BEFORE THE

FEDERAL ENERGY REGULATORY COMMISSION

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IN THE MATTER OF: :

CONSENT MARKETS, TARIFFS AND RATES - ELECTRIC :

CONSENT MARKETS, TARIFFS AND RATES - GAS :

CONSENT ENERGY PROJECTS - HYDRO :

CONSENT ENERGY PROJECTS - CERTIFICATES :

DISCUSSION ITEMS :

STRUCK ITEMS :

- -x

874TH COMMISSION MEETING

OPEN MEETING

Commission Meeting Room
Federal Energy Regulatory
Commission
888 First Street, N.E.
Washington, D.C.

Thursday, November 18, 2004
10:05 a.m.

APPEARANCES:

COMMISSIONERS PRESENT:

CHAIRMAN PAT WOOD, III, Presiding

COMMISSIONER NORA MEAD BROWNELL

COMMISSIONER JOSEPH T. KELLIHER

COMMISSIONER SUEDEEN G. KELLY

SECRETARY MAGALIE R. SALAS

ALSO PRESENT:

JANE W. BEACH, Reporter

P R O C E E D I N G S

(10:00 a.m.)

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

Please join us in the pledge to our flag.

(Pledge of Allegiance recited.)

CHAIRMAN WOOD: Good morning. I'd like to welcome everybody to our meeting today. I also -- on the opposite side of welcome or goodbyes, there are two folks on my staff who I wanted to take a moment to recognize today, who are in the process of moving on to bigger and better things, after having been good friends and good assistants to me for the past three years.

So I wanted to take this opportunity today to thank Andrew Soto and Larry Crocker for their assistance. Larry is moving down -- has moved downstairs to take the Deputy Associate General Counsel's job for General and Administrative Law, which handles all the ethics, contracts, employment, and general issues that Ms. Court handled in her prior position with us.

Andrew Soto is leaving this next week to go to the private sector, from whence he came, after about seven years here at the Commission. And half of that time was with me. I appreciate you guys' hard work, and want to present Andrew -- I'll start with you first -- the Exemplary Public Service Award with thanks for all the hard work you've done, not only for me and for the Commission, but for the betterment of the energy industry.

(Applause, and plaque presented.)

CHAIRMAN WOOD: And Lawrence Crocker, III, I want to also present you the Exemplary Public Service Award and thank you for all of your hard work for all us.

(Applause, and plaque presented.)

CHAIRMAN WOOD: Those are big shoes to fill, but we'll do it. I want to start. Why don't we start?

SECRETARY SALAS: Good morning, Mr. Chairman, and good morning, Commissioners, as usual. The following items have been struck from the agenda since the issuance of the Sunshine Notice on November 10th. They are: E-12, G-3, G-15, and C-1.

Your consent agenda for this morning --

CHAIRMAN WOOD: So the screen should read, not E-2, but E-12, right?

SECRETARY SALAS: That's right.

CHAIRMAN WOOD: Okay.

SECRETARY SALAS: Thank you.

Your consent agenda for this morning is as follows: Electric Items - E-3, 5, 10, 11, 14, 16, 17, 18, 19, 21, 23, 25, 26, 27, 29, 31, 32, 33, 34, 35, 36, 37, 38, 43, 44, 45, 46, 47, 48, 50, 51, 52, 53, 54, 55, 57, 59, 60, and E-61.

Gas Items: G-1, 5, 6, 7, 9, 10, 11, 12, 13, 14, 16, 17, and 18.

Hydro Items: H-1, 2, 3, 4, 5, 7, 8, 9, and 10.

Certificates: C-3, 5, 6, 7, and 8.

As required by law, Commissioner Kelly is recused from the following cases on the consent agenda: E-57 and G-12.

Specific votes for some other items on the consent agenda are: E-43, Commissioner Kelly, dissenting, in part, with a separate statement; E-44, Commissioner Kelly, dissenting, in part, with a separate statement; E-46, Commissioner Kelly, dissenting, in part, with a separate statement; E-60, Commissioner Kelly, dissenting, in part, with a separate statement; and H-1, Commissioner Kelly, dissenting, in part, with a separate statement.

Commissioner Kelly votes first this morning.

COMMISSIONER KELLY: With the exception of those cases from which I am recused, and the ones in which I am dissenting, I vote yes.

COMMISSIONER BROWNELL: Aye.

COMMISSIONER KELLIHER: Aye.

CHAIRMAN WOOD: Aye.

SECRETARY SALAS: The first item on the --

CHAIRMAN WOOD: Let me start with that one, thanks. I wanted to just make a brief announcement on the project that the Staff here has been working on for probably the better part of this year.

And that's the availability of the RTO Handbook. The RTO Handbook is a summary of the various aspects of the six RTOs and ISOs -- California, Midwest, ISO New England, PJM, New York, and Southwest Power Pool.

The Handbook addresses 14 aspects of individual RTOs and ISOs, and those are: The governance structure; the members' rights under Section 205; the members' exit rights; market monitoring function; the description of the markets operated, and the type of pricing that's used; reliability procedures employed; the treatment of preexisting contracts, Commission-imposed reporting requirements; treatment of non-public utility members such as munis, coops, and federal PMAs; information-sharing procedures; confidentiality requirements; demand response programs; which control areas are incorporated into the RTO and ISO; the difference in treatment of transmission and distribution facilities; and RTO/ISO compliance with Order 2003 on interconnection issues.

The information contained in this Handbook is for general guidance only, and should not be used as a substitute for the original source of the rules, which are the Orders themselves and the Regulations.

The Commission Staff will periodically update this handbook to reflect changes that occur over time. This can be found on our web page under What's New Today. Our web page, of course, is www.ferc.gov, but it will be highlighted under What's New, and each of the 14 topics that I laid out there, will be followed by a direct link to that issue in each of the six RTO and ISO regions.

The point is this is to really allow people to ascertain, and not just have to, quite frankly, pay a lawyer to devine it, but for people to read in clear English -- or at least as clear as FERC can write English, which may not actually be the clearest version -- but what it is that is going on here -- and really the attempt to get uniformity across the policy decisions, it's an internal document as well.

So, it's one that I hope people in the outside world and inside the Agency will find useful, and I appreciate the hard work that was put into pulling this together. Actually, Cindy Marchette, you all know who that was, and that would be nice to give them some public credit here.

MS. MARCHETTE: It's primarily Olga, but we've had a number of people putting in a lot of hard work on it.

COMMISSIONER KELLY: Mr. Chairman, I'd just like to note for the record that we've already had a request from members of proposed RTO West for a copy of it, so it's very useful already. Thank you. It's an excellent product and a good job.

CHAIRMAN WOOD: It should be available at this time on our web page, again, highlighted under What's New, which is the column right in the middle of the top page.

SECRETARY SALAS: The first item on the discussion agenda this morning is A-3. This is the Winter Energy Market Assessment. It's a presentation by Steve Harvey from the Office of Market Oversight and Investigations, who is accompanied by Tom Pinkston, Bob Flanders, Dean Wight, Ken Kohut, Chris Peterson, and Kara Mucha.

MR. HARVEY: Good morning, Mr. Chairman and Commissioners. Twice a year, the Office of Market Oversight and Investigations is charged with presenting an energy market assessment for the coming season, and to point out particular areas of Staff attention.

Today, it's our pleasure to present to you, our assessment of major energy market issues for the Winter of 2004-2005. Before I turn the presentation over to Tom Pinkston, I'd like to quickly introduce and recognize some of the members of the team that pulled together, this material.

Other than those sitting at the table with us today, this is a major effort where we get contributions from across all Staff, but I'd like to name a few, in particular: Stacey Angel, Judy Eastwood, from here on, names Alan Haymes, Rafael Martinez, Steve Michals, Gary Mahrenholz, Clint Ramdeth, Julia Tuzun, Ellen Schall.

With that, I'd like to turn the presentation over to Tom.

MR. PINKSTON: Good morning, Mr. Chairman and Commissioners. We are pleased to present Item A-3, the High-Level Preview of the Office of Market Oversight and Investigations Winter Assessment for 2004-2005. The full presentation will be publicly available on the FERC's website today.

(Slide.)

MR. PINKSTON: We begin our market monitoring effort this Winter, with commodity markets behaving as one would expect under conditions of tight supply. Nevertheless, these conditions have created high price levels, volatility, and market consequences to our market monitoring efforts.

Specifically in this assessment, we've identified four broad oversight areas for the upcoming Winter, as displayed in our initial graph. These areas are concerns about fossil fuel supply adequacy, the status of energy trading and its possible relationship to prices and volatility, the adequacy of the natural gas pipeline structure, and, finally, the response of electricity prices to fossil fuel increases.

We will conclude the presentation this morning with a summary of specific items we will be monitoring this Winter. Now, on to the next slide and the presentation.

(Slide.)

MR. PINKSTON: This slide sets the stage, showing the higher natural gas prices going into the Winter. This chart shows prices since January of this year.

The dark blue line at the top is the November to March futures strip. The lighter blue line is the next month's futures price, and the orange line is the spot gas price, as listed from ICE.

Going into the Winter, prices levels were 80 percent higher for November to March than last year. They've come down somewhat over the last couple of weeks. Looking forward now to December to March, it's $7.73, versus just under $5 last year. We're still 60 percent higher.

We think concern about supply is, in large part, driving these prices, as can be seen on the next chart.

(Slide.)

MR. PINKSTON: So, let's look at production more closely. The left vertical axis on this chart is dry gas production beginning in 1990. The right vertical axis is the gas rig count.

The top line is production, per the Energy Information Agency. The green line is the rig count. The darker -- and I apologize that it's a bit confusing, but the darker blue line extending from the EIA production line, is a Shearson-Lehman estimate of 2004 gas production.

The purplish line extending towards the bottom is CIRA's estimate for natural gas production for 2004. And these are all as compared to EIA's 2003 production.

As you can see, there's quite a variance in the estimates, ranging from flat, per EIA, to as much as negative five percent. The reasons for these variances are largely different sources of data.

Even in the best case, the production response to the rig count has been limited. This has been well documented with reasons including higher decline rates and fewer reserves added per well.

That shouldn't be considered as a sudden surprise. The industry has had studies showing that growth in demand will be met by different sources than OCS and traditional Gulf Coast production.

(Slide.)

MR. PINKSTON: Moving to the next chart, we want to try to show why this variance in production, which may not seem that large, you know, zero, minus-two percent, is very important, especially when compared to demand swings that occur with weather.

This is still very much a weather-driven business, as this year-on-year change in weather scenarios shows. And not to look so much at the absolute numbers here, but the chart is showing the last Winter's versus this Winter's changes in supply versus demand.

Beginning at the left is production, and this is from the EIA's short-term energy outlook. You can see it's flat. Pipeline imports are slightly down, compensated by an increase in LNG.

Storage is up somewhat. The total supply bar, then, is basically flat, but demand, even for expected Winter, is anticipated to grow one percent for a ten-percent colder Winter. Year-on-year demand might be as much as five percent greater. For a warmer Winter, it would be less.

(Slide.)

MR. PINKSTON: The next chart is the same graph, but considering a pessimistic supply scenario. So the only thing that's really changed is the total supply.

And what we really want to point out, are the gaps. And that doesn't indicate a shortfall in supply, but simply price pressure, and that price pressure would help bring supply-demand into balance.

The EIA has said that for a normal Winter, we should expect expenditures, per household in the Midwest, to be 15 percent higher than last year. We've seen ranges in the Northeast, estimates from LDCs that also are ten to 15 percent higher.

(Slide.)

MR. PINKSTON: The next slide shows that the upward movement in gas prices is consistent with what we're seeing with alternate fuels, and it compares gas prices in New York, which is the dark blue line, to No. 2 Fuel Oil, the green line, and No. 6 Fuel Oil, the red line.

For some time, gas typically has traded between No. 2 and No. 6, and most recently has moved toward the lower end of that range, which could indicate some easing of supply concerns. But I think the important thing to point out is that g as is facing some common issues with other fuels, and as long as No. 6, in particular, remains volatile, it means gas's downward price forward will also remain somewhat volatile.

(Slide.)

MR. PINKSTON: The next slide addresses speculative trading. There's been much discussion about trading's role in price behavior.

The vertical axis on this chart is open interests in NYMEX contracts, and open interests is shown for commercial participants, the top blue and orange line, and non-commercial participants, the lower lines.

Commercial participants would be LDCs, utilities, industrial users, while traditionally, non-commercial positions are considered to be more speculative trading. Open interests could be considered to be an indication of money flow into the market.

As you can see, there really hasn't been a lot of change over the last year, so we would conclude that speculation appears less significant to price movement, especially sustained price movement, than supply and demand concerns, but probably does have a role in the intensity of movements and volatility.

(Slide.)

MR. PINKSTON: In the next slides, we go through regional markets and begin to address some of our specific concerns. We'll be watching price increases with severe weather, especially in the Northeast.

(Slide.)

MR. PINKSTON: The next chart shows utilization of Northeast pipelines during -- or on January 14th of last year under peak demand conditions.

Capacity was adequate, but tight. There have been some additional projects completed since then, but they are more or less keeping up with demand, so we're really under the same conditions. And where we experience severe weather, we might anticipate this type of high utilization on the pipelines.

We probably should stress that this is rational from an end-user perspective, to often rely on paying high prices for very brief periods, versus committing to year'round capacity charges.

So, we don't necessarily see, short-term, paying premium prices for brief periods, as a problem.

(Slide.)

MR. PINKSTON: The next slide shows that electricity prices, as one would expect, are rising in response to increased fuel prices. Forward contracts indicate increases of roughly 22 to 45 percent.

More positively, however, we think that reliability issues that potentially could result from gas scarcity, may be lessened by operational market changes that have been made in reaction to last Winter.

COMMISSIONER KELLY: Tom, can I ask you, the infrastructure constraints, do you see a gas supply constraint, or just an infrastructure constraint?

MR. PINKSTON: This -- it's not so much a constraint as just tight utilization of the infrastructure and possibly bidding for available gas driving up the prices, especially among interruptible users.

COMMISSIONER KELLY: But you aren't looking at an actual shortage of the commodity?

MR. PINKSTON: No.

COMMISSIONER KELLY: Okay.

(Slide.)

MR. PINKSTON: Our concluding slide looks at what we want to monitor closely this Winter, given the context that's just been described, that is, again, supply adequacy issues, trading and volatility, regional infrastructure, and the price interaction between gas and electric.

We intend to work closely with public utility commissions to help them protect customers as prices flow from wholesale to retail markets. We will closely monitor gas market activity, including pipeline capacity utilization versus regional prices.

We will continue to assess the status, quality of, and market reaction to natural gas storage data, which is often the only real-time indicator of the supply-demand value -- it is the only real-time indicator of supply and demand balance available.

We will monitor Winter electric market behavior, looking at price effects, market design, reliability, and market participant behavior, and then, more generally, pay particular attention to unexplained price movements, particularly when divorced from fundamentals and market activity around the extreme weather.

So this concludes our presentation, and we'll be glad to answer any questions.

COMMISSIONER BROWNELL: So, if understand this, what you are seeing is infrastructure issues, supply issues, and while you are monitoring all these things, that is to be able to explain, to deal with, to intervene, as appropriate, but that's not what we're seeing.

And so I don't want to leave with the impression that we see all these things actually happening. We're simply fulfilling our obligation and responsibility to monitor those and to make sure they don't happen.

MR. PINKSTON: Yes, exactly.

COMMISSIONER BROWNELL: Okay.

MR. PINKSTON: We may tend -- we don't want to leave the impression that we see things negatively, but we're just looking at things that we want to watch for this season.

COMMISSIONER BROWNELL: And we're working with public utility commissions to help protect customers by giving them information? What is our role there?

MR. PINKSTON: It has been providing information on price occurrences.

COMMISSIONER BROWNELL: Okay, thank you.

MR. PINKSTON: You're welcome.

CHAIRMAN WOOD: Staff has told me that one of the fallouts from the New England price spike study last year, both the one that we did and the one that was done in New England, was a need to do more harmonization with the gas market and the electric market.

And I know that just in the recent -- recently, they developed some sort of operating procedure to improve the exchange of information between those two markets during these sort of high-stress periods.

I understand that one of the things that they did was shift the electric market timeline to the earlier-in-the day, to provide earlier information to the gas -fired electric generators, so that they can line up their gas supplies. Is that something -- have you all looked into that, and what's your assessment of that new procedure?

MR. FLANDERS: We've looked into this. We had a briefing from the ISO New England yesterday, and had their recommendations. Their proposal here does do as you say; it advances the day-ahead power market to 9:00 in the morning, which the bids would be in at that time, which gives the generators time to buy gas on the -- during the gas trading cycle.

CHAIRMAN WOOD: Good.

MR. FLANDERS: And make a commitment for pipeline capacity within the time window of their award for electric power. So, it avoids the situation of a generator being stuck with gas that they had to buy in advance without -- before they knew whether they would be committed in the power side.

But this would only apply during a cold-weather circumstance, whereas it's triggered by very cold and low-reserve conditions, so it would be an occasional operating condition, only triggered by tight gas conditions and tight power conditions.

CHAIRMAN WOOD: So you characterize it as a short-term patch?

MR. FLANDERS: It's a short-term patch. The plan is to operate this way, take a look at it, and report back at the end of the Winter season, next year, to see how effective it was.

COMMISSIONER BROWNELL: And we've been waiting for, I don't know, about a year for NAESB to resolve this issue. Where are they?

MR. FLANDERS: NAESB has a draft report that they're getting ready to circulate, that addresses a number of these issues. I'm not privy to the recommendations in the report.

Many of the points are primarily coordination between gas and electric users. We're waiting to see what their draft report says, though, in the next few days.

COMMISSIONER BROWNELL: I think we've all been very patient, waiting for the participants to solve the problem, which has been clearly identified for quite some time, so I hope this draft report actually answers the question, and isn't a draft of the next six months of study or year of study.

I think this studying has been done, and we need to get to some closure.

CHAIRMAN WOOD: I couldn't agree more. Thanks for bringing that up.

There's a slide, and it was -- and tell me if I've over-read this, but looking at the slide, the one that had the different bars -- I don't see page numbers, but the year-to-year --

And so this says this is the delta from last year on the effect of -- so all this injection into storage has just that negligible an effect? I mean, everybody was looking at storage numbers to be this big driver of the market, but, if fact, if it's that narrow of a sliver --

MR. PINKSTON: That's a very good thing to point out. This is for an expected Winter. We've shown the supply pieces for an expected Winter, versus a range of demands.

And the storage is limited because of the way it's used, where it's often hoarded -- "hoarded" is not the right word, but often conserved to the end of the season, to avoid late Winter peaks.

Were we actually to have the ten-percent colder demand, we probably would see perhaps another .1 Tcf pulled from storage, which would be roughly equivalent to the LNG line, so we would see some additional benefit, but that is limited by the fact that we're limited with working capacity.

COMMISSIONER KELLY: Tom, I noticed in the Appendix that there is some discussion of the dependence in the Northeast on LNG and some uncertainty connected to the LNG Winter deliveries. Could you talk a little bit about that?

How great a dependence in the Northeast is there on that, and how likely is it that there would be difficulties in getting the usual amount of LNG in?

MR. PINKSTON: Well, let me let Chris Peterson, who has done a lot of study of LNG, answer that question.

MR. PETERSON: It's my understanding that analysts anticipate that LNG will contribute about seven to ten percent of the total gas that's consumed in the Northeast this Winter. So far -- and EIA anticipates that LNG deliveries this Winter will be about eight percent higher than they were last year.

On an average daily basis, LNG, this year, through the data that are available, has contributed an additional 400 to 500 million cubic feet per day of natural gas, so it has made inroads in helping moderate some of the natural gas price increases we've seen nationally, and backfilling for some of the depletion effects that have occurred elsewhere.

I think part of what you're responding to on that other slide, deals with the fact that the LNG supply commitments we have at the various terminals, are not fully contracted out, going into the Winter. Different terminals have different contract structures in place, and to the extent that you'd want to increase those deliveries at given terminals, that would be dependent upon other global factors that affect the availability of spot cargoes that could be diverted to the United States.

So, the estimates that EIA and other analysts have anticipated in terms of what we'll be able to get in terms of sendout this Winter, are based on current contract structures. I think the concern in that slide relates to what's the ability of the U.S. market to perhaps get additional LNG.

COMMISSIONER KELLY: Okay, thank you.

CHAIRMAN WOOD: Anything else for the team?

(No response.)

CHAIRMAN WOOD: Nice job. We will make available on the web page, this report?

MR. PINKSTON: Yes.

CHAIRMAN WOOD: The dependencies?

MR. PINKSTON: Right, the more detailed report, which is over 35 PowerPoint slides, which has some support.

CHAIRMAN WOOD: Sounds good. Thank you all very much.

SECRETARY SALAS: The next item on the discussion agenda is M-1. This is the Price Index Monitoring and Use in Tariffs, a presentation by Steve Harvey and Ted Gerarden, who are accompanied by Rafael Martinez and Mike Strezlecki.

MR. HARVEY: Thank you. On January 15th, 2003, Staff reported to the Commission regarding our then, quote, "serious doubts about the accuracy of information reported in many wholesale natural gas price indices."

In that statement, we noted that the natural gas industry cannot function without accurate, dependable, and trustworthy wholesale price information. Consequently some action must be taken by the industry to address the problem.

The Commission responded by initiating a process designed to actively engage all segments of the natural gas and electricity industries, a process that led initially to the July 2003 Policy Statement on Price Formation and subsequently to Staff's report earlier this year on the Policy Statement's effects.

Today, we believe the time has come to recognize that the industry's actions over the past two years have led to significant improvements in the accuracy and credibility of price indices.

Significantly better controls over the price reporting process appear to be in place, both for reporting companies and for publishers. More complete information is being provided regularly by publishers to allow buyers and sellers to be better informed about the process used and about the robustness of the information specific to the indices that they use.

The Commission and Staff have actively observed, and, in some cases, actively participated in the changes made by the industry. Today, other than continuing oversight of wholesale price formation reporting, one last Commission effort remains.

In the January 2003 statement, we noted that, quote, "In the future, Staff proposes that the Commission require that certain minimum standards be met before natural gas pipelines are permitted to use natural gas price indices in new tariffs or for other new regulatory purposes."

We mentioned some general principles important to us at the time, but did not provide specifics. The Order presented to you today, fills in those specifics.

Work on the Order and associated tariffs was done by a large team, but, in particular, I'd like to recognize the efforts of Ted Gerarden and Rafael Martinez in the Office of Market Oversight and Investigations; Michael Strezlecki -- sorry, Mike -- the Office of Markets, Tariffs, and Rates; and Dave Perlman, until last week, of the General Counsel's Office and now in private practice.

Ted will review the accomplishments of the Commission's Policy Statement, the specific criteria developed by Staff to judge the adequacy of particular indices for use in tariffs, and the tariffs before the Commission currently in this matter. Ted?

MR. GERARDEN: Thank you, Steve. The Order before you reviews in some detail, measurable progress since the issuance of the Policy Statement in July of 2003.

This includes increases in the number of transactions being reported to price index developers, process improvements by the companies reporting transaction data to price indices, and additional information being supplied in price indices to help users gauge the robustness of the trading upon which index prices are based at any given location.

The record in this proceeding reflects an overall increase in industry confidence in price indices, leading to the decision that continued Staff monitoring of price formation is the appropriate course for the immediate future.

The Order also considers the use of price indices in Commission-approved tariffs. In the Policy Statement, the Commission said that in order to be used in a jurisdictional tariff, a price index, one, has to be published by an index developer that is in compliance with the Policy Statement's standards; and, two, must reflect adequate liquidity at the referenced location.

To address the first requirement, the Order reviews the statements of ten index developers and concludes that all of them are in full or substantial compliance with the standards of the Policy Statement, and that, subject to meeting certain other criteria, their indices may be used in jurisdictional tariffs.

Two issues highlighted by the May 5th Staff report should be noted: The Staff report recommended that indices used in tariffs, should provide the volume and number of transactions underlying an index value.

The order adopts this recommendation, but also notes that publishers need not provide it for thinly-traded locations, that is, locations that do not have enough trading activity to qualify for use in tariffs.

The second issue has to do with Commission access to confidential data in the event of investigation or inquiry within the scope of the Commission's statutory responsibilities.

Some index developers were reluctant to make an affirmative commitment, in the absence of specific circumstances, although most index developers expressed willingness to cooperate with the Commission.

Because there has not yet been an instance in which an index developer has refused the Commission access to confidential data, the Order assumes cooperation will be forthcoming, but if an index developer should refuse to provide data in response to an appropriate request, the Commission reserves the right to withdraw the approval for the use of that index developer's indices in tariffs.

Returning to liquidity, the Order adopts, with some minor modifications, the criteria proposed in the May 5th Staff report, for a minimum average volume, number of transactions or number of counterparties underlying prices at a specific location. The criteria are specified for daily, weekly, and monthly indices.

The Order also recognizes that there are hourly indices for electricity, but rather than set criteria for trading by hours, the Order allows hourly indices to aggregate the trading for the day and to use the daily index criteria.

The criteria are to be tested over an historical review period to determine whether the index is regularly available and meets, on an average basis, one of more of the minimum levels of activity.

Finally, the Order identifies 13 pending dockets in which the Commission has accepted tariff sheets making a change to a price index in the tariff, subject to further action concerning whether the new price index qualifies for use in a tariff.

Because the Order applies the new criteria prospectively, that is, to future filings only, because the tariff sheets that have been accepted in the 13 cases were expressly not made subject to refund, and because there have been no protests of the new tariffs in any of the 13 dockets, the Order closes these 13 dockets with no further action required.

For any future tariff filings making a change in a price index, if the filing company shows that the new or changed price index location meets the criteria, the Commission will apply a presumption that it will result in just and reasonable charges.

If a company wishes to use an index in its tariff that does not meet the criteria, it bears the burden of showing that such index will result in just and reasonable charges.

That completes our presentation, and we'd be happy to answer questions.

COMMISSIONER KELLY: I'm very pleased with this Order, and I just wanted to note that something that you all mentioned in your report to us earlier this year, that billions of dollars in electricity and gas trades are done annually, based on these price indices, so I don't think we can overemphasize the importance of them, as well as the importance of public confidence in them.

Certainly that confidence was shattered after the electricity crisis in California. I want to thank the Staff for your steady commitment to working this issue out, and the improved confidence in the price indices, as well as in the reporting, is very helpful to the industry and to consumers.

So, thank you very much for your work. I am pleased with this Order. I think that the approach we've taken is quite reasonable.

I like the idea of having the criteria for price index in the jurisdictional tariffs, and I am pleased with the industry's response to all the concerns that have been raised.

CHAIRMAN WOOD: I'd like to really second those remarks, Sudeen. I'm kind of the -- I don't know what the right word is -- hard-liner of this crowd on this issue, and I was very disturbed by what we found in the Gelinas Report and what has come out of subsequent investigations by us and by the CFTC at what happened earlier in this decade with regard to this index issue.

And I really appreciate that capabilities that this team right here and the folks that you all work with on the Staff and support people from across the industry, customers and suppliers and everybody in between, brought to this effort.

We didn't have that ability five years ago, and too bad that we didn't. I think some things might have come out differently, out West.

So, certainly the requirement that we'll stay engaged and vigilant on this is good, but I also think it's important to admit, I guess, for me, personally, and, I think, for the Commission, as a whole, if the facts show something different than you thought they would show --

And that's what this effort has been for the last year and a half, is just an effort to drill down deep, to provide some bully-pulpit leadership, to take care of our own business, which is to ascertain that the tariffs, which is the one thing that we really have here to kind of be the incentive here, is that imprimatur that the Commission's use in a jurisdictional tariff gives.

That's a pretty important thing for an index developer in the private marketplace, and I think we will continue to be very stingy with our approvals there, and I'm glad we have gone through these ones that we've got before us, and found they met the standard, as they should.

But the leadership by open public discussion and by example, which -- and I'm going to give you guys the credit. We're just the lucky four who get to sit here and provide guidance from the side. Usually our little table is sitting over here on the side, but it's been a very good example of government in the public interest.

It's also a prudent example of stewardship of agency resources. I could have sworn that this would have led the adoption of an independent data hub, and I personally hope, for the efficiency and good of the industry, that's where it goes, ultimately, but I don't think that at this time, the Commission needs to be ordering that.

I think what we've got here, quite frankly, is a full plate on the gas side. We just heard in your prior presentation, that there a lot of big, macro issues on supply and demand that are very important, that we have a lot to do with.

But this is an important indicator of where we are, and I think it's a positive development. I was struck, I think, by the percentage of people who are actually -- the percentage of trades that are actually being captured by those who are now participating in the price index disclosure, and I think it was 90-some percent. Is that right? Am I mis-remembering something in here, Ted?

I remember reading that 96 percent or 97 percent of the top volumes were --

MR. GERARDEN: That was information supplied by Intelligence Press, that they were getting reports from 13 of the top trading companies, and that those 13 presented 96 percent of the volume being done by the top 20 trading companies.

If you're looking at the whole of trading, the survey that we did in March 2004, indicated that, on the natural gas side, price index publications were capturing somewhere in the range of -- and we had a range in that Staff report -- but somewhere in the neighborhood of 55 to 60 percent of total trades.

CHAIRMAN WOOD: It's lower than that, okay. That's still helpful to know.

And then the compliance of those was laid out in a chart following Paragraph 9 in the Order, the proposed Order, percentage of companies who filed these reporting guidelines, which were reporting by independent group, in the March survey was now 63 percent, "Yes;" annual review by an independent auditor, 58 percent, "Yes;" public code of conduct available, 65 percent, "Yes."

I really do want to see those numbers, while they're up substantially from where we were before the Policy Statement, those are very important steps to continue the confidence here. I wouldn't mind, as far as I think this Order recommends in the State of the Market Report, which we're slated to do, Steve --

MR. HARVEY: June, I believe.

CHAIRMAN WOOD: June -- to reflect maybe an update on that, as well. We could put that in the queue on information we want to see there. I'd love to see that up in the 80s and 90s, that people are complying with those basic transparency and good practices criteria.

COMMISSIONER BROWNELL: Do we have a good understanding of why people wouldn't want to participate, where they're not reporting? How much of it has to do with uncertainty of perhaps a reaction from us or a reaction from another agency?

How much of it has to do with just unwillingness to restructure and spend the money they need to? I've not ever fully understood what the problem is?

MR. GERARDEN: Well, we've heard from a number of companies, reason why they have chosen not to report. A principal reason is perceived risk.

It is a voluntary system, and in many cases, companies considering the benefit of being a good corporate citizen and participating in price formation, is recognized, but, at the same time, there is sensitivity to risk there.

I think that is decreasing some, as the CFTC proceedings are pretty well wrapped up. I think a lot of companies, at the time when the CFTC was conducting active investigations, were concerned that if they were making a mistake, even if it was an inadvertent mistake, it could bring them within regulatory gunsights.

The Policy Statement safe harbor protection for companies that follow the Policy Statement standards and report in good faith, has made a difference. A number of companies have resumed reporting because they have been able to put the processes in place that give them the comfort that they will qualify for the safe harbor protections.

The CFTC also issued a press release last summer, which indicated that they were not going to be prosecuting companies for inadvertent errors, and I think that helped also.

The cost of putting systems in place has discouraged some of the smaller companies. When we got the over 700 responses to the behavior order requirement that companies notify the Commission whether they are reporting prices in accordance with the Policy Statement or not, most of the companies saying that they were not reporting, were the smaller companies.

For them, as we have heard in many instances, it was an issue of cost and priorities within the company for their IT resources. In order to put a good capture system in place, to be able to feed data reliably to the index publishers, takes some effort and some cost, and for the smaller players, that was prohibitive.

MR. MARTINEZ: Commissioner, in addition, there's one more factor. There are many trading locations. Some of them are pretty thin, and it is a legitimate concern, I think, that some companies are -- don't want to show their hand, their willingness to pay, and if there are very few participants in some locations, and it's easy to see when you see the published prices, that, ah, it must be X, Y, or Z, and they're willing to pay. They might be short, long, they might have this need.

COMMISSIONER BROWNELL: That's reasonable.

MR. MARTINEZ: And that's a legitimate concern. That was always happening, because we have a lot of trading locations. So it is likely that any one company might choose a few locations that they prefer not to report.

COMMISSIONER BROWNELL: So, in terms of evaluating kind of these percentages, we need to make sure that we're evaluating kind of significant players and acknowledging that some of those locations, we don't -- we shouldn't actually want that vulnerability in the marketplace; is that correct?

MR. MARTINEZ: Exactly.

COMMISSIONER BROWNELL: It would be interesting, in the next -- if you want to see these numbers go up, to make sure that we have a real good handle on what these three factors are and how they are influencing people's decisions.

To the extent that we and the CFTC have not addressed the issues of certainty that they need, I think we ought to take a look at that and see what we can do.

I think our Policy Statement did make a difference, but clearly maybe there's more work to be done.

CHAIRMAN WOOD: I think that's good. It's just -- that might be actually -- what's the best way to garner that comment, probably in the next couple of months?

Why don't we just invite them here, invite people in this docket, to file back in in the PL Docket, if they've got any suggestions along the lines that Nora laid out. That might be the best way to ascertain the types of things that we and the CFTC can work on together.

I think that now we're kind of past all the shock moments from the 2000-2001 cleanup -- and I think we are -- there might be a time when everybody can feel better about it. I know that was a year and a half ago. That was just not even within reason for some companies, because of their involvement with investigations at the time.

COMMISSIONER BROWNELL: I think that overhang is still being felt, I suspect. I don't know.

CHAIRMAN WOOD: Maybe there are some recently.

COMMISSIONER KELLY: I think, along the lines of Nora's comments, it would also be helpful for us to divide our statistics up when we talk about the companies not reporting, which ones we think should be reporting or which ones it would be reasonable to hope that they would report, versus the ones where they have reasonable excuses or reasons for not reporting.

CHAIRMAN WOOD: All right, let's vote.

COMMISSIONER KELLY: Aye.

COMMISSIONER KELLIHER: Aye.

COMMISSIONER BROWNELL: Aye.

CHAIRMAN WOOD: Aye.

SECRETARY SALAS: Next for discussion is E-40. This is an Order on Electric Creditworthiness, a presentation by Brandon Johnson, who is accompanied by Lee-Ken Choo, Sebastian Tiger, and Ed Murrell.

MR. JOHNSON: Good morning, Mr. Chairman and Commissioners. E-40 is a Draft Policy Statement that would interpret the credit review provisions of the Commission's pro forma open access transmission tariff or OATT for the electric industry.

Issued in Order 888, the OATT is applicable to the electric utility transmission providers, including independent system operators or ISOs, and regional transmission organizations, or RTOs.

This Draft Policy Statement was developed in response to industry's concerns, some of which were expressed at the July Technical Conference, that the lack of transmission and electric creditworthiness standards and procedures may foreclose full market participation by competitive entities.

The Draft Policy Statement would clarify that the Commission interprets the pro forma OATT to require these entities, first, to make their creditworthiness standards and procedures more transparent and comprehensive; second, to post on their websites, the procedures that they used to perform their credit analyses; and, third, to provide customers who have been required to provide collateral, with a written analysis of how these credit procedures have been applied to them.

Next, this Draft Policy Statement sets forth the Commission's expectation that each ISO or RTO will, through its stakeholder process, consider the benefits of taking certain measures to reduce the default risks that are specific to ISO and RTO markets, namely, shortening settlement periods from monthly or quarterly, to weekly, and netting obligations between market participants and ISOs and RTOs.

Finally, the Draft Policy Statement requests that each ISO and RTO report back to the Commission within 90 days, on its progress towards implementing these measures and any other measures to reduce default risk in their markets, or, alternatively, its reasons for not yet adopting these measures.

CHAIRMAN WOOD: Thank you. Thank you, Brandon.

Explain to me the interconnection between this and the gas, the gas project that we've got going on.

MR. MURRELL: Well, at this time the issues are very similar, but the processes are very different. A little more than two years ago the Commission asked what is now the North American Energy Standards Board to entertain a consensus process to see about developing industry-wide standards for creditworthiness polices applied by interstate pipelines.

They came back about a year and a half later, having agreed to some procedural and communications but not having agreed to any substantive standards or in some cases even prescribing specific reporting requirements.

Those issues are now pending before the Commission after a notice of proposal-making was issued last winter.

In the electric context we have had since 1996 this general language in the pro forma open access transmission tariff that that requires the utilities to apply good commercial practices in evaluating creditworthiness. And in recent years there have been concerns about how those have been applied and the direction they've been applied in.

There's a picture of contrast in the electric industry itself between the open access context with the individual utilities, on the one hand, versus the organized markets in the RTO's and ISO's on the other hand.

The organized markets have their own stakeholder processes. The main thing that I think really distinguishes the two industries -- our focus in gas is on the transmission service. And the standard setting exercise that we ask NAESB to look at and the issues that are currently pending before the Commission in the rulemaking proceeding only applied to the creditworthiness applied to interstate transmission services.

In the electric context the organized markets' creditworthiness issues apply across the whole industry from the commodity services, the operation of the transmission grid, all of the aspects of ancillary services and congestion pricing, and just the sheer dollars in the two industries. They are on a very different scale.

So in the case of the gas industry we've had an evolution of practices, individual transmission tariffs since the mid- to late-1980s to now. And in the electric industry it's a relatively less developed process that started in 1996.

COMMISSIONER BROWNELL: I guess I hear the rationale. I see it written that -- in the second paragraph -- that the differences in the maturity fundamentally of the electric and gas markets and the structure would lead us to conclude that a policy statement is better than a rulemaking.

I take away the differences between those two markets. And the maturity and the development is all the more reason to do a rulemaking. I think that when we look at the transcript and we see the profound impact of the lack of transparency and lack of consistency between and among organizations, I think inherently that's a barrier to entry. It could be a discriminatory practice.

And indeed, the evolution of the market, given all the barriers we've seen, may be slowed down because this isn't clear.

I also read here that the complexity and the differences in the marketplace would make a rulemaking impossible because one size doesn't fit all. That phrase, by the way, I would like to eliminate from the universe because I've heard it enough.

I don't necessarily think a rulemaking leads one to a "one size fits all." I think we have lots of opportunity to address some fundamentals that we insist on while allowing people to approach them in different ways. And, once again, I go back to banking. Different banks have different underwriting criteria. They have different credit standards. But they are all driven by certain fundamental principles either set by their regulator or certainly overseen by their regulator.

So I think this is a good start. I think there's a lot of encourage, wish, hope, want to -- and I'll be pleasantly surprised if in 90 days we get a flock of filings that say, "Oh, yeah, we thought this was a great idea and we've adopted it." And it's implemented, you know, in the next 30 days.

What I suspect we're going to get is, "We're thinking about it. It's going through the stakeholder process," et cetera, et cetera. And I think the stakeholder process works okay for some things. I don't think the level of expertise required for this kind of decision-making process actually lends itself to either a concise nor a substantive nor a timely outcome.

So I think it's timely. We really kind of looked at what's appropriate for the stakeholders and what's not. So I heard a huge number of very serious concerns raised in the transcript. I'm sorry I couldn't be at the meeting. And I just hope in 90 days if we don't get what we think we're going to get, we kind of reconsider this.

CHAIRMAN WOOD: Nora, are you more -- I mean, there are kind of two halves to this order. One was for the transparency of creditworthiness standards being applied to transmission customers and everybody's out.

COMMISSIONER BROWNELL: Right.

CHAIRMAN WOOD: And then the other half would be the ones focused on the netting and the bigger issues in the RTO-ISO markets -- kind of like Brandon was laying out or Ed was laying out just a minute ago.

And that was -- is it really more the second one that you're worried about that's going to get kind of just sucked into this stakeholder process and never get addressed where you get those settlement periods shortened so people don't have to have so much collateral put up.

COMMISSIONER BROWNELL: I think it's a little bit of each, Pat. I need to think about that. I hadn't thought about it quite in those terms. Certainly the latter is critically important. And I think there was a lot of comment focused on that.

But I want to think that --

CHAIRMAN WOOD: I mean, I'm sympathetic to a more directed stance here. And I think honestly the first step, which should be pretty much a no-brainer. I mean, we just say the OATT means you've got to put these things on your Web page, not you've got to put them in your tariff.

And I'm fine with that. I think the main thing is the customer knows what standards are going to be applied to him and he knows they're the same ones that were applied to everybody that stood in line before him and after him.

And I think that shouldn't be a big deal. And the way this is written here is not much different, I think, than a -- it certainly would lead to the same outcome as a rule.

The mutualized default risk issues in the RTO-ISO markets are ones we've grappled with in a couple of cases since we've been here. I think PJM had one. New England may have had one. I'd be willing to give them a little time to figure that out.

I think what we do here is elevate that to the level of we want to see something from you guys in 90 days. And in a stakeholder process that's actually a very short period of time.

COMMISSIONER BROWNELL: Trust me. That's a short period of time.

CHAIRMAN WOOD: But, you know, I think -- I guess compared to what we heard over on the gas side, that one was "help, fix it; we're drowning." This one was "this could be a problem."

And I don't necessarily disagree that rulemaking is not where we end up. I wouldn't mind just doing a little fishing with this in the next 90 days and seeing what we get in.

And so I'm fine with this being a policy statement. And I do think the second half of it to me is really the more important. And it is admittedly more mushy because it's a "we want, we like kind of approach" as opposed to "you're directed to do" approach.

COMMISSIONER BROWNELL: And you know what? We've liked a lot of things that no one's done.

CHAIRMAN WOOD: Yeah, well, we'll see if this one goes somewhere. But, I mean, I'll commit to you that we we'll definitely put this on the tickler and those 90-day reports. And we'll have a public discussion about it and what we want to do next at an open meeting in -- certainly come March or so.

COMMISSIONER BROWNELL: Great.

CHAIRMAN WOOD: I think -- well, three months from now will be February. So March, February. And see what we do.

So I will support the policy statement, but acknowledgement it. We can agree to disagree on the format here.

COMMISSIONER KELLY: I am also concerned about the same things you're concerned about, Nora. However, I do think that this policy statement is the appropriate first step for us to take.

We know that transmission providers, many transmission providers, some ISO's and RTO's already do some of the things that we expect everyone to do making their credit-related procedures and standards transparent by posting them on the Web site, considering both quantitative and qualitative factors. And it seems to me at least that it wouldn't take much for the industry as a whole to go along with that.

I like the third aspect of this policy statement about our expectation that the ISO's and RTO's reduce their risk in impact of a default by a market participant because I think that's consistent with what we've been talking about here since I joined the Commission about looking at cost controls for RTO's.

And I think this is a healthy and responsible way to encourage ISO's and RTO's to take measures to reduce -- in the long run reduce their costs and their risk. And I'm optimistic, perhaps more so than Nora, that we will get a positive response from the industry and reaction to this. So I support the policy statement.

COMMISSIONER BROWNELL: All right. Let's vote. Sudeen?

COMMISSIONER KELLY: Aye.

CHAIRMAN WOOD: Aye.

COMMISSIONER BROWNELL: No.

COMMISSIONER KELLIHER: Aye.

SECRETARY SALAS: Next for discussion is G-2. This is policy for selected discounting by natural gas pipelines. It's a presentation by Ingrid Olson, who is accompanied by Richard Howe and Wayne Guest.

MS. OLSON: Good morning, Mr. Chairman and Commissioners.

G-2 is a notice of inquiry seeking comments on the Commission's policy on selective discounting by natural gas pipelines.

Specifically, the draft order asks interested parties to comment on whether the Commission's policy of permitting pipelines to adjust their fee put downward in rate cases to reflect discounts given by pipelines for competitive reasons is appropriate when the discount is given to meet competition from another natural gas pipeline sometimes referred to as gas-on-gas competition.

The draft order explains that under the Commission's selective discount policy pipelines are permitted to discount in order to meet competition. For example, if a shipper were able to obtain an alternate fuel at a cost less than the cost of gas including the transportation rate, the Commission's policy permits the pipeline to discount its rate to compete with the alternate fuel and thus obtain additional throughput that otherwise would be lost to the pipeline.

This policy is based on the rationale that selective discounts benefit all customers including captive customers that do not receive the discounts because the discounts would allow the pipeline to maximize throughput and spread its fixed cost over more units of service.

The draft order states that in several Commission proceedings it has been argued that this rationale does not apply in the case of gas-on-gas competition. In these situations, parties have argued, gas-on-gas competition permits a customer who must use gas but has access to more than one pipeline to obtain a discount.

But if the two pipelines were prohibited from giving discounts when competing with one another, the customer would have to pay the maximum rate to one of the pipelines. This would reduce any discount adjustment and thus lower rates to captive customers.

The prior cases where this issue have been raised did not result in a final determination on the merits of this issue.

Therefore this NOIS parties for comments on the effect of the Commission's current selective discounting policy on captive customers, the impact of a rule implementing the discount -- eliminating the discount adjustment for discounts given to meet competition from another natural gas pipeline and whether the Commission should consider other changes to its policy, its discount policy, to minimize any adverse effects on captive customers.

Thank you.

CHAIRMAN WOOD: Thank you, Ingrid. This happened in a recent -- well, I don't know, in the past couple of years the Commission -- I think probably before we got here. But the Commission had committed to look at this in a prior case, but chose not to do it in some subsequent arena.

Is that how it -- can you walk me through maybe the sequence here where this has come up? Because I'm sure people are going to go, "Why is this an issue?" It actually is not a big one. But it's something we committed to do in the past and we had not done. And so someone's in court asking us to follow through on our promise. So this is follow through on the promise.

MR. HOWE: As part of the Commission's requests for comments in the rulemaking that led to Order Number 637, the Commission did raise the issue, but ultimately in Order 637 the Commission determined not to address the issue in that proceeding. It held open the possibility of doing it later.

That decision not to address the issue in 637 was part of the appeal to the D.C. Circuit. And when the D.C Circuit affirmed our decision but indicated quite clearly in its decision that it thought that at some point if the Commission continued not to address the issue, it would set the matter up for some sort of order for the Commission to address the issue.

CHAIRMAN WOOD: And the issue as it was kind of crisply teed up then was it discounting and the discount adjustment in general or the discount adjustment as relates to gas-on-gas competition? Or --

MR. HOWE: The primary focus, the issue that's been pursued, is the gas-on-gas competition issue. The Commission did address that on the merits about 10 years ago in the Southern case.

In that case it was somewhat easier to dismiss the argument than it might be other cases because Southern faced competition from nonjurisdictional intrastate pipelines.

But, in any event, it's been now 10 years since the Commission addressed it in the Southern case, which was at the very start of the first round of pipeline rate cases that actually raised the issues.

So the purpose of this notice of inquiry is just to develop a current record in order to address the issue one way or another.

COMMISSIONER BROWNELL: My history is not as in depth as yours. But I thought the question before the courts was the narrowly focused one. And I have not heard or seen a number of complaints or questions or a need for clarification on the broader issues of discounting.

Am I -- so what you're saying is we're doing this just because it's 10 years since we've done it. So we've taken this case, which asked one very narrow question and we're asking a much broader series of questions because it's time? Is that -- do I understand that correctly?

MR. HOWE: The primary focus of this is the gas-on-gas competition issue. It's just once that issue is raised, if conceivably the Commission, you know, based upon the comments, felt that there was some kind of problem that it wanted to address some other remedy than simply no discount adjustment for gas-on-gas competition, that is left open for people to address.

But the primary focus of this notice of inquiry is the gas-on-gas competition issue.

COMMISSIONER BROWNELL: It is a focus. It struck me as just a focus in the much broader series of questions addressing other aspects. That's my interpretation, which is why I was trying to kind of understand that history.

Thank you.

CHAIRMAN WOOD: Anything else?

CHAIRMAN WOOD: Let's vote.

COMMISSIONER KELLY: Aye.

COMMISSIONER KELLIHER: Aye.

COMMISSIONER BROWNELL: Aye, noting my

concurrence.

CHAIRMAN WOOD: Aye.

SECRETARY SALAS: Next for discussion is E-4. This is Midwest Independent Transmission System Operator with a presentation by Richard Hudson, who is accompanied by Mike Tonini, Kim Boes, Geraldine Stanley, and Larry Greenfield.

MR. HUDSON: Good morning, Mr. Chairman, Commissioners.

The draft order before you today and item E-4 would receive the beneficial goal of eliminating rate pancaking across the Midwest ISO and PJM scene.

Today's draft order would replace the MISO and PJM current through-and-out rates, which result in pancake trades across that border with the continuation of license plate rates and a transition mechanism to mitigate cost shifts, both becoming effective December 1.

The draft order is in response to two competing rate proposals filed as replacements to the existing through-and-out rates. These are the unified plan and the regional pricing plan.

The unified plan was filed pursuant to section 205 of Federal Power Act and is supported by the majority of MISO and PJM transmission owners, in addition to a wide cross section of other stakeholders including both consumer advocates and multiple state commissions.

The unified plan primarily consists of the continuation of the current license plate rate structure in place today in MISO and PJM, but it also proposes transitional settlement payments to certain transmission owners.

However, the regional pricing plan was filed pursuant to 206 of the Federal Power Act and is supported by the AEP, Allegheny Power, Ameran, Commonwealth Edison, Daton, and Excelon, plus a few nontransition-owning stakeholders.

The regional pricing plan, on the other hand, would restructure inter-RTO and intra-RTO rates in the region so that a portion of transmission costs would be recovered through a regional pricing mechanism. This regional pricing mechanism would recover some costs, those related to certain high voltage facilities, through a regional poster stamp rate and some costs through a usage based rate charged to net importers based on a system flow analysis.

The draft order finds that this regional pricing plan is not fully supported and presents various implementation issues that prevent it from being a viable option to replace the through-and-out rates on December 1.

The draft order conditionally accepts the continuation of license plate rates proposed in the unified plan, but rejects the offer of settlement payments as unduly discriminatory.

However, the draft order recognizes that in prior orders the Commission has approved transition mechanisms designed to mitigate abrupt cost shifts that can result with the adoption of license plate rates.

In an order issued last fall in this proceeding parties were directed to implement a transitional mechanism to mitigate cost shifts. This mechanism was called the SECA, which stands for seams elimination cost assignment surcharge.

The SECA was designed to prevent cost shifts between customers by assigning the cost responsibility of lost revenues proportionally to those who would benefit from the elimination of rate pancaking.

However, as part of a settlement approved by the Commission in March a majority of the parties involved agreed instead to delay the elimination of the through-out-rates until December 1 of this year so that they develop a permanent replacement rate that would replace the need for a transitional SECA.

However, the settlement also calls for backstop SECA filings, which are to filed on November 24th to take effect December 1 of this year in the event that an alternate rate design cannot be implemented.

The draft order finds that these backstop SECA filings represent the appropriate transition mechanism to accompany the continuation of license plate rates and that these two rate mechanisms together produce a just and reasonable replacement rate design for the through-and-out rates on December 1.

As the draft order indicates, these actions are consistent with the Commission's prior policies for eliminating rate pancaking.

Because the Commission has required that proposals for license plate rates must clearly address how the cost of new facilities will be allocated, the draft order requires that MISO and PJM develop a proposal addressing the allocation of costs for new transmission facilities that are built in one RTO, but provide benefits to customers in the other.

Implementation of such a proposal will eliminate pricing barriers to the construction of such new transmission facilities.

In conclusion, the draft order would achieve the goal of eliminating rate pancaking across the MISO-PJM border by establishing an appropriate replacement rate design which will promote the efficient operation of the current and developing energy markets and MISO and PJM.

Thank you. And we'll be happy to answer any questions that you have.

CHAIRMAN WOOD: Thanks, Richard. And thank you all for this. It's been a long time being patient here. We were talking about this in the summer of '03 I think. Is that when this first kind of came in here? Probably so. That hope that we would have gotten a full settlement here kind of makes you wonder why we sit around and wait for settlements to come in when they never do. We should just get it over it in '03.

But we're here. And the outcome here is about what we could have ordered last summer. So after a year of people spending time, we're where we started. But -- with just license plates plus the SECA and orders to get to a full program going forward. I do worry about that being still up in the air for the parties to work on going forward.

But in any event, the SECA filing itself -- tell me about that because I know it's one that they committed to do if they did not reach full settlement. And so what is -- and so what is -- and you mentioned it in passing. But just kind of flush that out a little bit.

MR. HUDSON: The details of the SECA or when and how it will be --

CHAIRMAN WOOD: Both.

MR. HUDSON: Both, okay.

CHAIRMAN WOOD: What is it? And when is it coming? And how is it -- when does it kick in?

MR. HUDSON: Well, the SECA is a form of a transitional lost revenue recovery mechanism, which we have used in other cases eliminating rate pancaking.

Basically what it does is it looks at the revenues that would be lost due to the elimination of through-and-out rates and tries to collect those on parties through a going-forward surcharge that's based on a historical test year.

Now, this historical test year looks at these companies historical import patterns and would assign those lost revenues in proportion to those. So someone who imported more in the past would have a higher SECA going forward.

The SECA is only a transitional mechanism, so what this means is that it's only for a two-year transition period. And this two-year transition period began in April before the parties went to settlement. So it would end in March of 2006.

And these SECA filings will be submitted on November 24th as consistent with our settlement that we agreed to in March.

CHAIRMAN WOOD: Good. I think it's important to really look at this for what it is. I mean, it is a change of rate design -- from a biometric based rate design across this region to a demand type. I always used to describe it as renting a car, where you don't get -- for 15 cents a mile anymore. It's just a flat rate for the car.

And while that has some implications on transmission usage, I think the more important implication is that it expands the footprint of the market. In the market that could be -- you know, without some observation markets, even in RTO's, could get to be concentrated.

So the steps that we take on rates is not to try to make that market actually broader and more accessible to the customer, such as eliminating the pancakes or the volumetric charges on each transaction, which are two separate things we're doing here at the same, are good steps.

And I think that will certainly benefit, in light of the jagged seam that we have between the two regions through the kind of Midwest there -- that will have a lot of, I think, benefits, particularly to the customers on both sides of the immediate seam.

And so I do think it's appropriate, though, to compensate the folks who have gone forward and volunteered to be in these RTO's to kind of look at the lost revenues for a transition period.

And again, with the urging to get to a more permanent solution that is compensatory for the revenue requirement going forward in a way that reflects the market patterns a little bit better.

So this a bridge to a different world, but we're finally on the bridge and it's about time. So I know it was a lot of work on you guys' part throughout the area. And I appreciate the judges, Chief Judge Wagner, and the parties' efforts to get their to eliminate barriers.

We've just eliminated one by -- it was kind of a mutual surrender -- in New England, New York. In our order we issued, I think, since we last met -- didn't that go out since we last met? The New England RTO order. We accepted the two-way elimination of rate barriers there.

And I do hope that this process of opening more markets can be of one we take maybe even outside the RTO context. It might be a very useful approach to open up the markets and get rid of the volumetric charges and the pancakes.

So this wasn't the easiest road to make that such a rubber stamp thing that we can easily do everywhere else in the country. But it certainly -- we learned a lot. And I do hope we kind of get some lessons learned here and take that when we go do elimination elsewhere.

COMMISSIONER KELLY: Well, Mr. Chairman, I think that your comments are appropriate. And I think that this is also an example of the fact that change is hard, and particularly when you have change that involves the shifting of costs.

And the fact that it would be ideal to have a new plan, a wholly integrated plan. But I think a two-year transition period is probably the fact of life.

So I support this. I want to emphasize the importance, though, of our request that the ISO look at a mechanism to address the pricing of new transmission because going forward -- that's so important that the appropriate transmission be built and there not be barriers to that.

CHAIRMAN WOOD: You know, it was an issue. I was at -- yesterday speaking on the using state and federal relationship issues. And, you know, it was the day after the regional state committee in the Southwest parapool had just voted on a proposal that they made to the board. And the board will do what it will do. And then maybe they will file something later this year.

But getting those basic steps about how do you pay for new transmission? -- that there was a rapport, that one of the people that has appeared before us, ESAI -- Ed Kraples? Is that?

MR. HEDERMAN: Yeah, Ed Kraples.

CHAIRMAN WOOD: Put out a statement I saw two days ago on the Web and said that the place where you're getting significant transmission built -- and they were kind of peering through all the reports because everybody reports local transmission and generator interconnections as if it's transmission.

But he said the significant inter-utility transmission being built is being built in New England in PJM and in ERCOT. And those are places where they've all got, ironically, pretty fixed cost allocation methods for new transmission.

And I'm not sure the one in PJM is as firm as it needs to be yet. But clearly the one we voted on in New England, and I'm familiar with the one in ERCOT as well, where you've got it pretty clear.

So, Sudeen, thanks for pointing that out. I do think, you know, that SVP is now saying that this is what we ought to do again -- that's not yet been before the Commission and approved.

But these steps taken forward about how are we paying for incremental transmission construction, how are we going to really do that, and how are these companies that are building that transmission going to get their money back so they'll actually consider this a good, safe investment -- that's a critical step.

And regulators can make that happen. And it was, you know, one of my messages yesterday: Keep on the good work because these don't have to be the same in every region. They can be done differently in MISO. They can be done differently in SVP than they were done in ERCOT or in New England. But let's get them all done.

So I was glad to see you all's recommendation that that be in this order. And I've always supported that being in here.

COMMISSIONER BROWNELL: And I think maybe it's time we kind of looked again at transmission pricing policy. And while I think we acknowledge regional differences, the extent they're wildly different means that investment levels are going to be wildly different.

And the kinds of investment you get? I mean, we look, for example, at the behavior of independent transmission companies who are investing 10, 12 times as much in their system. And even in PJM, when you look at the similarly sized system in the U.K., the U.K. is spending twice what we're spending in -- actually it's more than that -- in PJM.

So I think we really need to grapple with this issue. And I think a 10-year transition leaves us with a system that is frightening as far as I'm concerned. So I think even the Northeast, where they're building some stuff -- are they building enough? And is it the right stuff? I think we really need to focus on that.

CHAIRMAN WOOD: The statement. Well, bring it back.

COMMISSIONER KELLY: Aye.

COMMISSIONER KELLIHER: Aye.

COMMISSIONER BROWNELL: Aye.

CHAIRMAN WOOD: Aye.

SECRETARY SALAS: And the final item for discussion this morning is a joint presentation of C-2, Saltville Gas Storage Company, and C-4, Fine Prairie Energy Center. It's a presentation by Cecelia Desmond, William Howard, Howard Wheeler, and Joel Arnison.

MS. DESMOND: Good morning, Mr. Chairman and Commissioners. Both Items C-2 and C-4 relate to the certification of new natural gas storage projects. I will present C-2, and Howard Wheeler will present C-4.

C-2 amends the Commission's June 14, 2004 Order which authorized Saltville Gas Storage Company to construct and operate a natural gas storage facility in Virginia, by converting existing salt caverns for the underground storage of natural gas.

As amended, Saltville's maximum gas storage capacity is 6.75 Bcf, and its maximum working gas capacity is 4.79 Bcf. Saltville's facility is connected to East Tennessee Natural Gas Company, and it provides storage services in the Mid-Atlantic Region.

With certain exceptions, the Commission approved Saltville's cost-based rate proposal and granted it authority to charge negotiated rates. The Draft Order grants rehearing, in part, on the June 14th Order to permit Saltville to modify the Commission's traditional equitable method of rate design for storage services to reflect that Saltville is offering a new kind of cost-based storage service that has three, rather than two components.

In addition to reservation charges for capacity and deliverability, Saltville will have a separate reservation charge for the injection of natural gas into storage. This modification takes into account, the fact that salt cavern storage facilities such as Saltville's, can provide rapid response injections and withdrawals to provide an additional flexible and reliable storage service to its customers, as they needs arise throughout the year.

Approving this modification to storage rate design, facilitates the operation and rapid response of salt cavern storage facilities by taking into account, the non-traditional services that they can provide. Thank you. Howard?

MR. WHEELER: Good morning, Mr. Chairman and Commissioners. C-4 is a Draft Order authorizing Pine Prairie Energy Center, LLC, under Section 7(c) of the Natural Gas Act, to construct and operate a high-deliverability salt dome natural gas storage facility in Evangeline Parish, Louisiana.

The Draft Order also approves Pine Prairie's request to charge market-based rates for its firm storage and interruptible hub services, as well as blanket certificates under Parts 284 and 157 of the Commission's Regulations.

The proposed facilities consist of three salt caverns and the associated above-ground piping and compression for the storage operation; approximately 28 miles of pipeline connecting the storage facility to six transmission pipelines, and seven interconnections with the six pipelines.

In addition, Pine Prairie is authorized to acquire about 34 miles of existing nonjurisdictional pipeline to interconnect with the six pipelines.

Pine Prairie plans to construct the caverns in phases, placing the first cavern in service by January 1, 2006, and the second cavern in service by January 1, 2008.

Upon completion, each cavern will have a total capacity of 9.6 Bcf -- that's billion cubic feet -- and a working gas capacity of eight Bcf, for a total of 24 Bcf of additional storage capacity available to the region.

In operational terms the caverns will provide about 2.4 Bcf per day of withdrawal capacity, and 1.2 Bcf per day of injection capacity.

The Draft Order finds that the proposed storage service will further the development of natural gas infrastructure necessary to provide storage for gas-fired electric generation plants and may ultimately support the liquified natural gas import terminals proposed for the Gulf Coast Region. This completes my presentation.

CHAIRMAN WOOD: That's a pretty significant -- I know that's a feature of salt dome, is that it can be such quick withdrawal, but that, you can literally take out one-fourth of the capacity of the cavern in a day? That's pretty impressive.

MR. WHEELER: That's what they've stated and that's how they're engineered, yes.

CHAIRMAN WOOD: One of the reasons we wanted to focus here, is I know there was a lot of interest a month ago or last month -- it hasn't even been a month -- but a few weeks when we had the State of the Gas Industry meeting on market-based rates for storage, and what we have here is one that got traditional cost-based rates with a variation on the old equitable rate design, which was the Saltville case.

And then the second here, the Pine Prairie case in Louisiana, is one that gets market-based rates. We didn't hear a lot about it at the hearing a couple of weeks ago, that a lot of people have been qualifying all along for market-based rates, consistent with the 1996 Policy Statement of the Commission on market-based rates for storage companies.

So those looking for an answer about what's the Commission doing, of course, that's too soon. We've asked for comments that are probably in about now or coming in next week, comments on what to do about whether to apply this HHI test at all to other people who would otherwise fail as the Red Lake.

They didn't meet it before, so that -- we'll again take that issue up in a future case, so those looking to devine the entrails in these two cases, should wait a little longer, but this is a good chance to focus again on the need to have storage and the need for us to be creative and reflective with the industry, but yet observe our statutory obligations here, not only on the environmental and siting side, but on the rate design side. Nice work.

COMMISSIONER KELLY: Mr. Chairman, I wanted to point out that Pine Prairie, I think, is the poster child for market-based rate authority in storage. If it's going to be connected or allowed to be interconnected with six different pipelines, I know Staff's analysis shows that it will have only three percent of the market.

The HHI analysis shows 1,562 HHI for working gas capacity, and an HHI or 1,131 for peak-day deliverability, and that's well under the threshold of 1800, and indicates the Applicant would not be unable to exert market power in any of the relevant market areas. So I support the approach in C-4, as well as the approach in C-2.

CHAIRMAN WOOD: Good. More, Joe?

COMMISSIONER KELLIHER: I support the Orders, as well, and I think I agree with Sudeen that on C-4, it is appropriate to grant market-based rates, and I look forward to the comments to see if we could adjust our policy and perhaps be even a little more liberal on market-based rates.

And on C-2, I think we're doing the right thing by granting rehearing. We're showing flexibility for projects that get cost-based rates. The equitable policy was established in '86 and its roots go back to '76, so it's appropriate, after a quarter of a century, to show a little bit of flexibility in our cost rate policy with respect to gas storage, so I support both Orders.

CHAIRMAN WOOD: Okay, on that happy note, lets vote.

COMMISSIONER KELLY: Aye.

COMMISSIONER KELLIHER: Aye.

COMMISSIONER BROWNELL: Aye.

CHAIRMAN WOOD: Aye.

We'll have our closed meeting start at quarter to 1:00.

(Whereupon, at 11:40 a.m., the open session was to concluded, to be reconvened this same day at 12:45 in closed session.)