora that the public interest standard of review applies to the contracts at issue, I think you and I get at it a little different way. The order encompasses both.

But I want to just point out that for me, it is relying upon the specific evidence surrounding the execution of those contracts and the parties' intent that allow me to get there. But again, kind of independent of that standard,

this is a paragraph in the E-8 California contracts orders that I think is very helpful.

Based on the record, we conclude that there is no credible record evidence that the contracts at issue are placing the Complainants in financial distress or that other customers will bear an excessive burden as a result of upholding the challenged contracts.

In fact, one of the CDWR's central objectives was to achieve a portfolio that yielded a weighted average price no higher than \$70 per megawatt hour, which was the average cost of energy supply reflected in the IOU's retail rates as of January '01. In securing its contracts, CDWR achieved an overall portfolio that is diversified both in terms of energy products and durations and reflects an average price of \$70 per megawatt hour.

Later on in the order, we discuss a little bit about the procurement, about the unequal bargaining power, market power concerns:

Contemporaneous statements made by CDWR and the Governor of California indicate that they fully supported the price, terms and conditions of the contracts at the time they were executed. CDWR's lead negotiator stated -- and I believe this was from evidence dated May 24th '01 -- that, quote, I can't get terribly upset by these critics who say, oh by gosh, this is higher than what the price might be.

Well, hell, they don't know. We just didn't fall off of a turnip truck. I'm not saying that we took the shirt off their back, but I am saying that these were fair, negotiated, hard-fought deals.

I think that's for me, and pages of that in each one of these cases, why these went to a long hearing that took a year. If we're going to do something as I think dramatic either way as either abrogating, modifying or sustaining a contract, we need to understand with an intensive level of discovery and review what happened. And I want to tip my hat to the judges, to the parties on both sides of these issues, to our staff that spent a lot of time going through these issues, which perhaps in certain views of the standard could have been dispensed with last april when they were filed.

But it was very important to understand for me what was the context of these negotiations, because I do think it would be against the public interest, for example, Bill, as you and I have discussed, for some sort of contracting duress or unequal bargaining power issues to color a determination on whether a contract should be reformed or not. I didn't see that here.

I looked for that here. I looked for the burden on the customer here, on the rate impact on customers. I found that, as the orders point out, not proven, not shown

here by the Complainants.

I looked for the other issues certainly that are not as relevant here of undue discrimination. That didn't show up here, or effect on the utility's ability to provide service. But I do think that the public interest standard actually is a very robust one, not a stingy one. And I think in that review, nonetheless, these very voluminous and well documented records did not get me over the hurdle.

So I will vote to leave the contracts where they lie. I should add on E-8, the California contracts, that we did start with 24 contracts. Eighteen of them have been withdrawn either by settlement or for another reason. And so we're left today with contracts with six providers.

I think one of the benefits of allowing this to move on is some stability can return and that those contracts can nonetheless be shaped and formed and perhaps modified on a between-parties basis as opposed to including us in it to better suit the needs of California going forward, the California customers.

But as far as we're called upon to do, I would leave them where they lie and move forward. And I will concur in part on the standard of review issue as I discussed.

COMMISSIONER BROWNELL: Aye, noting my concurrence on the standard of review.

COMMISSIONER MASSEY: No.

CHAIRMAN WOOD: And aye, concurring in part on the standard of review.

SECRETARY SALAS: The next item for discussion is E-6, Puget Sound Energy, with a presentation by Jonathan First.

MR. FIRST: Good morning, Chairman, Commissioners. E-6 addresses the Pacific Northwest refund proceeding, which is an outgrowth of a complaint filed by Puget Sound Energy.

The order first rules on several outstanding procedural matters. The order denies Puget Sound's request to withdraw its complaint and request for rehearing. The order then grants Puget Sound's request for rehearing of the Commission's December 2000 decision to dismiss the complaint.

These procedural rulings allow the case to go forward so that the Commission may address the substance of the claims for refunds asserted by certain participants in the proceeding.

With regard to refunds, the order explains that based on the totality of the circumstances presented, including the large number of sellers and magnitude of transactions in the Northwest, and the fact that a large portion of the sales that took place are not within the

Commission's jurisdiction under Section 206 of the Federal Power Act, the appropriate relief was provided by institution of the West-wide mitigation plan in June 2001, and that the equities do not justify refunds.

The record established in the preliminary evidentiary hearing before Judge Cintron in this proceeding demonstrates that it is not possible to fashion an equitable remedy that would do justice to all the participants in the Pacific Northwest electricity spot markets.

Accordingly, the order does not require refunds and terminates the matter without further proceedings.

Thank you.

COMMISSIONER BROWNELL: I'll be supporting the order, kind of noting the comments made about other contract cases. But I think also adding that indeed the relief that was asked for was in fact granted, making it kind of a very different situation, but similarly situated in a market that was rife with dysfunctions of many kinds, but scarcity being a primary issue.

Again, there were choices that people had here. People exercised those choices, and I think the stability of the marketplace is critically important as we move forward to heal the past and develop a stable and predictable future.

COMMISSIONER MASSEY: Just for our listeners and

viewers, this is the case involving the Pacific Northwest spot markets. Is that an accurate characterization of the case for those that are following this?

MR. FIRST: Yes it is.

COMMISSIONER MASSEY: And we sent to the judge the question of what the spot market is, I think it was Judge Cintron, who is sitting here in the audience today. And she defined the spot market as roughly transactions of a month or less. It was a somewhat more complicated definition than that.

MR. FIRST: That's basically correct, yes.

COMMISSIONER MASSEY: Roughly. Roughly it. I must say that I agree with that characterization of what the spot markets were. I think that is a reasonable definition.

But I generally speaking disagree with today's order. I would not dismiss this complaint. In fact, I would set a refund effective date of December 25, 2000 and order refunds for spot market transactions defined as one month or less, through June 20th, 2001. That would be the conclusion I would reach in this case.

Puget filed a complaint on October 26, 2000, requesting the Commission to cap prices for sales into Pacific Northwest wholesale power markets. The Commission could set a refund effective date of December 25, 2000. Thus refund protection could be available for much of the

time that prices throughout the West, including the Northwest, were at their highest due to the Western power crisis.

Today's order notes that this Commission has recognized the integrated nature of the Western markets and notes that the ALJ in this case determined that dysfunctions in the California spot markets affected prices in the Pacific Northwest.

I would note that the Commission found as early as November of 2000 that conditions in California cause and continue to have the potential to cause unjust and unreasonable rates, and that market power could be exercised. Unjust and unreasonable California spot prices during the relevant period drove Pacific Northwest prices to unlawful levels as well. And the Staff's Western Markets Report details evidence of manipulation that influenced prices throughout the West.

Yet today's order finds that refunds would be inequitable and refuses to order any refunds to customers in the Northwest region that suffered some of the heaviest economic consequences of the Western market meltdown.

I strongly disagree with this conclusion. This market crisis had a significant impact upon the economy of the Pacific Northwest. Consumers were harmed. Jobs were lost. Businesses closed. The aluminum industry virtually

exited the Pacific Northwest.

The order sets out a number of what I would consider to be unpersuasive rationales for not requiring refunds. First the order is concerned that the burden of paying refunds will fall on a limited class of jurisdictional sellers in the region. This is because a large portion of the power in the Northwest is bought and sold by government entities whose sales are not jurisdictional to the Commission, and such entities are embedded in the chain of power purchases and resales that occurred in the region.

Nonetheless, the order perpetuates an inequity that is in my view much worse by comparison; namely, customers paying unjust and unreasonable rates that are unlawful under the Federal Power Act.

The Commission has always taken its jurisdiction as it found it and made the best of it. We must do that here. We would never, for example, refuse to remedy undue discrimination by jurisdictional utilities by arguing that we have no power to remedy the same conduct by nonjurisdictional utilities. We simply take our jurisdiction as we find it.

I do not believe that Section 206 of the Federal Power Act gives us the luxury of discretion here when it comes to remedying unlawful rates. And the fact that we

cannot do complete justice, which we admittedly cannot, is not an excuse for doing no justice in this case.

The order also holds that refunds would have adverse consequences on the market in that ordering them would rewrite the rules that participants relied upon, would undermine the credibility of the regulatory process, would jeopardize investment. How one characterizes the consequences of a refund decision probably depends on which side of the market one sits.

I would strongly argue that not providing refund relief would have many of the same consequences. The Commission wisely rejected these same arguments in ordering nine months of refunds to compensate for unjust and unreasonable spot prices in California markets.

Market participants in the Pacific Northwest will quickly lose faith in competitive markets if the Commission fails to protect them from unjust and unreasonable prices arising from a dysfunctional market that allowed the opportunity to exercise market power and were market prices were driven in part by serious market manipulation that the Commission is still remedying.

In fixing unjust and unreasonable prices and measuring refund liability, I would use the mitigated market clearing price methodology, the so-called MMCP, established in the California spot markets and set out in a series of

Commission orders, most recently in an order of March 26, 2003. Admittedly, it would be complex to provide these refunds. And admittedly, this methodology would have to be modified to fit daily and up to monthly transactions, but it would provide a rational rough benchmark for determining refund liability in the Pacific Northwest.

Mr. Chairman, and Commissioner Brownell, I will be respectfully dissenting on these grounds.

CHAIRMAN WOOD: When we discussed this one three months ago, I was inclined to I think try to equate as much as we could the outside California markets to the California markets and try to do a similar remedy there, and I think clearly, Bill, you're wanting to do that as well.

I think the oral argument actually is where it became more evident to me that there was going to be injustice either way we went, either with an MMCP for that locked-in period of six months, or to basically say the remedy is from the price cap forward and there is no locked-in period for refund relief.

It's not satisfactory either way. I think you laid out kind of how you came on that, and I don't disagree with it. It is unfortunately a distinction between having an organized market in California where we could actually fashion a remedy that although I think we don't agree on the ability to reach nonjurisdictional people through a

jurisdictional tariff, though, the Commission order did in the California case actually have a vehicle through which it could credibly, although I'm sure it will be tested before court, argue that we can do some sort of justice after the fact, dislocating though it may be, we can do some justice for the dysfunction that the Commission found.

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Here, I just do not think it was available. I think it was helpful for me to hear from the state commissions up in that region, who are skeptical of markets, to say that they didn't think a remedy of the method we had asked Judge Cintron to consider for us would be that effective.

And I do put a lot of weight on their words, both in the RTO discussions, as we do here. So those things really colored my opinion on this. I do note that what we did do here actually is grant rehearing and go back and flip the Commission's decision in December of 2000 to deny the complaint, and actually granted the complaint. We just, in effect, say that there's not going to be a remedy period between the time that the Commission said no and the Commission moved to something that said yes.

So I don't think that's unfair. In fact, I think it is a proper way to go forward, considering all of the countervailing equities, so, for that reason, I would support the way we handle that in this Order.

COMMISSIONER MASSEY: If I might just say that I disagree with my colleagues on these cases, but Chairman Wood and Commissioner Brownell, when they first came to the Commission, when these markets were raging out of control, stepped up to the plate almost immediately and voted to impose price mitigation for the entire Western

Interconnection, and essentially prices have been reasonable ever since. I greatly appreciate that.

I think that's the right thing to do at the right time. It calmed the waters and has allowed us to take a hard look at the matters that we have addressed today.

So I want to tell you both that I very much respect the fact that early in your tenure when you came to the Commission, you were willing to address these issues head on.

CHAIRMAN WOOD: Thank you. That was two years ago this week or last week. Happy anniversary.

All right, let's vote.

COMMISSIONER BROWNELL: I'll vote to support the Order, noting my concurrence.

COMMISSIONER MASSEY: No.

CHAIRMAN WOOD: Aye.

SECRETARY SALAS: The next item for discussion is E-2, Attorney General of the State of Connecticut versus NRG Power Marketing. This is a presentation by Eugene Grace.

MR. GRACE: Good afternoon. This draft Order considers an amended complaint that asks that the Commission determine that the Bankruptcy Court's approval of NRG's request to reject an agreement between it and Connecticut Light and Power, does not preclude the Commission from making an independent determination as to whether NRG must

continue to provide service to Connecticut Light and Power.

The draft Order concludes that the Commission is not required to forgo its regulatory responsibilities, simply because a regulated entity such as NRG has filed for bankruptcy.

The draft Order also establishes procedures for the submission of information to develop a factual record concerning whether NRG's proposed cessation of service meets the Mobil-Sierra public interest standard and requires NRG to continue to perform its contractual obligations under the agreement until the Commission rules on the merits of the public interest issue.

This Order also addresses a related Petition for Declaratory Order that requests a declaration from the Commission that the implementation of the SMD New England, results in certain sellers being responsible for congestion charges and losses under certain circumstances. The Order sets that issue for hearing. Thank you.

CHAIRMAN WOOD: Thanks, Eugene. Nora?

COMMISSIONER BROWNELL: This is a difficult Order to deal with, in that I think there's some legitimate debate going on about what the law actually says. Underneath all of this, however, is the continued issue that we have in terms of sufficient economic signals to get infrastructure built, the lack of infrastructure in Connecticut, the lack

of clarity in some markets as we transition to standard market design.

I think that the lesson learned for us all here is that we need to get contracts as clear on transitional issues as we possibly can. I'll be voting, in part, to support the Order to send the issue for hearing, but I will be dissenting -- I would have supported vacating our Order.

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I think that bankruptcy law, in fact, is quite clear in terms of the authority of the executor of contracts, and I have to go that way.

COMMISSIONER MASSEY: I'll be supporting today's Order.

CHAIRMAN WOOD: As will I. Even the Bankruptcy Judge acknowledged some trepidation about wandering into this, and so I -- actually, my first vote on my last job was for the bankruptcy of El Paso Electric coming out, the conflicts we had as a state regulatory body with the Bankruptcy Court in the Western District of Texas.

But this issue was, quite frankly, avoided, as it has been, I think, through this Agency's recent history in bankruptcies. I don't know if we can do that here, and I, label lover that I am, agree that this ought to be probably decided by a jurisdictional court.

I do think, however, that I remain to be

persuaded, as it was set up here in this case, whether, in fact, NRG has met the Mobil-Sierra standard for trying to get out of its contract, independent of what right a Bankruptcy Court has to decide.

We set that for hearing, as we did with this last batch of cases. I don't expect that this one will take as long, since we set it on a 10-day and 20-day turnaround time with a paper hearing, which may be how we ever handle these in the future.

And I will just keep my powder dry until then to see if this looks like the California cases, or is, in fact, something different.

But I do think we ought to take it on and have the Court tell us that that's something we have the right to do. I appreciate your difference on that, Nora, but where the law is unsettled, we need to move ahead, reading our law as robustly as we do everywhere else, and go forward. So I will support this Order.

COMMISSIONER BROWNELL: I will dissent, in part, and concur, in part.

COMMISSIONER MASSEY: Aye.

CHAIRMAN WOOD: Aye.

SECRETARY SALAS: Mr. Chairman and Commissioners, before we move ahead to M-1 and M-2, the Staff has asked that we call back E-5, just for a brief moment, the Western

Investigation of Anomalous Bidding Behavior and Practices, so that Mr. Dennis O'Keefe, from the Office of Market Oversight and Investigation can present some brief remarks.

MR. O'KEEFE: Good afternoon. This is a statement regarding our investigation of physical withholding of power. The Staff recommends that the Commission not issue Show-Cause Orders on physical withholding at this time.

Instead, the Office of Market Oversight and Investigation is conducting an investigation, building on the data requests we sent out this Spring. OMOI has served data requests and requests for admissions on more than 80 entities that control generation in California.

This is a preliminary investigation regarding possible physical withholding of power from the California markets during the May 1st 2000 to June 30th 2001 time period under the Commission's rules in Part 1(b) of 18 CFR.

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OMOI has been reviewing responses to the initial data requests to determine whether further investigation of individual companies for potential physical withholding is warranted.

We expect to complete this determination by July 31, 2003. By that date, Staff will have contacted every respondent to tell them either that the preliminary

investigation is closed as to their company, or, alternatively, that the investigation will continue in greater detail.

For those companies that warrant further investigation, OMOI's goal is to complete the detailed investigation and bring each case to closure by January 31st, 2004. Thank you.

CHAIRMAN WOOD: Thank you, Dennis.

COMMISSIONER BROWNELL: Okay, I can do that. On July 31st, are you going to be prepared to publish a list of the people that you're not investigating further? How are you going to handle the communication of information to the broader world?

MR. GRACE: My intention would be to notify them privately, because I'm not certain at all that any of them wants the honor of being publicly identified as having been exonerated. They, of course, are going to have the opportunity, if they want to issue a press release, but I think that should be their call as to whether they want to publicize that or not.

COMMISSIONER BROWNELL: Thank you.

COMMISSIONER MASSEY: Dennis, I appreciate the update. This has been a belaboring issue, on one that I have advocated for quite some time that we look at. I am glad we are. I appreciate the update and look forward to

the results that you reach.

CHAIRMAN WOOD: Thanks, Dennis.

SECRETARY SALAS: The next item for discussion is M-1, Regulation of Cash Management Practices, with a presentation by Wayne McDanal. Wayne is accompanied by Peter Roidakis, Rosemary Womack, and Abram Silverman.

MR. McDANAL: Good afternoon, Mr. Chairman and Commissioners. Today we have an interim final rule in Docket No. RM02-14, the Cash Management Practices. Before we go any further, I'd like to identify some staff people who worked on this who are not at the table. Without their input, we couldn't have done it: Steve Hunt, Monica Miller from the Office of the Executive Director, Ellen Shaw, and Julia Lake from the Office of General Counsel, Janice Garrison from the Office of Markets, Tariffs, and Rates.

This interim final rule adopts recommendations as amendments of the Uniform Systems of Accounts. It also seeks comments for proposals to require FERC-regulated entities that are participating in cash management programs to file their cash management agreements with the Commission and to notify the Commission, when and if their proprietary capital drops to less than 30 percent of their total capital.

The amendments to the Uniform System of Accounts will require and assure that the availability of information

on cash management activities of jurisdictional companies, the amendments require that companies participating in cash management arrangements keep and maintain current written cash management agreements, specifying the duties and responsibilities of the cash management administrator and the participants in the cash management arrangement, and also the operational rules under the cash management arrangement.

In an effort to provide financial transparency and to assure ratepayer protection, the interim final rule also proposes that the cash management agreements be filed with the Commission and that jurisdictional entities participating in cash management arrangements, notify the Commission when their proprietary capital drops to less than 30 percent of total capital.

This information would be available in the Commission's public files. The information proposed to be required will provide transparency of financial dealings, allowing the Commission, customers, and investors to evaluate the actions and operations of regulated entities and the effects of the actions of the regulated entities that they might have on their ability to perform their regulated functions. Thank you.

COMMISSIONER BROWNELL: Have we looked at the information that the SEC requires, and are we consistent and

compatible with one of my favorite issues, as everybody knows, because I talk about it all the time, is the redundancy of filing requirements, filing the same information, but in a different format, adding burdens where we don't get the information necessarily that we're going to use. Have we kind of done all those screens?

MR. McDANAL: Yes, ma'am, we have. We met with the SEC staff, in particular, the PUHCA, Public Utility Holding Company Act staff. Under the Holding Company Act, the companies have to get approval to participate in money pool arrangements or cash management arrangements.

The SEC requires, on an ad hoc basis, some information. They don't have any strict rules as to what has to be filed. Their information would generally mirror what we would be requiring.

What we're requiring was noted by one of the commenters at our public conference, that the written agreements simply constitute sound business practices and should be maintained by anyone participating in a money pool arrangement.

We don't anticipate filing that document under the new proposal will constitute any significant burden to the company. As far as having that maintained currently for their existing money pool arrangements, we don't anticipate any burden with that, because it's something that they

should be doing in support of all their money pool activities.

COMMISSIONER BROWNELL: Could you elaborate, if you will, on the discussions that you've had with your colleagues about how we intend to use this information, what we want to learn from it, what we might do when we do learn things from it?

MR. McDANAL: Well, the information will give the Commission the ability to see what the companies are doing through their money pools, how the funds are being used, whether they're being used by non-regulated entities that also participate in the pools. It will give the Commission the opportunity, from looking at the information maintained prior to filing, will give the Commission the opportunity to see whether the companies are acting prudently, or whether the money pool is a drain on the financial reserves of the regulated entity.

COMMISSIONER BROWNELL: I hope we'll also work with our colleagues at NARUC, who, I think, in the end, may have more authority at the state level to deal with the repercussions of what we might learn. I'm not entirely convinced we have a great deal of authority, but I think that on some regular basis, we might want to meet with the Finance and Technical Committee at NARUC to review what we're learning.

As I have often cautioned in the past, I think we should hold ourselves to a standard of review and a year from now, kind of evaluate what it is we've asked for and how we've used it and what we've learned, to make sure that we don't institutionalize information-gathering that ten years from now, somebody looks and says, why have we done this?

I think we should do that with any new information that we ask for, just to hold ourselves to a standard of accountability in terms of asking for information, so I would just suggest that we take a look at that and that in a year, we get a report from you and your colleagues about why this has been a good thing.

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MR. McDANAL: Yes, ma'am, thank you.

COMMISSIONER MASSEY: As Nora has asked you about, the concern we're addressing was that let's say the parent of a pipeline using one of these sweep accounts or money pool arrangements could somehow erode the financial health of the pipeline, which is the regulated asset over which we have jurisdiction. We would be concerned if those arrangements were used in a way that degrade service in some way.

The original proposal had a requirement for a 30 percent proprietary capital requirement for the regulated entity, and investment grade credit rating for the regulated entity and its parent in order to participate in one of these accounts. This interim final rule backs off of those two proposals and takes a different approach. Can you explain why the different approach is taken?

MR. McDANAL: The original proposal to require the 30 percent proprietary capital and investment grade credit ratings were resoundingly rejected by the commentators to the notice of proposed rulemaking. We looked at industry data and industry information.

From looking at simply the Form 1, Form 2, Form 6, we found that the vast majority of the companies met the 30 percent proprietary capital requirement, but the vast majority going the other way did not have investment grade

credit ratings or credit ratings at all, because they were subsidiaries of other entities that did the financing for them. There was concern that they would have had to have gone out and gotten formal credit ratings or provided information otherwise that would have persuaded the Commission that they would have met an investment grade credit rating.

Considering the number of entities involved, there was concern that it would have been an unwieldy if not unworkable proposal. So we went forward with what we have now, proposing that the proprietary capital be -- I hate to use the word "trigger" -- but a trigger for the filing of a notification with the Commission of that information. The Commission would still have the information available to it.

As you said, there is a concern that if a cash management arrangement or money pool is used inappropriately, the jurisdictional entity which in many cases generates a significant amount of funds within those pools, would or could be put in an awkward situation as far as availability of funds.

COMMISSIONER MASSEY: So what we do here is change that to a reporting requirement if proprietary capital balance starts below 30 percent or if it's below 30 and then increases to over 30. In either case, the entities must report to the Commission within 20 days?

MR. McDANAL: That's correct.

COMMISSIONER MASSEY: That puts us on notice and puts you as our accountants on notice, and you can either take whatever steps you need to take or make recommendations to the Commission to take whatever steps that we need to take in that circumstance. That's the idea here?

MR. McDANAL: Yes it is.

COMMISSIONER MASSEY: Thank you.

CHAIRMAN WOOD: It's five days, right?

MR. McDANAL: There is a requirement that the computation be made within 15 days of the end of the month, and you have a five-day window for notification. So it's 20 days from the end of the month.

CHAIRMAN WOOD: Okay.

MR. McDANAL: They have to close their books on a monthly basis anyway. The information is there.

CHAIRMAN WOOD: I would have preferred, like you, had we had any clear authority, that's helpful. But I mean, the bottom line is, it's our responsibility to do this job, whether people like it or not. Had we had clearer authority, I think we would have gone there and actually conditioned the participation in these programs on meeting a debt equity standard and a bond rating standard. I would have gone there.

I think it was actually more compelling on the

legal arguments back to us that this is not the strongest place to go, and I think substantially we can get there as we talked about earlier today, with the Scarlet Letter approach. You're out there as a pretty thinly capitalized company. Our auditors are showing up on your doorstep tomorrow, and that kind of makes you aware of where the cash is and everything else. It's workable. I think it's second best as far as substantive outcome, probably first best as far as getting up to the minute and getting substantively what we wanted to accomplish.

You and I have had this discussion, but I think this one should get the work done, and if we need more, then we'll go ask for it.

COMMISSIONER BROWNELL: I want to thank Wayne and his staff, whom I think do a good job of sorting through the comments and getting a full understanding of what we do and do not have the authority to do, but to getting us to an outcome that I think actually will achieve our goal. So, Wayne, as the office that drove you insane, I want to thank you and your colleagues for being patient as we work through these issues, and I will vote aye.

COMMISSIONER MASSEY: Can I ask you a question? If you get one of these reports that the proprietary capital level has dropped below 30 percent, what will you do with that information?

MR. McDANAL: Review what we got, the reasons why it happened, and what their proposals are to get it back above 30 percent, evaluate whether or not there are any negative implications from it.

You can't make a decision right now as to what happens with a drop below the 30 percent, because you don't know the reasons why. It's an ad hoc review.

COMMISSIONER MASSEY: So you guys will be on top of this if there is some aspect of this that you need to report to the Commission on?

MR. McDANAL: Definitely.

COMMISSIONER MASSEY: Or will you do that as a matter of course? Will you look into it?

MR. McDANAL: I would think we'd report back to the Commission if we do get that type information, because the Commission needs to be informed, especially when we're looking at something new, when you haven't had a chance to get your feet wet.

COMMISSIONER MASSEY: I would encourage that. I think the full Commission needs to be informed.

CHAIRMAN WOOD: Let's make that a standard reporting thing in our closed meeting discussions on issues like this.

MR. DELAWARE: Part of this will be tied to the second issue we have coming up on the quarterly financial

reporting, because we'll see this information sooner as we go through it.

CHAIRMAN WOOD: Okay. M-1.

COMMISSIONER BROWNELL: Aye.

COMMISSIONER MASSEY: Aye.

CHAIRMAN WOOD: Aye. Thank you all.

SECRETARY SALAS: The final item for discussion this morning, or this afternoon rather, is M-2, Quarterly Financial Reporting and Revisions to the Annual Report. This is a presentation by Julie Kuhns with Mike Klose, Julia Lake and Christopher Bublitz accompanying her.

MS. KUHNS: Good afternoon, Mr. Chairman and Commissioners. M-2 is a proposed rule that would require jurisdictional entities to file quarterly financial reports with the Commission. Currently, jurisdictional companies file financial statements and supporting data with the Commission on an annual basis.

In light of current rapidly changing business environments, more frequent and transparent financial reporting is needed. Quarterly financial reporting will assist the Commission as well as ratepayers, investors and other customers in identifying and evaluating emerging trends, business conditions and financial issues affecting the energy industry.

It will aid the Commission in achieving its statutory goal of vigilant oversight of the energy markets by giving the Commission and others more timely, relevant, and transparent financial information.

Specifically, the proposed rule will add two quarterly reports to supplement current annual financial reporting forms, a Form 3Q for electric and natural gas companies, and a Form 6Q for pipeline companies.

These quarterly financial reports will contain a basic set of financial statements, and certain schedules currently filed with the Commission annually. It will also include a management discussion and analysis section of financial condition and results of operations, commonly called an MDNA, and other selected financial data.

The proposal calls for these reports to be filed electronically and to be certified by the appropriate officers of the company. Jurisdictional entities who currently are subject to the Commission's Uniform System of Accounts and who file the annual report Forms 1, 1F, 2, 2A, or 6, will be required to file the quarterly reports.

In addition, the proposed rule will revise the current FERC annual reports to add an MDNA to the annual reports. It will update the annual income statement to include the fourth quarter information.

It will add a schedule for ancillary services

participated in by jurisdictional companies, and it will update the officer certification requirements in the annual reports.

Finally, the proposed rule will accelerate the filing dates for the annual reports in response to the Sarbanes-Oxley Act. More frequent financial reporting will aid the Commission in assessing economic consequences of transactions and events of jurisdictional entities. It will aid in measuring the effects of regulatory initiatives in the energy industry.

It will also aid in evaluating the adequacy of existing, traditional cost-based rates. Finally, the proposed rule will aid in developing needed changes to existing regulatory initiatives. Thank you. We would be happy to answer any of your questions.

COMMISSIONER BROWNELL: I think my comments would be the same. Does this conform with what other agencies are asking for? Is it redundant to or consistent with SEC or whomever?

MS. KUHNS: Currently, companies compile this information and they file consolidated financial statements with the SEC at the consolidated level. But in order to prepare the consolidated financial statements, they have to do it at the jurisdictional entity level. It's information they already compile, so there is no additional burden.

They already have it within their entity. They already give us this information on an annual basis. We're just asking to see it more frequently so that we can do more analysis and have more accurate information to use.

COMMISSIONER BROWNELL: Good. I actually am really pleased that we're breaking it out, because consolidated information, I don't think is particularly useful for what our responsibilities are, and I think we certainly learned that in the last year or two. So, once again, I'd love us to kind of look at this a year from now, and have you all make a report about how did we use it, who in the building found it useful, what next? Have we eliminated any information that we're getting, based on the fact that we're getting this more often? Is there any kind of thing that we can wipe off the slate, so that people don't have to report? Have we looked at what we now get and said, well, this will replace that?

MS. KUHNS: I don't believe we're eliminating any information, however, in the report that we prepare next year, we will look at it and evaluate what we don't use. We have looked at the information that does come in and looked at what's missing and what would be more helpful and be more precise in the types of analysis that we do need.

COMMISSIONER BROWNELL: One of the things that just comes to mind -- and I don't know if this is correct --

is for getting quarterly reports, do we then need an annual report that tells us what the quarterly report said? I just want us once again to be disciplined and focused. Thank you.

CHAIRMAN WOOD: They did combine the fourth quarter report with the annual.

MS. KUHNS: Right.

COMMISSIONER MASSEY: This is a NOPR, correct? So we'll get comments on it.

MS. KUHNS: Yes, we'll get comments.

COMMISSIONER MASSEY: It seems like a good idea to me. I'm counting on our accountants to tell us what we need to do to spiff up our requirements. This seems like a proposal whose time has come, and I support it and look forward to the comments that we get.

CHAIRMAN WOOD: I think that while we have traditionally viewed our accounting and reporting information for the purposes of internal use for ratemaking and for oversight, I think it became pretty clear to us, both by the Congressional inquiries and that of Wall Street types, customers and people that have testified before us, that, in fact, the information we obtain for our utilities is different than exists at the SEC and is useful and has uses beyond those just within the four corners of our statute.

Now, it's not our job to do every good idea people think of, but if there is a synergy that can happen with us getting information for our needs that's also beneficial to counterparties, to investors, to state regulators, for example, then I think that's a good thing. So I do hope to hear from those outside the frequent-flyer constituencies here, that may have some suggestions about what's surplus here and also what's actually lacking here. It looks good to me, too.

I defer to the arcane science and art of you accountant folks who keep the trains running on time, but we'll hear from people, and I think, as we just did in the last rule, we can get a good digest of where everybody is on these issues before we go final. So, thanks for the work on this, and we will hear from the world what they think.

COMMISSIONER BROWNELL: Aye.

COMMISSIONER MASSEY: Aye.

CHAIRMAN WOOD: Aye.

The closed meeting will start at 2:30 in 3M4AB.

Meeting adjourned.

(Whereupon, at 1:25 p.m., the open meeting was adjourned.)