

1 APPEARANCES:

2 COMMISSIONERS PRESENT:

3 CHAIRMAN PAT WOOD, III, Presiding

4 COMMISSIONER LINDA KEY BREATHITT

5 COMMISSIONER NORA MEAD BROWNELL

6 COMMISSIONER WILLIAM L. MASSEY

7 SECRETARY MAGALIE ROMAN SALAS

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1 PROCEEDINGS

2 (11:40 a.m.)

3 SECRETARY SALAS: Good morning, ladies and
4 gentlemen. May I please have your attention? Thank you
5 very much. I just wanted to let you know that the
6 Commissioners and the legal assistants are working on last
7 minute details for this morning's agenda. We do expect them
8 to come down shortly, probably around 11:30. Thank you very
9 much.

10 (Recess.)

11 CHAIRMAN WOOD: Good morning. This open meeting
12 of the Federal Energy Regulatory Commission will come to
13 order to consider the matters which have been duly posted
14 for this last day of July 2002 at this time and place.
15 Actually, not quite at this time, but almost at this time.
16 Please join me in a Pledge to the Flag.

17 (Pledge of Allegiance recited.)

18 CHAIRMAN WOOD: Thank you. Before we proceed to
19 consider the substantive issues in today's agenda, we need
20 from the Commission a vote to waive the provisions of the
21 government and the Sunshine Act 5 U.S.C. 522(b)(e)(1) to
22 permit the following docket number to be added to item
23 number E-31, Alliance Companies. It is Docket Number EL02-
24 111-000, Midwest Independent Transmission System Operator.

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Commissioner Breathitt votes first.

1 COMMISSIONER BREATHITT: Aye.

2 COMMISSIONER BROWNELL: Aye.

3 COMMISSIONER MASSEY: Aye.

4 CHAIRMAN WOOD: Aye. Madam Secretary?

5 SECRETARY SALAS: Good morning, Mr. Chairman and

6 good morning, Commissioners. Let me first note for the

7 record the items that have been struck from the agenda since

8 the issuance the Sunshine notice on July 24th. These are E-

9 6, E-25, E-33, G-28, G-30, H-1, H-5 and M-3.

10 Mr. Chairman and Commissioners, your consent

11 agenda for today is as follows:

12 Electric: E-2, E-4, E-7, E-17, E-20, E-26, 26,

13 28, 32, 34, 36 and 42.

14 Gas: G-1, G-2, 3, 4, 5, 6, 8, 10, 12, 14, 17,

15 18, 21, 24, 25, 27, 31 and 32.

16 Hydro: H-4.

17 Certificates: C-1, 2, 5, 6, 7, and C-12.

18 Miscellaneous: M-1.

19 The specific votes for some of these items are as

20 follows: E-7, Chairman Wood and Commissioner Breathitt

21 concurring with a separate statement.

22 E-42, Commissioner Breathitt dissenting and

23 Commissioner Breathitt votes first this morning.

24 COMMISSIONER BREATHITT: Aye. My dissent is

1 noted.

1 COMMISSIONER BROWNELL: Aye.

2 COMMISSIONER MASSEY: Aye.

3 CHAIRMAN WOOD: Aye, with concurrence as noted.

4 SECRETARY SALAS: The first matter for discussion

5 this morning is a group of three items as follows:

6 E-12 and E-11 of Esta Corporation and E-41,

7 Arizona Public Service Company.

8 CHAIRMAN WOOD: We're doing this without a

9 presentation. The reason why they weren't struck. I just

10 wanted to use the opportunity to say that we are well at

11 work on these important cases trying to sew up the three

12 parts of the important Western Interconnection.

13 And in light of focus this meeting on the item

14 which began earlier in September on the SMD, we're going to

15 endeavor to work on these through August, along with all the

16 other items that were struck or omitted from today's agenda

17 as well as those that have been carried forward from recent

18 agendas through the month of August, and we will have a

19 fallback meeting in the first week of September to just deal

20 with all the holdover items so that we start our second

21 September meeting with a fresh set of agenda items.

22 So I appreciate the hard work that the RTO West

23 applicants, the West Connect and the Trans Connect

24 applicants have done on their agendas, and please know that

1 we want to give those the full force of thorough analysis

1 and response to all the comments so we can expect to be
2 getting those out in the near future.

3 SECRETARY SALAS: The next item for discussion is
4 E-30, Standardization of Small Generator Interconnection
5 Agreements and Procedures.

6 CHAIRMAN WOOD: Similarly, E-30 was an item that
7 we're also looking at that relates in part to the ongoing
8 NOPR that we've got on generation interconnection
9 procedures, and like the other items, we'll be working on
10 that through August with our fallback date as the first
11 meeting in September for getting those out.

12 SECRETARY SALAS: The next item for discussion
13 this morning is M-2, Electronic Registration, with a
14 presentation by Chris Cook and Wilbur Miller.

15 MR. COOK: Good morning, Mr. Chairman,
16 Commissioners. I'm Christopher Cook from the Office of the
17 Chief Information Officer. This is Wilbur Miller from the
18 Office of General Counsel.

19 (Slide.)

20 The FERC Online diagram shown here demonstrates
21 electronic registration's relationship to future FERC online
22 applications and shows e-registration as the vital link
23 between the two main areas of FERC Online, documents
24 electronically distributed, and documents electronically

1 submitted.

1 All documents electronically submitted
2 representing filed documents in the left box will be
3 mandatory by October of 2003. Documents electronically
4 distributed by FERC, seen in the right box, include
5 voluntary and mandatory services that FERC will begin to
6 implement this summer.

7 E-registration itself will be mandatory after
8 January 7th, 2003, and at that time paper filings with
9 waiver or those users that are exempted from electronically
10 registering, will be entered into the e-registration system
11 as well.

12 So e-registration in a nutshell is this: If you
13 do a lot of business with the FERC, e-registration gives you
14 the equivalent of FERC frequent filer status. For you, the
15 frequent filer, e-registration will act as a springboard and
16 a facilitator to each of the FERC online applications
17 represented on the screen.

18 If, on the other hand, you're a once-in-a-blue-
19 moon filer, that's okay too. E-registration has a
20 flexibility for FERC to accept paper filings from infrequent
21 filers on a case-by-case basis with waiver or exemption.

22 Next slide, please.

23 (Slide.)

24 So why e-registration? E-registration has these

1 high level requirements:

1 Provide FERC customers one-stop shopping for all
2 their transaction needs;

3 Establish a clean database;

4 Support all FERC legal and statutory requirements
5 as the existing electronic and paper processes do;

6 Give the user an easy and intuitive access to
7 FERC Online and document retrieval;

8 Provide cost savings to FERC and its customers by
9 providing cleaner service lists and thereby reducing postage
10 costs.

11 Next slide.

12 (Slide.)

13 Successful electronic registration is really a
14 two-way road. It involves a FERC customer giving the FERC
15 information, and then FERC providing the customer
16 information he or she will use to access FERC Online
17 applications.

18 The customer begins the registration process by
19 entering data in the data fields. He or she provides the
20 system a user ID, which happens to be their e-mail address,
21 a password and a password hint. In return, FERC assigns
22 them a FERC registration number, gives them an access to the
23 appropriate FERC Online application, and optionally e-mails
24 them a record of their transaction or transactions from the

1 session.

1 The benefits of e-registration will provide are
2 potentially enormous. The registrant will periodically be
3 prompted to give FERC updated user data, thus providing FERC
4 a much more efficient and streamlined approach to managing
5 its database information.

6 FERC will be providing the registrant an easy to
7 use platform from which to conduct their business here at
8 the FERC while giving them access to cleaner, more reliable
9 service lists.

10 (Slide.)

11 Okay. This slides shows e-registration's three
12 major milestones. We've got today's discussion of e-
13 registration highlighted here in the first bullet. We show
14 implementation of e-registration on a voluntary basis in
15 late August, and then in January a mandatory phase of
16 registration where the registrant uses e-registration to
17 access the FERC Online applications except in cases where
18 waiver has been granted or the registrant has been exempted.

19 And that concludes the presentation. Are there
20 any questions or comments?

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1 CHAIRMAN WOOD: Well, my comment is one of
2 praise. There is another thing on this agenda that I put a
3 slightly higher level than this one, but this one is up in
4 the first echelon of important things to do, because it is
5 time for this Agency to really join the 20th Century before
6 it's really over and forgotten.

7 And this is a real key thing to do, is to really
8 reduce the amount of paper and let people take advantage of
9 all the electronic capabilities. And I appreciate the hard
10 work that has gone on in the CIO's Office, and in other
11 parts of the Agency to really standardize this.

12 And I think the way you laid it out on Slide 1
13 makes it so clear as to what we're trying to achieve here.
14 I encourage our customers on the outside to give us constant
15 and frequent feedback, FERC Frequent-Filer feedback,
16 friendly or not, is very helpful in making this the most
17 effective process we can have. So I appreciate the work
18 that went into the rule, and, more importantly, to the
19 underlying systems work that was necessary here at the
20 Commission.

21 MR. COOK: Thank you.

22 COMMISSIONER BROWNELL: Pat, I think you have
23 provided real leadership on this, for which I am grateful,
24 and I think to really make this work, you probably ought to

1 start a rewards program for frequent filers. And I'd say

1 maybe you would want to start with a little lunch to the
2 most frequent filers in the first couple of months,
3 something to make it worth their while.

4 (Laughter.)

5 CHAIRMAN WOOD: Lunch with a Commissioner.

6 (Laughter.)

7 CHAIRMAN WOOD: I'll do that, and I'll tell you
8 what I propose to do later. And I don't know if people -- I
9 haven't been an associate in a law firm, and this would not
10 be the most welcome news, so I will consider it as
11 something.

12 But if you file electronically, we'll give you a
13 few more hours. I mean, I always know that rushing to get
14 it in the courier to get it in the copier, to get it in and
15 all that stuff; we're dropping couriers, we're dropping
16 copiers. And I don't know what Kinko's and Ace Courier is
17 going to do about that, but making it all electronic sure
18 knocks a lot of costs out of the system. I wouldn't have an
19 issue with giving extra filing time later. If people think
20 that's a great incentive, let me know.

21 Lunch with me is pretty cheap.

22 (Laughter.)

23 CHAIRMAN WOOD: But I do like Thai food. I think
24 that's a good idea. We'll -- of course, with my strict

1 rules, I've got to pay for yours.

1 (Laughter.)

2 CHAIRMAN WOOD: Take us up on it. I think it's a
3 good idea, Nora. And we will track and announce -- we won't
4 be nasty. We won't announce the people who are lagging, but
5 we'll announce the people who are at the front of the pack.

6 And so if the folks in CIO and OSEC can work
7 together and get us a list, we will announce that publicly
8 and lay it on thick. Voting for the rule.

9 COMMISSIONER BROWNELL: Aye.

10 COMMISSIONER BREATHITT: Aye.

11 COMMISSIONER MASSEY: Aye.

12 CHAIRMAN WOOD: Aye.

13 SECRETARY SALAS: The next item for discussion
14 this morning is E-1, Electricity Market Design End
15 Structure, with a presentation by Alice Fernandez.

16 MS. FERNANDEZ: Good morning. We're glad this
17 time has come. I'm Alice Fernandez, and with me today are
18 Dave Mead, Mark Hagerle, Andrea Wolfman, and Kevin Kelly,
19 and we have slides.

20 (Slide.)

21 MS. FERNANDEZ: I'm going to give a brief
22 overview of the rule, talking at a fairly high level. And
23 I'm also going to point out a few things, one of which is
24 that it has a new name. When people see the document, which

1 hopefully will be today. And that new name is Remedying

1 Undue Discrimination Through Open-Access Transmission
2 Service and Standard Electricity Market Design.

3 The slide is also important because, although
4 it's in small print, the other names are all of the Staff
5 people who have been working very hard on this effort for
6 the last several months.

7 (Slide.)

8 MS. FERNANDEZ: The next slide is basically just
9 sort of an overview of items that are in the business plan,
10 the Commission's business plan. And the main thing I'd
11 point out on this is that the current, the NOPR addresses
12 all of these: Encouraging the development of infrastructure,
13 creating balanced market rules and protecting customers
14 through vigilant oversight.

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1 The NOPR goes into a good amount of detail on the
2 reasons why a standard market design initiative is needed.
3 Basically it details a lot of examples of discrimination,
4 problems that have occurred in the wholesale market, due the
5 lack of standardization, market design flaws, which has
6 resulted both in discrimination, has resulted in higher
7 costs for customers. And those are basically the reasons
8 for doing the NOPR at this time.

9 This is just sort of a brief summary of some of
10 the basic goals from the process that are trying to be
11 achieved with standard market design, the first in terms of
12 reducing wholesale electric prices and sort of bringing the
13 benefits of competition. And that in solving some of the
14 undue discrimination that may have prevented cheaper
15 supplies from reaching customers. It could result in lower
16 rates.

17 There also is a lot of emphasis in encouraging
18 the development of infrastructure. There's a lot of
19 emphasis in encouraging technology, particularly in demand
20 response, and also recognizes that there are benefits to the
21 environment from the use of more efficient generation.

22 (Slide.)

23 And this slide is just sort of to point out, I
24 think as we've been sort of going through this now since

1 October 2001, and for those that have been following it, I

1 think you'll see an awful lot of things in the NOPR that
2 have been previewed throughout the process. This is just
3 sort of a list of the various opportunities that we've had
4 so far in addition to the public meetings that we've had,
5 we've also had a number of meetings with industry segments
6 to discuss various aspects of the rule and to get feedback
7 and input into designing the NOPR. And also would like to
8 point out that the NOPR itself continues that process.
9 There's an opportunity, a 75-day period for comment.

10 In the NOPR itself, there are several areas where
11 it discusses other conferences that will be called. It
12 doesn't list I think all the ones that we will have, but
13 there is a plan to have a number of additional conferences
14 within the next couple of months.

15 Also there's going to be a major, I think,
16 standard market design outreach effort that's going to occur
17 starting in August where I know we've already set up
18 meetings with a number of the various state groups to talk
19 about standard market design.

20 These are some of the general principles that I
21 think you'll see that are reflected in the NOPR. The first
22 is sort of the same set of rules for all customers, and that
23 the rules are administered by a fair and independent entity.
24 That's basically designed to go at some of the

1 discrimination issues that have come about.

1 Also, there is a new tariff that is attached to
2 the NOPR. In designing the market rules, we've tried to
3 work in protections against market manipulation. The NOPR
4 also contains an analysis of the various Enron trading
5 strategies that were sort of in the infamous memo that came
6 out in May of this year, and discusses how those would be
7 handled through standard market design. And as you can
8 anticipate, we found out that they could be handled much
9 better through standard market design than under the
10 California market design.

11 There are specific measures that are included in
12 the NOPR for market power mitigation and there's a strong
13 emphasis on market oversight. And also following in on the
14 principle of encouraging the development of infrastructure,
15 there's a discussion of transmission pricing and planning
16 policies to try and start the process quickly.

17 In designing the NOPR and the various provisions
18 there are several things that are trying to be accommodated
19 and where there's been a good deal of emphasis on trying to
20 deal with these. One of these is respecting existing
21 contractual rights. The NOPR the basic standard market
22 design builds off of contracts. There is a spot market that
23 is included but the real foundation is longer-term bilateral
24 contracts.

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And there also are provisions included so that

1 existing customers will be able to convert rights to the new
2 system. There also is a good deal of emphasis on protecting
3 reliability, there is a resource adequacy requirement for
4 load to help ensure reliable service. There's the good old
5 security constrained dispatch to ensure reliable
6 transmission service on a day-to-day basis. And again an
7 encouragement of new infrastructure to also help reliable
8 service.

9 (Slide.)

10 And I realize this slide looks a lot, very busy,
11 but the reason I listed it all is there also is a good deal
12 of emphasis on coordination with states. The rule
13 encourages development of regional state advisory
14 committees, and the first list is basically a list of the
15 topics that the Commission and the NOPR suggest that the
16 RSAC or Regional State Advisory Committee would be involved.

17 The NOPR also mentions or actually discusses and
18 complements recent recommendations from the National
19 Governors Association that recommends the creation of multi-
20 state entities for planning additional facilities.

21 (Slide.)

22 (Slide.)

23 The next two slides are basically, just very
24 briefly, and when you see the size of the document, you'll

1 realize how brief this is, just sort of various major

1 elements in there. The first is that it calls for having an
2 independent transmission provider administer the tariff and
3 operate the transmission systems. There's also the
4 discussion of governance for the independent transmission
5 provider. It proposes a new transmission service, a more
6 flexible one than we have today, that also has tradeable
7 congestion revenue rights. That's our new term for
8 transmission rights or FTRs.

9 And the service intended to take many of the best
10 aspects of network service and point to point service as
11 they exist today and combine them.

12 It does require an open and transparent energy
13 spot markets that would be operated by the independent
14 transmission provider both day ahead and real time. And it
15 does use congestion management through LMP.

16 There are specific market power mitigation
17 measures that are built into the NOPR. The focus is on
18 local market power, lack of price responsive demand. There
19 also is a lot of focus on monitoring of markets and there
20 are rules of conduct for market participants.

21 There's a resource adequacy requirement that
22 would apply to load that is forward-looking that gives a lot
23 of discretion to the regions to develop the specifics. The
24 requirement's designed to both encourage long-term contracts

1 for supply and encourage the development of more price-

1 responsive demand.

2 In summary, I think when you look at the NOPR,
3 you observe a couple of key points. One is that it's more
4 of a restructuring or a different type of regulation. It's
5 not deregulation. And in this sense, as a former gas
6 person, it's very similar to what the Commission did with
7 Order Number 636 wherein trying to set up market rules that
8 worked for customers and worked for a stable market that
9 everyone comes out better and the objective is to try and do
10 something very similar on the electric side.

11 And that concludes my presentation.

12 COMMISSIONER BREATHITT: Well, it's been a long,
13 arduous month, and I'm glad today has finally arrived. I am
14 attaching a separate statement to the NOPR which is a bit
15 unusual, but the reason I'm doing that is because quite
16 frankly I may not be here when the final rule issues, and I
17 wanted to point out the things that I would have pointed out
18 in the final rule today. It's just uncertain whether I'll
19 be here for that or not. So I wanted to take this
20 opportunity to do that and I will try not to be too
21 repetitive for some of the sections that Alice just spoke
22 about.

23 First of all, I do have to say thank you to all
24 of the team. My staff did an incredible job on this

1 document. All three of them were involved from the get-go,

1 and without their help in parsing out all the sections, I
2 don't know if my office could have been ready today, quite
3 frankly.

4 Also, Chairman Wood, without your feet-to-the-
5 fire from the day you got here, I don't think we would have
6 seen this deadline actually realized, so you set forth a
7 vision and a time line and we all helped you get there but
8 it was your leadership that got us to today.

9 And Bill and Nora, your offices provided terrific
10 input on many of the sections that will be reflected in
11 today's NOPR, so thank you for all of your staff's hard work
12 and yours as well.

13 I mentioned why I'm writing separately today,
14 which is a little unusual but you know why. There is much
15 to like about this roughly 600-page document. Many of the
16 NOPR's features have been welcomed and embraced by various
17 entities, associations, company representatives, and
18 academics, through the outreach that has been going on that
19 Alice talked about, the white papers, the RTO week, etc.

20 Just as many participants have cautioned us to
21 make sure the procedures and the protocols and the standards
22 that we wish to impose on the industry we regulate are
23 practical in implementation, fair to consumers and
24 respectful of state jurisdiction. They have also asked us

1 to recognize that not all regions of the country are the

1 same or have the same historical ways of providing
2 electricity to retail and wholesale customers.

3 For example, the way the Northeast has evolved
4 with their power pools is vastly different from how the
5 Southeast and the Southwest has traded bulk power. The
6 Northwest has a heavy reliance on hydroelectric generated
7 power. Even with these differences, all the regions have
8 provided reliable and steady service, especially in times of
9 extreme weather conditions.

10 People are going to be pouring over this NOPR to
11 see if it is practical and if it's doable. During October,
12 SMD or RTO Week, we were advised to keep it simple. I
13 believe Professor Hogan particularly cautioned us to keep it
14 simple.

15 However, this is a very comprehensive proposal
16 and it's complicated. But I believe that over time, it will
17 result in a very sophisticated market. People are just
18 going to need time to understand its complexities and
19 implement its many features. And I think the Commission is
20 going to need patience and flexibility. I cannot stress
21 this enough, patience and flexibility. We have the road map
22 before us but I think we're going to need patience and
23 flexibility.

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1 In Order 2000 we paired a voluntary rule with
2 very tight compliance deadlines that I believe we all knew
3 at the time would be difficult to meet, and that has proven
4 to be true.

5 Today's rule pairs many complicated, mandatory
6 requirements with short implementation timeframes. And I
7 know there's a reason to put in timeframes, and I think we
8 should, but, for example, locational marginal pricing and
9 the energy and ancillary services markets required to be run
10 by the new independent transmission providers -- we're using
11 a new term in this NOPR, ITPs -- have not been proven
12 outside of the Northeastern-type power pools.

13 Also, allocation of initial congestion revenue
14 rights will be complicated, if not problematic, for some
15 areas of the country. But I am pleased that today's order
16 recognizes that not all areas of the country will be able to
17 move ahead with all requirements of standard market design
18 at lightening speed.

19 The Commission intends to be flexible in some
20 compliance states, and while it is the objective to have
21 standard market design in place within two years of the
22 effective date of the final rule, the Commission will
23 consider requests to extend that date, upon a showing.

24 The fundamental goal of SMD requirements, in

1 conjunction with the standardized transmission service --

1 and this is taken from the proposal -- is to create seamless
2 wholesale power markets that allow sellers to transact
3 easily across transmission grid boundaries.

4 I think that was your mantra when you came here.
5 In fact, you probably wrote this sentence.

6 Once the final rule is in place and implemented,
7 it is my hope that the squabbling on which entities belong
8 in which RTO will end, and we should be able to put our
9 Magic Markers away for good.

10 Today's NOPR puts forward a detailed vision of
11 the roles that these new ITPs, independent transmission
12 providers -- this Commission and the states will play in
13 planning for expansion of the transmission grid. I am
14 pleased that the Governors have requested a significant role
15 in transmission planning through the formation of multi-
16 state entities that Alice talked about in her presentation.

17 I'm also pleased that we propose to give MSEs a
18 role in both overseeing the plans developed by the ITPs, and
19 in developing a fair pricing methodology for these
20 expansions. I feel very positive about the bottom-up
21 approach that is described in the Planning section of this
22 NOPR.

23 This approach allows merchant transmission
24 companies and utilities, as well as generators and demand

1 resources to bring economic solutions to the table to solve

1 the problems of under-built infrastructure.

2 These projects must be vetted by the ITP to
3 determine their impact on the grid in terms of loop flows
4 and other regional impacts, but the real test will be the
5 demand for the projects, such as we see in gas pipeline
6 certificates. That's how I'll look at it, anyway.

7 I do have concerns about the planning protocols
8 that would be enacted by the ITP, once it is determined that
9 economic projects cannot fulfill all the reliability
10 requirements of the grid. My concern is that this central
11 planning aspect may direct projects that are uneconomic,
12 with costs socialized to all users of the grid.

13 It's pretty hard to imagine right now, gold-
14 plating of the transmission grid, when we're in such an era
15 of under-built infrastructure, but I believe that once we
16 get the incentives right for building needed infrastructure,
17 there won't be such a need for the ITP to direct the
18 construction of possibly uneconomic infrastructure.

19 Getting the incentives right in grid expansion
20 has been on my Top Ten List through this NOPR process and in
21 my tenure here at the Commission. I am pleased that the
22 NOPR proposes to adopt a form of participant funding, once
23 independent transmission entities are in place.

24 I'm also pleased that we're willing to consider

1 proposals submitted by the regional state advisory

1 committees -- also, that was in Alice's presentation -- for
2 participant funding prior to nationwide adoption.

3 The Order gives a push to state and regional
4 entities that already have significant momentum, and I hope
5 to see the fruit of the regional/state groups' efforts in
6 the form of actionable plans for cost allocation of expanded
7 transmission.

8 However, if these groups have difficulty getting
9 organized and implemented, there is a default mechanism that
10 would allocate the costs of expanded transmission, locally,
11 if the facilities are below 138 kv, and regionally, if the
12 facilities are above 138 kv, and these facilities would be
13 socialized.

14 So I urge the parties, especially the states, to
15 carefully read this section of the NOPR and comment on this.
16 I still have some uncertainty on whether we reached the
17 right balance here.

18 I have come from a pretty big reliance on
19 participant funding, and have moved some in the other
20 direction for certain projects, as some of my colleagues
21 have moved the other way. And what we were trying to do is
22 find a balance here that's workable. So I hope that we
23 have, but read that section.

24 There is a lot to like for the states in this

1 proposal. I think they're going to play a very important

1 role in developing the resource adequacy standards in
2 transmission expansion pricing methods. They've asked for a
3 role for almost as long as I have been here at FERC. They
4 have asked us to give them a role in reliability.

5 And I believe this section of the NOPR does that.
6 We give deference to areas, also when talking about things
7 that states should care about, to areas that are not as far
8 along in standardizing markets, allowing states to manage
9 the pace of the required changes. That's in the
10 Implementation section of the NOPR.

11 And finally, the proposed rule, while it asserts
12 jurisdiction over native load, it does not abrogate either
13 actual or implicit contracts. And I'm not so Pollyanna as
14 to believe that everyone is going to be jumping with joy
15 over our assertion of jurisdiction over native load.

16 You know, that question was settled last year by
17 the Supreme Court. In fact, the issue, even though it was
18 settled, is likely to be a big bone of contention.

19 But take a look at the rule, I'm saying to the
20 states. I think that you will find that it tries to be
21 balanced and to allow significant -- allows you quite
22 significant say in determining outcomes.

23 Another area that I focused on this process is
24 cost shifts. I agree that embedded cost charges for will-

1 through and export transactions should be eliminated or

1 minimized, while at the same time, assuring recovery of the
2 transmission owners' revenue requirement.

3 My concern with respect to cost shifts resulting
4 from this removal of inter-regional rates is twofold:
5 First, I fear that areas with low-cost energy, such as in my
6 home state of Kentucky, will see resources flow to high-cost
7 areas located several states or regions away.

8 Now, that, in and of itself, is a good thing.
9 You want low-cost power to move around. But it is a
10 mathematical fact that when costs are averaged, that
11 someone's costs go up. So this particular concern has been
12 alleviated in the proposal by the ability for those in low-
13 cost areas to lock up their low-cost power preferences or
14 resources with long-term contracts, and it notes that these
15 transactions, which will flow over greater distances, now
16 that they no longer have the fixed costs of the transmission
17 system, will be subject to marginal losses as opposed to
18 average losses, and congestion charges that should be
19 credited back to the area where the power is originating. I
20 mean, I got a little technical there, but that was an
21 important part of the proposal to me.

22 My second concern with cost shifts relates to the
23 determination of how these costs will be apportioned among
24 different types of customers. Even if the costs are

1 allocated to import zones instead of to each independent

1 transmission provider, one customer in the zone that relies
2 solely on generation within the zone could subsidize a
3 customer that imports all of its requirements.

4 This is due to the fact that embedded costs for
5 imports would be spread across all load within the zone. My
6 hope is that parties will come in on these and the other
7 cost shifts, giving us concrete examples of the kind and
8 level of shifts that may occur. So that's another section
9 I'm recommending some heavy reading on.

10 I'm about finished. I believe that one of the
11 fundamental underpinnings of this rule is to give equal
12 access to the transmission grid to all, and I support that
13 notion. However, I recognize that giving equal access will
14 be based on each party's willingness to pay.

15 This means that the price certainty that we gave
16 through Order 888 will disappear, but this does not mean
17 that all price certainty will disappear, because SMD
18 provides mechanisms for customers to use to hedge the
19 volatility in transmission markets and in real-time markets.

20 My concern is that both small players and less
21 sophisticated players will have increased transaction costs
22 and steep learning curves in finding their way through these
23 markets and in hedging these high prices. And that's where
24 my patience and flexibility might need to come in.

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Also, I wanted to point out that we are, for the

1 first time, defining market power on the electric side. And
2 we consulted several textbooks in trying to make sure that
3 we came up with a definition that is used in certain
4 economic circles. I think, Dave, you helped us research
5 that, and, Kevin, you did, too.

6 We have defined market power for the first time
7 in an electric order and NOPR says that it's the ability to
8 raise price above the competitive level. And we caveat that
9 definition by stating that the determination of when to
10 intervene in a market, i.e., when the price is significantly
11 raised for a sustained period, will be incorporated into our
12 triggers for intervention, rather than the definition.

13 So I am not positive that we have the definition
14 exactly as every economist would like. I'm not certain as a
15 non-economist, if it's a definition that I would have
16 written into this rule, but economists have admonished us in
17 the past year for not having defined it, so we're doing so
18 today, and I hope that parties will let us know if they
19 think we have used the right definition.

20 On the three-pronged mitigations, I'm just going
21 to say that Alice went over those adequately, and I support
22 those wholeheartedly. I would also like to say, though,
23 that with the stringent new mitigation measures in place,
24 the Commission should reassess its reliance on the supply

1 margin assessment test, and study the need for the 206

1 refund obligation. That would be something to be done down
2 the road, but with these three prongs in place, and the
3 automated mitigation procedures as a voluntary measure that
4 could be used upon very critical or crisis situations, that
5 we may not need that kind of a test anymore, and we may not
6 need the 206 refund obligation, which is fraught with
7 uncertainty.

8 And last, but definitely not least, I am pleased
9 that today's proposed rule keeps the same provisions for
10 reciprocity as that of the OATT. Entities that already have
11 waivers of the reciprocity provision will not have to come
12 in again and request additional waiver from the SMD
13 provisions.

14 Today's proposed rule also would allow reciprocal
15 888 tariffs to be grandfathered and require no further
16 changes to those tariffs to meet the new SMD requirements.
17 This provides necessary relief to small transmission owners,
18 including municipalities and cooperatives.

19 I would like to just mention very briefly that
20 the Governance Section in the NOPR is very similar to what
21 we said on governance in the California Order at our last
22 meeting. I have some concern that we might be getting too
23 prescriptive with exactly how the stakeholder committees
24 have to be designed and how they would work, and exactly

1 being so prescriptive on how boards have to be picked.

1 It's probably -- there's probably a balance that
2 can be struck there, but I think we might be getting a
3 little too prescriptive in that area.

4 And, lastly, I urge my colleagues to carefully
5 consider the comments and not be shy about considering
6 changes to the proposal. As I stated earlier, it's 600
7 pages; it has multiple appendices. It has a new tariff; it
8 has reg text, and we ask over 75 questions, and at one
9 count, my staff said it might have been 100 questions.

10 So that indicates that we still need the
11 industry's and the public's advice on a number of issues, so
12 I urge my colleagues to not be shy and reticent about
13 considering changes to the proposal. Once the final rule
14 issues, it's somewhat common practice that there aren't a
15 whole lot of changes when the Commission issues a proposal
16 and when the final rule gets issued, but this may be one
17 area where we will need to do some tweaks and some changes,
18 because we ask so many questions and there are so many
19 important, complicated, and comprehensive sections to the
20 NOPR.

21 So, with that, I have said what I want to say,
22 and I will turn it over to my colleagues. Thank you for
23 being patient.

24 CHAIRMAN WOOD: Thanks, Linda.

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COMMISSIONER BROWNELL: Thanks, Linda. That was

1 actually a great summary. I can't believe you actually
2 remembered all of that, in that we were drafting, I think,
3 up until about an hour ago. And to the team, I can't even
4 believe you're still standing, much less explaining this to
5 all of us.

6 We are enormously grateful for the efforts of
7 those at the table and others who showed a remarkable
8 tolerance for the many times we asked questions, and, in
9 fact, changed our minds. I think that if we did anything,
10 Linda, we proved this week we can change our minds a lot on
11 the 11th floor. So I have every confidence that that will
12 continue.

13 I think this was an exhaustive and very much a
14 front-loaded process where we had the input of people who
15 have to live by these rules. And I expect that they will
16 find that in this NOPR they will see, as you said, Alice, a
17 lot of what they have recommended. And we will certainly be
18 guided by the comments that we get from them.

19 I am most excited about this because -- for many
20 reasons. It's a well-balanced integrated set of design
21 rules. It's clear; it's fair. It brings equity where
22 there, in fact, has been none. But most importantly -- and
23 I think we all need to keep this in mind as we move forward
24 in the process, it brings certainty, certainty for

1 customers, certainty for investors, and certainty for the

1 market participants.

2 And a lot of people in the last month or so have
3 raised the question, why are we doing this now? We have
4 heard, I think, from almost every participant in the market,
5 whether it be financial or actually in the business, to say,
6 please, we are desperately in need of this; we need the
7 vision for the future; we need to understand how the rules
8 are going to work; we need the basis on which to make
9 investment decisions, and for customers who say we don't
10 need any more surprises in our marketplace.

11 So I would say that for those who suggest that we
12 sit back and wait, I think that we've seen what happens when
13 we lack a set of balanced business rules, and I don't think
14 we want to go there again.

15 So I think it creates certainty; I think it adds
16 value and protection for customers. I think it eliminates
17 the opportunity for discrimination and gaming. It
18 acknowledges regional differences in a meaningful way, but I
19 think recognizes that to allow significant differences with
20 no real basis, simply perpetuates the opportunities for
21 gaming.

22 I think it creates more options for transmission
23 customers. It respects native load, but does not allow it
24 to be used for discrimination.

1

It encourages innovation; it brings new

1 technologies into the market, and I think the demand side,
2 while I think it probably needs more development, will be
3 critically important going forward.

4 I believe it sends the right price signals. I
5 think there are still questions to be answered there, but I
6 think we have begun to send the right signals, so that we
7 can get that desperately-needed investment, not only in
8 transmission and generation, but in the new technologies
9 that could address many of the environmental issues, Alice,
10 that you mentioned.

11 I think it respects existing contracts and allows
12 for a transition plan, so that, indeed, it is less
13 disruptive than I think people might have feared. So I
14 think we've done an extraordinary job, or the Staff has done
15 an extraordinary job in accepting the input from a lot of
16 smart people to develop a plan that I think is eminently
17 workable.

18 And I would simply also ask that -- there will be
19 a resistance to dive into one small piece and say I hate it,
20 therefore, I hate the whole thing. I think we have to step
21 back, and I think we have to say this reflects the realities
22 of today's marketplace; it also reflects the opportunities
23 of today's marketplace, opportunities that we've seen
24 developed in England and New Zealand and in other markets,

1 and opportunities that we have not taken advantage of.

1 So I hope that we can work collectively to
2 respond to concerns, to differences of opinion, and emerge
3 sometime late Fall or early in January with a rule that
4 really moves us forward into this century.

5 And I just have a couple of questions, if I could
6 ask them now, or do you want me to wait?

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1 You've talked about eliminating discriminatory
2 practices, and I think you've done a very good job of
3 addressing those. Could you expand a little bit, however, on
4 exactly what those are? I think people will tend to think
5 of the Enron gaming strategies which you should also
6 address. But I think we found a great number of
7 discriminatory practices. And then maybe talk about how
8 we're going to deal with those.

9 MS. FERNANDEZ: In terms of the discriminatory
10 practices, there's a very long section or actually two
11 fairly long sections in the NOPR called The Need for Reform,
12 and I think it's Appendix C, that goes into various ways
13 where much of it revolves around the difference between how
14 network customers and transmission owners that have native
15 load can use the transmission system versus those who are
16 mainly the new entrants who are using point-to-point
17 contracts, and various ways where transmission owners can
18 sort of use those differences to favor their own generation
19 and making competitive sales.

20 There also is a long discussion of problems that
21 the Commission has encountered, for example, with having a
22 sufficient available transmission capacity. Postings, I'm
23 trying to think of some of the other ones, Mark, do you
24 remember that we mention in there? I think they get into a

1 discussion of parking and hubbing, the differences in

1 curtailment rights for native load versus wholesale
2 customers.

3 MR. HEGERLE: Set asides for CBM as well.

4 MS. FERNANDEZ: Set asides. So I mean, it goes
5 through a fairly long litany of ways where certain customers
6 are treated differently than others, and that does confer
7 commercial advantages on those, many of whom are
8 transmission owners with their own or affiliate generation.

9 Also the need for reform section and Appendix C
10 also discusses various market design flaws that have been
11 encountered. And we also have Appendix E, sort of
12 coincidentally Appendix E for Enron, that discusses the Enron
13 trading strategies and also various other market manipulation
14 gaming-type strategies that have been encountered in the
15 eastern ISOs and how we've tried to learn from that
16 experience and incorporate those into the various market
17 rules.

18 COMMISSIONER BROWNELL: Tell me how, if you will,
19 these will be incorporated. There has to be an interim
20 tariff I think filing to deal with that?

21 MS. FERNANDEZ: I'm sorry. Yes. The NOPR
22 proposes that, and I think we changed the dates this
23 morning, July 31st, 2003, that all public utilities that own,
24 control or operate transmission facilities would have to come

1 in and file a new interim tariff, and that basically takes

1 out most of the sort of preferences for native load and
2 would put transmission service for bundled retail customers
3 on the open access tariff. And it's basically the open
4 access tariff that was issued in Order Number 888. And that
5 would go into effect no later than September 30th, 2003.

6 And then there's a later process for compliance
7 with the full Standard Market Design.

8 COMMISSIONER BROWNELL: Because native load has
9 been such an issue, though, I think we have in fact included
10 ways in which that native load can be protected. We're not
11 putting that native load or that inexpensive hydro or the
12 opportunities in Linda's home state of Kentucky at risk. Is
13 that correct?

14 MS. FERNANDEZ: Yes. We've tried to put in
15 protections for it so that existing customers, whether they
16 be customers with existing contracts or customers, native
17 load customers, that ways where they will basically get the
18 same quality and quantity of service under the Standard
19 Market Design tariff.

20 We basically also allowed a lot of flexibility in
21 the NOPR in terms of the various regions as to how they
22 would actually implement the conversion process and come up
23 with transition measures.

24 And while there are market rules, the NOPR also

1 recognizes that there are special issues for hydroelectric

1 resources and notes various ways that differences that could
2 be done, special things that might be needed for those type
3 of areas.

4 And Staff has also had some discussions about
5 trying even to come up with different types of financial or
6 congestion revenue rights for hydroelectric type of systems
7 that would better suit their needs.

8 COMMISSIONER BROWNELL: Could you actually --
9 that brought me to my next question. could you describe,
10 particularly since we changed the name I guess, CRRs, how
11 they work, how we're assured that, for example, new entrants
12 can access the CRRs that they need in order to fully
13 participate in the market?

14 MR. MEADE: Let me take a stab at that. As Alice
15 mentioned earlier, CRRs are Congestion Revenue Rights. They
16 are financial transmission rights in our earlier staff
17 papers earlier this year and last year where I think we
18 referred to them as financial transmission rights or FTRs.
19 They are rights that come along with the LMP system of
20 congestion management and energy pricing that allow the
21 holder of these rights a stream of congestion revenues.

22 So the basic idea is that in the day ahead and
23 real time markets, people who want transmission service will
24 be paying congestion charges whenever there's congestion.

1 But anyone who holds one of these Congestion Revenue Rights,

1 CRRs, would be able to receive the congestion revenues back
2 so they in essence protect those customers from variable
3 congestion charges and basically lock in a long-term price
4 for transmission service.

5 How do they get allocated? Our intention was to,
6 as much as possible, preserve the existing rights that
7 existing customers have, whether they're network customers
8 or point-to-point customers or customers who are providing
9 bundled retail service to their native load.

10 The NOPR provides sort of a two-stage process.
11 Initially, there's really a choice between what we call
12 direct allocation or allocating the rights by auction. I
13 would expect probably most of the time in this initial
14 phase, customers would be allocated Congestion Revenue
15 Rights directly that are very similar to the types of
16 transmission rights that they currently have under network
17 and point-to-point service.

18 Then after an initial phase, we propose that all
19 CRRs be allocated through an auction mechanism. And of
20 course this auction mechanism will generate revenues to the
21 extent people are buying them, there's a pot of money. And
22 the revenues that are generated from this auction would be
23 allocated back to the entities that are paying the embedded
24 cost charges, access charges that recover the fixed costs of

1 the transmission system.

1 So the idea is that people who initially were
2 directly allocated CRRs, and they were directly allocated
3 them largely because they were paying embedded cost charges,
4 these access charges, that in the second stage they would be
5 entitled to the congestion revenue -- to the revenue from
6 the auction that's generated from the sale of these rights,
7 in such a way that if they hoped to continue holding the
8 CRRs that they would be financial;y able to bid enough
9 money to retain them, becuawse whatever they paid in the
10 auction, they would get back through the allocation of the
11 auction revenues.

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1 COMMISSIONER MASSEY: So it is sort of a plug-
2 and-play system for generators.

3 MR. HEGERLE: I would only add to that that our
4 anticipation is that the load would be taking the service,
5 the network access service. So as you say, generators would
6 just fill in as what we call now network resources under the
7 current tariff to serve the load. They wouldn't even need a
8 transmission contract at all.

9 MS. FERNANDEZ: So it does give them the
10 opportunity. I mean while the contracts are set up so that
11 it's anticipated that the load would be the one ultimately
12 taking the delivery and paying the access charge. The
13 tariff is also set up to allow for hub-to-hub transactions
14 which are the type that someone like a generator or marketer
15 might be interested in doing, and those would be performed
16 under the same operating schedule.

17 COMMISSIONER MASSEY: Now this would be similar
18 to the kind of system that exists now in PJM or New York
19 ISO?

20 MR. HEGERLE: Exactly.

21 MS. FERNANDEZ: Yes.

22 COMMISSIONER MASSEY: So we know it works. Okay.
23 Thank you for very clear answers to those questions.

24 Well, today a unanimous Commission, Republicans

1 and Democrats, literally shouts from the roof tops. No more

1 California-type market meltdowns. No more runaway markets.
2 No more bad market rules. No more confusing and conflicting
3 rules for fair access to the grid. Why now and why this?

4 Because we simply aren't doing our jobs if we
5 allow the existing national helter skelter in market rules
6 and transmission access to continue. The risk of inaction
7 is simply too high. It is my view that the very future of
8 competitive markets for electricity hangs in the balance.
9 That status quo is not in the public interest.

10 A sharp change is necessary. And today we
11 propose such a change and we base it upon not just our whims
12 but the best and the brightest recommendations that we could
13 glean from months of discussions with market participants,
14 the industry itself, from a variety of academics and
15 thoughtful consultants who've been involved with electricity
16 restructuring around the world for years.

17 This proposal is long overdue. It is a natural
18 progression from Order 888, which was issued in 1996, Order
19 2000 issued in the year 2000, and here we are in the year
20 2002. And I might add, as Pat calls me the "Old Man" of the
21 Commissioners, I was here for all of those votes, but I'm
22 not an old man.

23 (Laughter.)

24 COMMISSIONER MASSEY: As you all know, of course.

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(Laughter.)

1 COMMISSIONER MASSEY: We propose mandatory common
2 rules of the road for all wholesale electricity markets and
3 for our nation's electric transmission system. We are
4 committed to a market-based approach for wholesale
5 electricity, but we realize that no region of the nation
6 should ever again have to tolerate an economic catastrophe
7 that arises from poor market rules, no market rules,
8 inadequate infrastructure, which leads to shortages, market
9 abuses, soaring energy prices, entire factories closing down
10 because they can't pay their electricity bills, and an
11 absolute crisis in confidence in electricity markets.

12 A tsunami that is still rolling over all of us in
13 this room even today. Today this Agency insists that
14 electricity markets have in place a sufficient
15 infrastructure of transmission, generation, demand
16 resources, to ensure reliability and to dampen price
17 volatility.

18 We propose a reserve margin floor, as has been
19 pointed out, for each region of at least 12 percent,
20 although the region could adopt a higher standard. We
21 insist that there is a single set of rules for the nation's
22 transmission grid. Whether you're delivering power in
23 California or Arkansas or Maine, you get the same access to
24 the interstate highway. As Mr. Meade points out, plug-and-

1 play access.

1 Everyone will drive on the right side of the
2 road, everyone will wear their shoulder harnesses, everyone
3 will obey the speed limit. We will insist on spot markets
4 organized around the concept of locational marginal pricing
5 that has worked so successfully in the PJM market and the
6 New York markets, markets that are efficient where if you
7 cause congestion you pay the freight and if you relieve
8 congestion you are rewarded with highly valuable congestion
9 revenue rights.

10 These are market rules that are highly unlikely
11 to be gamed. It is unlikely that bidding strategies such as
12 Fat Boy or Ricochet will work in a well-monitored,
13 transparent spot market that clears through a bid-based
14 security constrained dispatch.

15 We insist upon well understood off-the-shelf
16 market power mitigation tools that operate up front before
17 the bids are accepted and finalized. We propose that each
18 regional market monitor unit consider implementing the
19 automated mitigation plant or AMP similar to that that is
20 now in place in New York, and which we have recently ordered
21 to be implemented in California.

22 It is voluntary but it is a tool that will be
23 available to them. These programs mitigate prices above
24 certain thresholds, thresholds that are well-known, vetted

1 in advance, and on the shelf. We recently, as I said,

1 implemented such a plan for the California market.

2 For the first time, this Commission will insist
3 that every transmission provider, as a matter of Commission
4 rule, operate its transmission system independently of
5 merchant interest. The transmission owner must hire an
6 independent transmission provider such as an RTO that has an
7 independent board of directors, and no affiliation with
8 market participants.

9 We require a very thorough on-going and very
10 efficient regional planning process. It will be conducted
11 by the RTO with the cooperation of regional state advisory
12 committees and they will have a key role in the planning
13 process. This process must treat all potential market
14 responses whether transmission, generation, or demand
15 resources, fairly and equitably and without discrimination.
16 We're insisting that each market have in place on the ground
17 an independent and aggressive market monitoring unit that
18 reports often and directly to this Commission working hand-
19 in-hand with our own in-house market monitoring unit that is
20 run by Bill Hederman, who is here at the table, as an early
21 warning device for possible problems and market power
22 abuses.

23 This is obviously a thorough and comprehensive
24 proposal with a number of features that I believe hang

1 together very well. It's my view that it is make-or-break

1 time for wholesale electricity markets. We need to restore
2 public confidence in those markets. Investors need
3 confidence and certainty that the market structure that we
4 propose today will endure, that it won't be changed every
5 year, that infrastructure investments will be rewarded,
6 market participants, large and small, need confidence in the
7 fairness of market operation and grid access, and we provide
8 that once and for all.

9 Policymakers, lawmakers and consumers need
10 confidence that this Agency will protect consumers from
11 market abuses and that the rules will be obeyed, that
12 markets will produce just and reasonable prices. I think
13 today we provide all of these assurances to investors, to
14 market participants, to lawmakers, and to consumers.

15 So this proposed rule has my full support. I
16 have nits or gnats here or there, but I am championing this
17 so aggressively that I do not want to point them out today.
18 I thank Chairman Wood for his strong leadership. He took
19 this up almost immediately after becoming Chairman of this
20 Agency. I thank my fellow Commissioners for their good
21 will, good ideas and for their insight and cooperation.

22 But I particularly want to thank our brilliant,
23 hardworking staff, some of whom are sitting here at the
24 table before us. As usual, they were energetic, thoroughly

1 professional. This is one of the most challenging and

1 perhaps the most complex rulemakings that the Commission has
2 proposed in recent memory. And it came together because of
3 the professionalism of our staff, and I thank you all very
4 much. And I thank you, Mr. Chairman, for bringing this
5 before us.

6 CHAIRMAN WOOD: Well, it's a group effort but
7 I'll take a one-handed applause after the stem-winding
8 southern Baptist, an old bad accented Texan who makes it
9 hard to come last. But what a joy it is. I want to build
10 on the last thought. I was down in the pre-agenda room a
11 couple times over the past couple days to just check in on
12 everybody and it did bring back a real sense of deja vu and
13 I saw Alice and Dave and Andrea and Marsha and a number of
14 others, that we all did this ten years ago in Order 636,
15 which I hope that this effort very strongly emulates, both
16 in the way it's put together and its reliance on good,
17 efficient markets to deliver value to customers, and
18 ultimately in its success.

19 I think, as I call it, the third book of the
20 electric trilogy, I hope that movie's as great as the one
21 that the gas trilogy produced because I go to that one again
22 and again and again, and am ready for it on DVD.

23 (Laughter.)

24 CHAIRMAN WOOD: Ten months ago, the Commission

1 adopted a strategic plan and I was pleased that my first

1 meeting as Chairman that we all put on there the things that
2 both the law required of us and that we as policymakers
3 wanted to accomplish in the coming years as a collective
4 agency, and I am so pleased to, you know, occasionally
5 review this document, more than often, several times a week.

6 But to look at just how much this single
7 enterprise, this document that's before us today to vote for
8 actually addresses on this list.

9 I think Alice pointed that out in your first
10 slide that I just want to encourage folks on the outside to
11 look at our web page, look at the strategic plan 2001 to
12 2005, which is titled "Making Markets Work" and look at how
13 much, particularly in Challenge two, which is to foster
14 nationwide competitive energy markets as a substitute for
15 traditional regulation, every single one of the eight
16 bullets under the two objectives there are accomplished
17 here.

18 Throughout Challenge One, our infrastructure
19 goal, there are many things that are addressed in this rule.
20 And throughout Challenge Three, Protection of Customers and
21 Market Participants Through Vigilant and Fair Oversight of
22 the Transitioning Energy Markets. There is so much and I
23 think my colleagues and the staff have laid out a lot of
24 that.

1

I want to say as a personal goal what I had hoped

1 for here as one who had just come from that not-fully-
2 jurisdictional wholesale electric power market in the
3 country. We had a little fun with that in pre-agenda folks,
4 but ERCOT, rest assured, your safe.

5 (Laughter.)

6 CHAIRMAN WOOD: As one who had come from that in
7 my prior job immediately before coming up here, I knew how
8 important it was to get the smartest, most pragmatic people
9 in the country, in a full country, to come and teach us and
10 engage with us at this table and at others about how best to
11 go to closure on wholesale power markets so that they work.

12 And I cannot, words don't really fill my mouth to
13 let me say how much that process meant to me, both as an
14 intellectual and professional exercise, but on a personal
15 level of just the joy of this job. And there are days when
16 there aren't a lot of joys. But this process had so many,
17 because there are so many bright people that spent a lot of
18 time educating me and ya'll and all of us, and I just want
19 to lay out what that particular process of listening and
20 learning did for me.

21 I walked in here with three pretty pig-headed
22 ideas on three very important prongs of this rule, I would
23 say certainly in the top ten parts of this rule are three
24 that I have substantially changed my opinion on based on

1 what I learned through the process that led to the

1 development of this proposed rule.

2 The first dealt with how to allocate and recover
3 transmission costs. Apart from the LMP and the congestion
4 issue, the underlying role of collection of the access
5 charges, certainly within a contained environment such as
6 ERCOT, was a whole lot easier to deal with than in one that
7 is multi-state and multi-NERC-regioned that we have in the
8 Eastern and Western Interconnections.

9 And I think that what came out of this rule, and
10 Linda probably laid it out as clear as anybody but it's
11 certainly an important part of this rule, and for that
12 reason it's put right up at the front, is that the
13 transmission cost allocation with an eventual evolution,
14 shorter in some time frames than others, to a participant
15 funding methodology, actually makes a lot of economic sense,
16 and was an important part of hanging this rule together with
17 the overall vision of how markets work.

18 I know we talked about this as recently as March
19 in the generation/interconnection NOPR when we put out
20 questions there, and I think those questions, quite frankly,
21 are largely answered in this proposed rule today, although
22 we will go through the formal process.

23 But I think what was so important to me was that,
24 as we've moved to a world where you are having truly

1 independent transmission operators/providers making

1 determinations about cost allocation and benefits and needs
2 and who gets the benefits of certain construction as opposed
3 to having a self-interested vertically integrated utility
4 making those decisions, it's a lot easier for me to move to
5 what actually makes good economic sense, which is what I
6 have been an advocate for although not perfectly for over my
7 career, which is that cost responsibility should follow cost
8 incurrence.

9 And I think the discussion of cost allocation,
10 both as a pragmatic recognition that we're not all the way
11 there yet in parts of the country but the end goal is
12 clearly one that we want to move to, and that end goal is
13 one that relies on a preference for market investments that
14 we used price signals and property rights as the incentives
15 for investment. That's how our pipelines were built, that's
16 how at least up until recently our generators on the power
17 side were built and have been built, and the need for an
18 additional regulatory tool, regulatory incentive to get that
19 built, other than clarify the rules, give us price signals,
20 give us property rights that we can trade.

21 I got off the Internet today a notice that a
22 company that I used to regulate in Texas is now joining with
23 a merchant transmission provider that we've dealt with here
24 recently before to provide investment capital for merchant

1 transmission, and this is one of the more conservative

1 investing companies I have ever dealt with in my career.
2 But it says a lot about the need for certainty that we have
3 already created with just our few orders in the U.S.
4 Northeast with regard to merchant transmission that that is
5 a viable and welcome and market-based investment
6 transmission alternative, and I'm thrilled that just the
7 minor steps we've taken on providing that kind of certainty
8 have created that viable market niche that I think will be a
9 big part of the scene in the years to come.

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1 When the market does not provide barriers to
2 entry, when the market has barriers to entry, when we have
3 externalities, we do have a transition period on the
4 transmission cost allocation methodology, and I think that
5 is realistic and appropriate and appreciate the external
6 parties who made sure that we knew that the PJM methodology
7 was not where everything else in the world was.

8 And so we have really looked here at the best
9 practices, not just of PJM and New York, because it was
10 actually a mixture of both. And there are a lot of things
11 about New York's more unbundled market that actually
12 informed the debate more than PJM's, but I think both of
13 those fine institutions deserve a lot of credit for being
14 the laboratory for what works.

15 But that's not the only laboratory. There are a
16 lot of others and they will be familiar to many as they read
17 the rule.

18 Why do the rule? Bill, I can't add a thing to
19 what you said. Nora, the imperatives you laid out as well
20 are so real. The leadership is needed now. It was needed
21 when FERC did it in '96, did a great step in 888, when FERC
22 recognized that behavioral remedies were not sufficient in
23 Order 2000, that behavioral remedies need to actually be
24 supplanted by structural remedies such as RTOs. I think

1 this is clearly the culmination of both of those. It's

1 details. Details matter.

2 It is a comprehensive document, but
3 interestingly, it's nine pages of double-spaced regulatory
4 text that we're doing here. It's the most potent nine pages
5 I think this agency has done, certainly as long as I've been
6 alive, and I think that the combination of the mere 10 pages
7 of regulatory text with the revised SMD tariff that it
8 references in substantial part really provide a lot of
9 leadership.

10 They also provide leadership internally for our
11 management of our agenda, the myriad issues that come forth
12 on the electric side. We now have a template of policy
13 decisions that the four of us are in large agreement upon,
14 shall allow us to give not only to the industry external
15 certainty but internally to allow us to manage the type of
16 things here that we do, and when we get puzzled with issues,
17 we do have a touchstone now to look at as this is what the
18 Commission feels we need to move for, and to have to kind of
19 do the nickel and diming policy again is an era I'm ready to
20 let go far behind, and where we deal only now with issues of
21 first impression, because a lot of this will have been
22 incorporated here.

23 A couple of issues that haven't been pointed out
24 by my colleagues. I would like to point out were the other

1 two things I should mention that I've changed my mind on are

1 the LMP as I think all of us in Texas were going, it's too
2 complicated. It's too hard. At the end of the day, it's
3 also too wrong not to do it. When you've got congestion
4 costs that are billed to people who had nothing to do with
5 causing that congestion, you create a lot of opportunities
6 for gaming and exactly one year ago today that the ERCOT
7 market cut over to a single control area, and promptly
8 created much congestion that was socialized across the
9 entire state by a few companies, and now the PUCs down there
10 trying to get the money back. That sounds familiar.

11 Yes, there is a better way to do congestion.
12 Unfortunately, I don't have a list of five to pick from. We
13 got LMP. I think LMP has a proven track record. I am a
14 late comer to it, and I just carried my baggage with me.
15 But I think quite frankly as I've stated in a couple of
16 speeches recently, LMP makes economic sense. I'm not an
17 economist, but I do read, and I do think, and I do cogitate
18 and I do listen to people. And I think that LMP is clearly
19 the appropriate approach to take. I think those who are
20 looking to simplify will also look to create opportunities
21 for further manipulation. And I think we've got to just
22 recognize that the transmission of a basically nonstorable,
23 vitally important commodity to our nation's economy is not
24 going to be able to be dumbed down.

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We've got to recognize that there is a certain

1 level of complexity and maturity that we have to appreciate,
2 and the LMP market is a very I think tested attempt to try
3 to map the realities of the market with a business model
4 that works.

5 And finally, the other one of the big ten issues
6 that I changed my mind on from where it was a year ago to
7 walking in the door is the resource adequacy requirement. I
8 think coming from a retail competition state, I do and I
9 think, Nora, you and I share this view, this if mishandled
10 is both an opportunity for market power abuse, as we have
11 already seen, and also as a tax on retailers who are trying
12 to break into markets that are operating under price caps.

13 The creators of the price caps didn't take into
14 effect that oh my gosh, we do have to buy a 12 percent
15 insurance policy. But I think as a practical matter, we've
16 got to work through that with the state regulators as far as
17 the price caps are concerned and the impediments to
18 retailers coming into the market.

19 But it's so important to make sure that in this
20 market where you've got so much public interest in what
21 we're doing that we do have the plan ahead requirement. And
22 it's very flexible, and I think very recognizing of multiple
23 ways to address resource adequacy other than just building
24 hardware and putting it on the ground.

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I think that environment for the demand side and

1 for contribution by customers as to reducing their loads is
2 something that I felt very strongly about in my last job,
3 and I'm so glad to see it permeate this document, the
4 importance of having demand-side response be co-equal with
5 supply-side response.

6 Finally, and that's the three I've changed my
7 mind on, and the rest I'm just as pig-headed as I was when I
8 walked in here. And the most important of which is one that
9 is critical, and that is a single tariff. It is hard to
10 have an equal economic society if you have separate and
11 disparate treatments. And I do think that, with all due
12 respect to the authors of 888, that was probably the one
13 item that slowed down this transition substantially. And I
14 think it's appropriate to fix it here.

15 I think as Linda pointed out and as Alice pointed
16 out, as far as state issues are concerned, I think you got a
17 lot more than you gave. If I were a state commissioner and
18 I saw my ability now to be part of my -- with my multiple
19 states that I share borders with, to do the resource
20 adequacy, to do transmission planning, to do rate design and
21 revenue requirements, to do market power mitigation, market
22 monitoring oversight with this Commission, to create an
23 institute regionwide demand response and load management
24 programs, to institute distributed generation and

1 interconnection policies across entire regions, and to

1 continue to engage in energy efficiency and environmental
2 issues which always, always do not recognize state
3 boundaries, and importantly, to watch with us and to oversee
4 the cost and management of the RTOs so that they can
5 continue to deliver good bang for the buck, I think that is,
6 were I a state commissioner interested in making wholesale
7 markets work for the benefit of my retail customers, I would
8 see this extended hand from FERC as one I would gladly
9 shake.

10 And I am pleased at the level of trust that my
11 colleagues and I developed over the last year with our
12 colleagues at the states to continue to be able to work in
13 this coordinated way with them.

14 One discrete issue that is important is the
15 allocation of transmission rights or congestion revenue
16 rights, as we call it. And a key step in that is cataloging
17 how much transmission there is in the first place.

18 I am a strong fan of allocating those rights to
19 existing customers, much as was laid out by Alice. I think
20 we found on gas that independent operation of these or
21 nonaffiliated operation of these network institutions really
22 in fact unlocks a lot of capacity that we didn't know was
23 there. And I think this order specifically addresses a
24 number of those in specific.

1

But the overall structure of having somebody

1 who's independently operating a transmission grid, we will
2 discover I think without exception across the country that
3 there is in fact more transmission there to be allocated and
4 distributed than if it were operated by an affiliated party.
5 And I will let the record stand open on that to be persuaded
6 otherwise, but I do think that in the initial allocation of
7 rights, those who favor strongly the auction mechanism
8 should be more comforted by the fact, as was a gentleman out
9 in RTO West when I visited there last month, that in fact
10 opening up the grid and putting it under independent control
11 opens up and creates a lot of excess capacity, particularly
12 in certain parts of the country where it's been managed and
13 administered in a different manner.

14 So in this most public process of any of FERC's
15 major rules in a long, long time, I am pleased and look
16 forward to our further outreach to the states, to the
17 industry, through the NOPR process. Linda, take your advise
18 wisely that keep an open mind. Been doing that for a long
19 time and I think we've got a good record of how that ought
20 to work.

21 I would say, Nora, I did hear you say one thing
22 about slates on governance. Is that in the rule?

23 COMMISSIONER BROWNELL: I don't think it made it
24 into the final draft, and I was suggesting that if it didn't

1 we add the question.

1 CHAIRMAN WOOD: I found the question. You found
2 the question?

3 COMMISSIONER BREATHITT: I didn't really like the
4 question. I thought we had put the order to bed, quite
5 frankly. If we're opening it back up, I have a laundry list
6 of things that I'd like to add.

7 CHAIRMAN WOOD: Well, let me ask another one.
8 You have indicated marginal losses where the standard, on
9 paragraph 271, though, it says average losses per megawatt
10 mile. Where are we on that?

11 MS. FERNANDEZ: It's marginal losses is how it's
12 drafted. I think it was one area where we flipped back and
13 forth.

14 CHAIRMAN WOOD: So the tariff says marginal?

15 MS. FERNANDEZ: Yes.

16 CHAIRMAN WOOD: So we're going to have the
17 preamble conform to that?

18 MS. FERNANDEZ: Yes.

19 CHAIRMAN WOOD: Okay.

20 MS. FERNANDEZ: Yes.

21 CHAIRMAN WOOD: All right. Well, I think we
22 should probably ask a question on slates of governance. I
23 think that clearly is the way I certainly heard from the New
24 England parties that that was an issue, and I had actually

1 suggested to the pre-agenda folks to put that in there, but

1 I guess there weren't three votes for that.

2 That's probably broad enough to let people ask
3 that question, to let people suggest that alternative.

4 Bill, did you?

5 COMMISSIONER MASSEY: Well, it depends on whether
6 you want to open it up. My view is anyone who wants to ask
7 a question gets to ask it in a NOPR.

8 CHAIRMAN WOOD: Okay. Linda?

9 COMMISSIONER BREATHITT: Just the general, my
10 general malaise or discontent over all the specificity and
11 all the prescriptiveness of this governance section section.

12 And I don't know if FERC is the best entity to be
13 saying what sectors people can sit on and how the
14 stakeholder boards should be made up and exactly how -- it's
15 just a general discomfort with who prescriptive we have
16 suddenly become in this whole area. Nobody tells other
17 entities -- I've been on a lot of not-for-profit boards, and
18 I've never encountered that level of prescription. So I
19 just didn't see the need for it. But if we want to open the
20 rule back up to add it.

21 CHAIRMAN WOOD: We ain't voted till we vote. So
22 I would suggest adding it. I was fine with that.

23 MS. MARLETTE: Then we will have it added to the
24 rule. We worked out the question. We just didn't have the

1 consensus before we came in the meeting. So it will be

1 added.

2 CHAIRMAN WOOD: Just a thought on the governance
3 issue. I think clearly from both the Southeast and
4 Northeast mediations, that was one of, you know, all the
5 substantive issues everybody seems to work through, but then
6 they get just stuck on this governance issue.

7 So I would rather not to be prescriptive either,
8 but I don't want to waste another two years of trying to
9 dither around on this stuff if people haven't solved their
10 governance issues yet, we'll come to the rescue and do it.
11 We probably don't have any more expertise than the parties
12 do, but we're the top of the pyramid, so I think sometime
13 when the folks don't figure out their own problem and it's
14 kind of a show-stopping problem, I do think it is important
15 for us to lead.

16 COMMISSIONER BREATHITT: Once it goes into a rule
17 and there's reg text, that's it. I mean, if the way boards
18 are selected, and, you know, we're saying, we said in the
19 California, you had to have an economist, you had to have
20 this, you had to have this, it's just a level of
21 prescription that I just wasn't comfortable with in the
22 California order. I voted it out.

23 I want independence and we've said -- we've
24 talked about the rules for hiring independent search firms,

1 and then we sort of leave it up to them to do that. But now

1 we're getting into a huge level of specificity.

2 CHAIRMAN WOOD: Anything else? Bill, did you --
3 I heard one question from you and I wrote something
4 incomprehensible down.

5 (Laughter.)

6 COMMISSIONER MASSEY: Well, that couldn't have
7 been me.

8 (Laughter.)

9 CHAIRMAN WOOD: I think I was so blown away by
10 the flourishes of your great prose that I just didn't write
11 it down.

12 COMMISSIONER MASSEY: Oh, thank you.

13 CHAIRMAN WOOD: Did I miss something?

14 COMMISSIONER MASSEY: No.

15 (Laughter.)

16 COMMISSIONER MASSEY: No, I just said that I
17 thought anyone who wanted to ask a question in a NOPR ought
18 to get the question.

19 CHAIRMAN WOOD: That was it. Okay. What's the
20 plan, Madam General Counsel?

21 MS. MARLETTE: Well, we will add the question and
22 we need your vote.

23 COMMISSIONER BREATHITT: Aye, with my
24 concurrence.

1

COMMISSIONER BROWNELL: Aye.

1 COMMISSIONER MASSEY: Aye.

2 CHAIRMAN WOOD: An enthusiastic aye. Thank you
3 all very much. Look forward to the final rule.

4 (Applause.)

5 SECRETARY SALAS: Next for discussion we will
6 take up two items together. They are E-3, Great America
7 Participants, and E-31, Alliance Companies, with a
8 presentation by Patrick Clarey, Larry Greenfield, Thajuana
9 Miller, Michael McLaughlin, Mike Donnini, Tony Ingram and
10 Penny Murrell.

11 (Pause.)

12 MR. CLAREY: Good afternoon. My name is Patrick
13 Clarey and at the table with me today are from OMTR, Mike
14 McLaughlin, Penny Murrell, Tony Ingram, Mike Donnini, and
15 from OGC, Thajuana Miller and Larry Greenfield.

16 Also involved in the preparation of these two
17 orders were Diane Grunenke of OMTR, Kimberly Bose of OGC,
18 and Gilda Thompson of OGC.

19 E-31 is a draft order that addresses the Alliance
20 Companies compliance filings, which identify whether they
21 are joining PJM or the Midwest ISO. Consistent with the
22 direction provided at the last Commission meeting, the draft
23 order conditionally accepts the Alliance Companies choices.

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1 The draft order explains that the expeditious

1 creation of a common market structure stretching from New
2 Jersey to the East, to the Rocky Mountains in the West and
3 certain other conditions, resolve the objections to the
4 individual Alliance Companies particular choices.

5 The first had most critical condition is the
6 creation of a common market by October 1st, 2004. The order
7 reminds the parties that the Commission has available a wide
8 range of remedies in order to ensure that this deadline is
9 in fact met.

10 Among the other conditions contained in the draft
11 order, I will mention only four here. First, the order
12 relies upon national grid's participation in both PJM and
13 Midwest ISO performing the same functions pursuant to the
14 same requirements in both organizations as a means of
15 bridging the two organizations and managing the seams
16 between them.

17 Second, the order is contingent upon NERC's
18 approval of the parties' updated reliability plans as a
19 means of addressing reliability concerns.

20 Third, the order requires PJM and Midwest ISO to
21 resolve the disparity in the through and out rates between
22 the two organizations as a means of addressing the rate
23 pancaking between the two organizations.

24 If the parties cannot resolve this matter on

1 their own, the draft order institutes a Federal Power Act

1 Section 206 proceeding in which to resolve this matter.

2 And finally, the parties must develop a means of
3 holding the utilities in Wisconsin and Michigan harmless
4 from any loop flows or congestion that may result from the
5 Alliance Companies particular choices.

6 Turning now to E-3. E-3 is a draft order which
7 conditionally accepts in concept the proposal of Grid
8 America to join Midwest ISO as an independent transmission
9 company under Appendix I. The draft order explains that
10 certain aspects of the applicants' proposal will require
11 further development and provides direction to the applicants
12 to allow them to move forward with their efforts to
13 establish an ITC, thus furthering the Commission's goals of
14 successful RTO development and operation.

15 That concludes my presentation. Thank you.

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1 CHAIRMAN WOOD: Patrick or one of you all, on the
2 October 2004 date, how did we arrive at that for
3 implementation of the full common market, PJM, MISO, SPP?

4 MR. CLEARY: Well, I believe Midwest ISO has
5 committed that they could reach a single market-type
6 structure, similar to PJM by early 2003. And the thought
7 amongst Staff was giving them nine months more to actually
8 push the button to make it common between the two, would be
9 an adequate amount of time.

10 CHAIRMAN WOOD: I notice from the report that the
11 communication that they file with us with the GANT chart
12 now, that the implementation date is later than that, and I
13 just wanted to say that I think the approach in the Order is
14 correct, but I do recognize that that's going to require the
15 parties to step it up to a lot higher gear than they have to
16 date about the importance of the common market.

17 And I'm very pleased that that goes on this
18 agenda here today, because it's really critical to start a
19 lot of that work that's envisioned on a later time on the
20 GANT chart, back to something that starts this current year.
21 So it will be necessary to meet that date for a lot of that
22 activity to begin now.

23 And I do hope that a lot of the good that has
24 been already done in the smaller application of the ERCA

1 rate treatment between the old Alliance and MISO can now

1 largely be incorporated, in philosophy, to the broader PJM-
2 MISO footprint. And I do think, in front of a settlement
3 judge is probably the best place to get that to happen
4 expeditiously, so that can be put to bed.

5 I know there were a lot of our colleagues out in
6 the Midwest who were not very pleased with our decision a
7 couple of weeks ago, but I think we've got to stick with a
8 plan that works, and then monitor it on a daily basis, and,
9 importantly, fix that rate seam. And hopefully I think a
10 lot of the way the FERC fixed that before can be
11 incorporated here again.

12 So, I support the Order.

13 COMMISSIONER BROWNELL: Pat, I just want to say
14 that I was candidly alarmed by the tenor and the passion and
15 the depth of the comments that we received on everything
16 from seams to loop flows to unintended consequences, to
17 unnecessary costs for customers, to the isolation of parts
18 of Michigan and Wisconsin.

19 And I would hope that the parties take these
20 conditions very seriously. I think I heard them say that
21 they were so pleased with the approval that any conditions
22 we put upon them, they would be happy to meet. I think
23 there are still a lot of unanswered questions, and I think
24 the Staff has identified, very wisely, where we need more

1 information.

1 I did not hear an enthusiastic endorsement of
2 this on reliability or any other issues, so I think it's
3 important to have these conditions. I think it's important
4 to meet those deadlines.

5 This has got to be more than a hope and a
6 promise, and I, for one, look forward to receiving the
7 information. And, in fact, we'd like to use this moment,
8 actually, to suggest that maybe Bill Hederman get together
9 with PJM and maybe have them in in our next meeting on the
10 18th, and, if not, if we have a special meeting, to talk
11 about the seams issues and some of the surprises that have
12 been experienced as PJM West has come into the fold.

13 I think we perhaps have something to learn there
14 that might inform the development of this market. I also
15 think, given the last couple of days, it would be helpful to
16 have the three Northeast ISOs in to talk about how their
17 demand-side management programs, which we have worked hard
18 to improve, actually were triggered; whether they were
19 effective, and just to get a better understanding, since
20 we're relying on that as an important part of our new
21 markets.

22 So this probably isn't just the right place to
23 talk about demand side, but I think it's important we get
24 them in. But, most importantly, I want to hear about what's

1 going on in those other areas.

1 CHAIRMAN WOOD: Let's do that. Bill?

2 COMMISSIONER MASSEY: If I might add, there still
3 is a lot of concern, and we've seen it in filings before us,
4 about the makeup of choices in the Midwest. And the
5 Commission has determined to respect the choices of the
6 transmission owners about which RTO to join.

7 And I, for one, have some reservations about
8 those choices. But I am willing to go along with this
9 approach, based upon the assurances that we can achieve this
10 common market as quickly as possible. And I think the
11 Commission will insist that it be achieved, otherwise, all
12 bets are off, and we go back to take -- we try something
13 else.

14 But it's extraordinarily important to work
15 through all of the seams issues in that region of the
16 country and to come up with a common market which, as I
17 understand it, will have a single integrated dispatch.

18 COMMISSIONER BREATHITT: I am dissenting, in
19 part, on this Order, and agreeing with my colleagues, in
20 part, on this Order, and I'd like to explain my vote:

21 The Order does support the acceptance of the
22 former Alliance Companies' decisions to join either PJM or
23 MISO, and I'm very pleased to support that. This Order
24 hopefully will conclude the uncertainty brought about by

1 abrupt, and, in my opinion, not well-thought-out changes in

1 Commission directives with RTO formation in the Midwest.

2 It should also provide certainty in the goal of
3 establishing a joint and common market for an area spanning
4 from the Mid-Atlantic beaches to the Rocky Mountains. It's
5 a huge area.

6 MISO has stated that this single market could
7 potentially eliminate many seams issues, and that it should
8 be operational by 2005. Consequently, there are real
9 benefits which will derive from today's actions.

10 The parties in this area are also endeavoring to
11 implement in a timely manner, many of the concepts found in
12 our SMD NOPR, as well as from Order 2000.

13 I'm also enthusiastic about the ITC developments
14 in the region. I have long been a proponent of the ITC
15 model, because I believe that the for-profit entities will
16 have incentives to bring the critical infrastructure that we
17 need and that we talk about in the standard market design.

18 As the Grid America Order notes, there are very
19 significant benefits that ITCs can bring to bear, including
20 such areas as seams management. It's also important to me
21 that there be room in the RTO development for different
22 models or structures, so I'm encouraged that we're allowing
23 that to develop, not only in MISO, but in PJM as well.

24 The area that I'm dissenting on, in part, are on

1 several of the conditions imposed throughout the Order. The

1 concern that I have is that the parties have told us that a
2 single market can be operational by 2005.

3 However, if the common market does not develop by
4 October 1, 2004, the parties would be faced with potential
5 penalties, so even if they meet their 2005 date, the
6 utilities in the region could be faced with conditions, for
7 example, a reduction in their return on equity.

8 I don't think this is the right time to be adding
9 uncertainty and risk to a marketplace by threatening
10 uncertain penalties such as ROR or others. I think that at
11 a time when we want investment in transmission assets, we
12 need to provide a steady hand, and not hold uncertainty in
13 the form of unknown penalties over the heads of entities
14 which have already spent millions of dollars trying to
15 comply with FERC.

16 I'm also concerned about the arbitrary and
17 irrational nature of the dates set forth in the mechanism.
18 The parties have stated that they will have a common market
19 developed by 2005. I would have preferred to have the
20 parties provide us with an implementation plan as to how
21 they will meet the 2005 date, prior to making judgments as
22 to the timeliness of the parties' plans.

23 I believe that the desire is shared by MISO, PJM,
24 and National Grid to get a single market up and running as

1 quickly as possible, and these parties have worked hard and

1 have spent a lot of money to overcome obstacles to get to
2 this point.

3 As a result, I would have deferred action on any
4 mechanism until we have time to review the plan for
5 implementation.

6 There are several other conditions imposed
7 through this Order, and while some of them make sense, I
8 question the basis for others. We are taking several 206
9 actions in this Order, and specifically on the through- and
10 out-rates charged for transmission service in the region.

11 We have all talked about the need to eliminate or
12 minimize export charges, through- and out-rates, and we
13 address that in standard market design, but we don't know
14 how to do it. So we're telling the parties here that they
15 have to come up with a plan to eliminate the through- and
16 out-rates through a Section 206.

17 This is noted in the Grid America order for
18 service through and out of the MISO system, and it discounts
19 its current rate so as to maximize revenues, while
20 minimizing the charges applicable to this service.

21 So I think that MISO and PJM could do more to
22 address the rate issue, but the fact remains that we don't
23 have an answer to cost shifts that will occur by reducing or
24 eliminating the through- and out-charge.

1

I am also not comfortable with the condition that

1 the parties file reports every 60 days on the progress of
2 their plans.

3 And, finally, I'm concerned about the total
4 number of conditions that are imposed. The majority is
5 requiring so much process and so many conditions of the
6 business at hand, which are joining RTOs, forming ITCs,
7 addressing seams, implementing a common market, almost
8 become secondary to the meetings, the reports, the 206
9 investigations, and the like.

10 As I stated earlier, these organizations and
11 their individual utilities will be actively pursuing the
12 vision laid out in our SMD NOPR. These conditions, I think,
13 are rather onerous, and they may be imposed in a way that
14 sets a precedent that others around the country may not find
15 very inviting.

16 And, finally, I find it troublesome that we may
17 be penalizing the very entities that we should be
18 encouraging for their efforts towards creating a joint and
19 common market. I really believe, deep in my heart, that
20 this region would have been far better off, had we left well
21 enough alone last December.

22 But it's put -- and for the FERC to have put its
23 significant power and muscle behind the inter-regional
24 cooperation agreement or the ERCA, and the independent

1 duties of National Grid. I think this has been a region in

1 a big state of conflux for some time, largely because of the
2 change in directions that we've given, and for these
3 reasons, I am dissenting, in part, on the Order.

4 CHAIRMAN WOOD: I'd have to respond. I don't
5 think Alliance was well enough alone, so I don't think we
6 had an option to leave it alone. It was not sufficient in
7 scope; it was not sufficient in configuration, and although
8 National Grid provided a lot of promise, it certainly did
9 not, in my mind, set a template for the type of transco that
10 we wanted, and that I think was envisioned in Order 2000.

11 I don't know another way to fix the through- and
12 out-rate issue, other than to have a 206 proceeding, and to
13 put a date certain by which customers can know that if it
14 goes beyond 60 days, that it will -- the new rate structure
15 will take effect.

16 That's why we're sent to hearing, is to find out
17 the right answer. They found out the right answer in the
18 ERCA agreement, and I think they can find it again. But if
19 they don't have the right answer, I think we will be glad to
20 give them one.

21 But I think like you, and I think parties can
22 come to their own accommodations, oftentimes better than we
23 can, but we have to provide the incentive for them to do
24 that when perhaps the incentives of all of their ownelves

1 are not as well aligned.

1 The Staff gave a pretty reasonable answer to why
2 we picked 10/01/04, based on the dates that they had
3 committed to having local market -- local LNP markets, and I
4 think perhaps a deferral to review the plan that they filed
5 with us might have been better, but I think it was very
6 important for their certainty to give them the answer today,
7 which is the day that we had promised them, and I do think
8 that that's as important.

9 I do acknowledge that the details of the
10 conversion -- or the timeline plan will continue to be an
11 ongoing iteration, but, quite frankly, the 60-day filings we
12 require now are half as often as they are providing them
13 voluntarily, anyway, so I'm -- we're getting those every
14 month now.

15 So I do think the Order is right. I think we owe
16 it to the people of that region to do it right once. And I
17 do have some trepidation that in particularly the case of
18 the Illinois companies staying in PJM, that we may not have
19 gotten it right, and I think in making up for that is going
20 to require very engaged and involved roles for our staff in
21 overseeing and helping manage that process with a lot of
22 cranky stakeholders.

23 It is important to capture the victory out there,
24 and I think that this Order actually is the best shot at

1 doing that. I recognize the variance of opinions among us

1 on how joyful we are about this Order, but I do think that
2 it is actually, of all the suboptimal options, the best one
3 for today, and actually the best one for the long term. So,
4 I will un-joyfully support it.

5 SECRETARY SALAS: Are we ready to vote?

6 COMMISSIONER BREATHITT: Aye, with partial
7 dissent, as noted.

8 COMMISSIONER BROWNELL: Aye.

9 COMMISSIONER MASSEY: Aye.

10 CHAIRMAN WOOD: Aye.

11 SECRETARY SALAS: And the final item for
12 discussion this morning is E-43.

13 CHAIRMAN WOOD: Do we vote on 3 as well?

14 SECRETARY SALAS: That was for 3.

15 CHAIRMAN WOOD: That was for 3, okay.

16 CHAIRMAN WOOD: I'm sorry.

17 SECRETARY SALAS: E-43, Policy Statement
18 Regarding Standard of Review for Proposed Changes to Market-
19 Based rate contracts, with a presentation by Jonathan First.

20 MR. FIRST: Good afternoon. My name is Jonathan
21 First. With me is Shaheda Sultan.

22 In E-43, the Commission is proposing to adopt a
23 policy statement to announce a general policy regarding the
24 standard of review that must be met to justify proposed

1 changes to market-based rate contracts for wholesale sales

1 of electric energy by public utilities.

2 The intent of the proposed policy statement is to
3 promote the sanctity of contracts, recognize the importance
4 of providing certainty and stability in competitive electric
5 energy markets, and provide adequate protection of electric
6 energy customers.

7 The Commission is inviting comments on the
8 proposed policy statement to be filed 45 days after it is
9 published in the Federal Register. The Commission is
10 proposing precise language that parties will be required to
11 include in the electric power sales contracts, with the
12 intent that the Commission apply the public interest
13 standard of review to the contract.

14 If the parties include in their contract, the
15 proposed language, they would be able to bind themselves,
16 and, if they choose, they would also be able to bind the
17 Commission, acting sua sponte, on behalf of a third party,
18 to a public interest standard of review.

19 Under the proposed policy, if parties to a
20 market-based power sales contract do not include this exact
21 language in the contract, the Commission would construe the
22 omission as demonstrating the intent of the parties to allow
23 a just and reasonable standard of review.

24 Thank you, and this concludes my presentation.

1

COMMISSIONER MASSEY: I'm in general support of

1 this proposed policy statement. I think it makes the right
2 call. The default standard of review, in my judgment,
3 should be just and reasonable standard. If the parties want
4 to bind the Commission to a higher standard, the public
5 interest standard, they should say so, unmistakably, and we
6 propose language that ought to be included in the contracts.
7 Do I have that right?

8 MR. FIRST: Yes.

9 COMMISSIONER MASSEY: All right. The draft order
10 would have been stronger if it had made clear that the
11 Commission would be sensitive to the potential use of market
12 power to actually extract an agreement to a Mobil-Sierra
13 clause in a contract.

14 Despite the fact that these market-based rate
15 contracts involved a prior Commission determination on the
16 market power issue, the potential for coercive behavior
17 remains, as the court in the recent Atlantic City Electric
18 Company case recognized--and this is a D.C. Circuit Court
19 decision, I think within the last month, that related to
20 issues in the PJM--and here's what the court said, and I
21 quote:

22

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1 "As we have held, the purpose of the Mobil Sierra
2 Doctrine is to preserve the benefits of the parties' bargain
3 as reflected in the contract," and this is what I want to
4 underscore, "is reflected in the contract, assuming there
5 was no reason to question what transpired at the contract
6 formation stage." And that is citing Town of Norwood versus
7 FERC.

8 So my strong preference would have been for this
9 proposed policy statement to refer explicitly to this case
10 and to include language that states the following:

11 The Mobil Sierra Doctrine presupposes that
12 contracts are entered into voluntarily. A seller may not
13 dictate the standard of review specified in a contract
14 through the exercise of market power.

15 And I commend this proposal to commenters. Some
16 may like it, some may object to it, but I think the document
17 would have been stronger if we had recognized, as the Court
18 of Appeals for the D.C. Circuit has, that the insertion of
19 the Mobil Sierra clause itself could be reviewed if there's
20 an argument that one party exercised market power over the
21 other in requiring the clause to be inserted in the
22 contract.

23 Thank you, Mr. Chairman. I'll be writing a
24 separate, short concurrence to make this point.

1

CHAIRMAN WOOD: And just on the record, I don't

1 disagree with the point. I think, I don't know that
2 defining public interests in this policy statement is going
3 to provide the necessary clarity that I had hoped when we
4 talked about doing this a couple of meetings ago, but to me
5 the main goal here is that you have on a going forward basis
6 the magic language for binding the parties, and then on page
7 9, binding the parties and the Commission if it issues an
8 order on behalf of a third party, comes in to review the
9 contracts to the public interest standard.

10 I think public interest standard is what contract
11 law would certainly look at, and I think putting a gun to
12 say that you wave this standard certainly would be a fact-
13 based issue that could and should be looked at at a hearing
14 if anyone wanted to claim that even under the public
15 interest, they still want to have their contract reviewed.

16 I think what this will do in helping with some of
17 the concerns about our, I think necessary under the law,
18 referrals to hearing of certain contracts that were entered
19 into in the West in the past couple years, that we need to
20 provide a vehicle by which contracts can have the measure of
21 certainty that I think most people assume was there without
22 reading the Power Act all along, and I think this certainly
23 gives people the clear way that quite frankly a good lawyer
24 would have probably stuck in there because these Mobil

1 Sierra cases are older than me, but for some reason if the

1 lawyers didn't stick them in there or the parties negotiated
2 them but chose not to stick them in there, then I think at
3 means something and should mean something to a judge.

4 So I think just the point of this rule is to say
5 here's the magic language. If this is what you intend, this
6 is how you should say it. Template it. Vote it out and I
7 hope that we won't necessarily have to read a whole lot more
8 into it than just saying, folks, here's the way out of the
9 box.

10 So for those that are trying to read between the
11 leaves here at least from my branch, this is kind of black
12 and white, so I support it and look forward, and hopefully
13 that people will file electronically in light of our earlier
14 presentation their comments rather than paper.

15 COMMISSIONER BREATHITT: We'll have to let them
16 have lunch with the guys.

17 COMMISSIONER MASSEY: We'll offer a T-shirt for
18 that, too, Pat. Okay?

19 (Laughter.)

20 CHAIRMAN WOOD: But I thought you were changing
21 the name of OMTR--

22 UNIDENTIFIED VOICE: That's why we're offering
23 the T-shirts now. They've become less valuable.

24 (Laughter.)

1

CHAIRMAN WOOD: What was it? Energy,

1 Reliability, Competition--

2 (Simultaneous voices.)

3 (Laughter.)

4 CHAIRMAN WOOD: You'll take jurisdiction any way

5 you can. All right. We need a vote I think on this.

6 COMMISSIONER BREATHITT: Aye.

7 COMMISSIONER BROWNELL: Aye with concurrence as

8 noted.

9 COMMISSIONER MASSEY: I with the concurrence as

10 noted.

11 CHAIRMAN WOOD: Aye.

12 Meeting adjourned and no August meeting. We'll

13 meet back at 3:00 in Hearing Room 5.

14 (Whereupon, at 2:00 o'clock p.m., the open

15 Commission meeting was recessed, to reconvene in Closed

16 Session in Hearing Room 5 at 3:00 p.m., this same day.)

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