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BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

- - - - -x  
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

897TH COMMISSION MEETING  
OPEN MEETING

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

Thursday, October 20, 2005  
10:03 a.m.

1 APPEARANCES :

2 COMMISSIONERS PRESENT :

3 CHAIRMAN JOSEPH T. KELLIHER

4 COMMISSIONER NORA MEAD BROWNELL

5 COMMISSIONER SUEDEEN G. KELLY

6 SECRETARY MAGALIE R. SALAS

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18 ALSO PRESENT :

19 JANE W. BEACH, Reporter

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

(10:03 a.m.)

CHAIRMAN KELLIHER: 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 of Allegiance.

(Pledge of Allegiance recited.)

CHAIRMAN KELLIHER: I'd like to begin this meeting with an announcement concerning future Commission meetings and technical conferences based in the District of Columbia. In an effort to better serve the public, states, and Congress, the Commission will be offering free access to webcasts of our open meetings, and D.C.-based technical conferences to the first 750 viewers, beginning with the November 17th open meeting. So, go to the webcast early, if you want to make sure that you get in.

But it will be available free for the first 750 viewers. Anyone with Internet access who desires to view these events, can do so by going to our website, [www.ferc.gov](http://www.ferc.gov), and locating the webcast link on our home page.

This change provides greater openness in Commission proceedings. One reason we made this change, is

1 that many citizens have an interest in a single Commission  
2 proceeding such as siting an LNG facility or licensing of a  
3 hydro project or a gas pipeline, and these citizens are not  
4 likely to subscribe to a paid service for the privilege of  
5 watching the Commission all year'round.

6 Indeed, they might not have an interest in our  
7 proceedings after the disposition of that LNG facility or  
8 hydro project.

9 (Laughter.)

10 CHAIRMAN KELLIHER: So it's really with an eye to  
11 those citizens, the FERC Bar, if you will. They are  
12 probably perfectly content with our current level of  
13 service, but I don't think it really serves the average  
14 citizen very well.

15 So that was the thing that drove this decision.  
16 This step will make sure that our meetings are available to  
17 those citizens.

18 I do want to point out that we did solicit a  
19 number of bids to make sure that the taxpayer receives this  
20 service at a fair price.

21 I want to recognize that this was Tom Russo's  
22 idea, from the External Affairs Office, that he brought to  
23 the attention of Cathy Tripodi on my staff, and she  
24 presented it to me. I thought it made a lot of sense.

25 And Tom Herlihy, our Executive Director, made

1       sure that we got a number of bids and we got this service at  
2       a good price.

3               On a second matter, FERC currently syndicates its  
4       most important web content with other websites, using a  
5       technology called Really Simple Syndication, RSS, for short.  
6       If you follow FERC proceedings and you want to keep track of  
7       when we issue rules under the Energy Policy Act of 2005, or  
8       press releases, you might want to consider subscribing to  
9       our RSS feed.

10              You can think of it as FERC e-mailing you "What's  
11       New" information, which is posted on our website. It  
12       includes the most important news events and information on  
13       the FERC website. This is -- I'm making this announcement  
14       because there have been a lot of inquires about our Energy  
15       Policy Act implementation efforts.

16              A lot of the steps we're taking on Energy Policy  
17       Act implementation, fall in between the open meetings, and  
18       there's natural interest on the outside to track our  
19       progress towards Energy Policy Act implementation. This is  
20       one way you can do that.

21              Now, you'll save time and you will not have to  
22       constantly check our website for updates, if you subscribe.  
23       Now, you can find out how to subscribe by going to our home  
24       page, again, [www.ferc.gov](http://www.ferc.gov). Just look for the bright orange  
25       button and click on "What is RSS?"

1           And if you have any further questions, you can  
2           contact our Office of External Affairs.

3           Let me make a couple of comments about some of  
4           our activities related to Hurricanes Katrina and Rita. As  
5           everyone knows, those hurricanes have had a severe effect on  
6           our nation's energy infrastructure in the Gulf of Mexico.

7           And particularly hard hit is offshore gas  
8           production. Twenty percent of the U.S. gas supply comes  
9           from the offshore Gulf, and most of that production has been  
10          lost in recent weeks, and recovery has been slow.

11          To that end, the Commission stands ready to act  
12          on emergency filings to authorize more efficient use of our  
13          existing energy infrastructure. Over the past month, we've  
14          extended the waiver of certain standards of conduct rules  
15          and recordkeeping requirements for Entergy; we've granted  
16          several pipelines in the Louisiana area, the authority to  
17          waive on a nondiscriminatory basis, certain penalties, fees,  
18          or other charges incurred as a result of Hurricane Katrina;  
19          and we have granted, in particular, Discovery Gas  
20          Transmission's request for an emergency exemption to  
21          transport gas around the Venice processing plant.

22          And this emergency request, the Discovery Gas  
23          emergency request, will expedite the transportation of up to  
24          300 million cubic feet per day of offshore natural gas that  
25          is now shut in as a result of damage to a Dynegy processing

1 facility.

2 We granted Discovery Gas Transmission's request  
3 to construct and operate interconnections, and waived FERC's  
4 regulations that restricted emergency transactions to 60  
5 days, with one 60-day extension. Discovery Gas will  
6 utilize the gathering line to gather up to 300 million cubic  
7 feet of unprocessed gas that has bypassed the shutdown  
8 processing plant, and transport this gas to an alternative  
9 processing plant in LaRose, Louisiana.

10 I want to point out that I'm particularly  
11 impressed that we acted very quickly on this emergency  
12 filing. We received this request at 10:30 in the morning,  
13 and we approved it that same afternoon. I think that's a  
14 tribute to the dedication and expertise of the Commission  
15 Staff.

16 Now, last Friday, the Commission also issued an  
17 Order approving Stingray Pipeline's emergency request for  
18 waiver of certain tariff conditions. Again, we approved  
19 this emergency request filing, the same day it was received.

20 This waiver allows Stingray to begin deliveries  
21 to the neighboring HIOS offshore pipeline system, of up to  
22 240,000 Mcf per day, bypassing the damaged Stingray  
23 processing plant.

24 Together, these two emergency Orders, the  
25 Discovery and the Stingray Orders, allow one-half of a Bcf

1 per day of shut-in production to flow to market, and that  
2 will improve natural gas supplies and serve to affect  
3 prices.

4 Now, last week, we held a conference here at the  
5 Commission on the state of the natural gas infrastructure.  
6 That conference focused on issues relating to both the  
7 short-term damage caused by Hurricanes Katrina and Rita, as  
8 well as long-term infrastructure issues.

9 Information regarding that conference is  
10 available on our website in the Public Calendar section, and  
11 there are select materials from the conference, such as  
12 presentations, talking points, and staff reports that are  
13 available on the website.

14 Let me discuss -- I'd like to discuss some of the  
15 notational Orders that we've issued since the last open  
16 meeting. We are doing more of our work notationally.

17 Since the September 15th open meeting, the  
18 Commission has issued 91 notational Orders, including some  
19 very significant Orders.

20 I want to thank my colleagues and the Commission  
21 Staff for working so closely and effectively to make sure  
22 that we've been able to do so much business, and I do want  
23 to acknowledge the hard work of the Commission Staff to make  
24 this possible.

25 Now, in particular, we continue to implement the

1 Energy Policy Act of 2005. And as I've said before, I'm  
2 committed to meeting the deadlines established by Congress  
3 in this law.

4 Over the past month, the Commission has taken a  
5 number of very significant actions to implement the law. In  
6 the past month, we have issued a merger review proposed  
7 rule; we've issued an Order establishing Joint Boards on  
8 Economic Dispatch; we've issued the LNG Pre-Filing Final  
9 Rule; we've issue a proposed rule regarding PURPA provisions  
10 in the law.

11 We have signed a Memorandum of Understanding with  
12 the Commodities Futures Trading Commission, and we've issued  
13 a consolidated record policy statement.

14 I want to take this opportunity to briefly  
15 discuss these Orders and invite my colleagues to comment, as  
16 well. First of all, the merger review proposed rule: EPACT  
17 2005 clarified the Commission's authority over holding  
18 company mergers, and granted the Commission significant new  
19 authority over generation facility transfers, strengthening  
20 our ability to prevent the exercise of generation market  
21 power.

22 Congress largely codified our three-part merger  
23 test, which looks at the effect of a merger on competition,  
24 rates, and regulation. One significant change to the test,  
25 though, that Congress made, was the requirement that we find

1 a proposed merger will not result in cross-subsidization or  
2 the pledge or encumbrance of utility assets.

3 I want to note that there's very little  
4 legislative history on this new requirement, and the  
5 Commission asked, in its proposed rules, a series of  
6 questions about how the Agency can best implement this new  
7 provision.

8 There also have been some concerns about the  
9 extraterritorial application of the new merger language and  
10 whether the Commission would assert authority to review  
11 mergers of foreign utility companies, when one of the  
12 merging parties has a U.S. subsidiary, and the Commission  
13 sought comment on how we can pre-approve or expedite such  
14 transactions, while protecting U.S. captive customers.

15 Another Order that we issued, was establishing  
16 the Joint Boards on Economic Dispatch. We established four  
17 of those Boards. Two will be chaired by my colleague,  
18 Commissioner Brownell, and one will be chaired by Sudeen and  
19 one by myself.

20 Now, I just want to note that we're moving  
21 quickly, not just to establish the Boards, but to start  
22 holding meetings. Right now, it looks like those four  
23 boards will all have meetings over the next month in  
24 November.

25 Now, these will be the first Joint Boards that

1 the Commission has established in decades. And this is an  
2 area where, since I have gotten to the Commission, I've been  
3 interested in looking for opportunities to establish a Joint  
4 Board.

5 Now, Congress has given us that opportunity, and  
6 I think this process will be interesting. If it proves to  
7 be productive, perhaps the Commission will establish more  
8 Joint Boards in the future -- if the process proves  
9 productive.

10 Now, the Commission is charged by the Energy  
11 Policy Act with making a report to Congress, based on the  
12 record of the Joint Board meetings, including possible  
13 statutory recommendations.

14 And I just want to clarify that we start this  
15 process with no preconceptions on what those recommendations  
16 might be. I think this process is simply an honest  
17 assessment of economic dispatch -- nothing more.

18 Now, on the LNG Pre-Filing Final Rule, we did  
19 meet the 60-day final deadline in the law, which is not  
20 easy to do under the Administrative Procedures Act. That  
21 Final Rule provides, among other things, that applicants  
22 that propose modifications at existing facilities, comply  
23 with pre-filing procedures, if the modifications involve  
24 significant state or local safety considerations that have  
25 not previously been addressed.

1                   Now, under the PURPA proposed rule, the  
2 Commission issued a proposed rule to implement some of the  
3 PURPA provisions in the Energy Policy Act of 2005 -- not all  
4 of the PURPA provisions, but some of them, namely those  
5 related to thermal efficiency and the ownership limits.

6                   Under the proposed rule, the Commission would  
7 effectively end its reliance on the presumptively-useful  
8 standard that it has used in the past.

9                   The Commission will scrutinize the use of thermal  
10 output by a cogeneration facility, to assure that it is not  
11 a sham use, and the NOPR would eliminate the ownership  
12 limits, consistent with the Energy Policy Act.

13                   Now, we also, last week, entered into the MOU  
14 with the Commodities Futures Trading Commission. Under the  
15 law, we were given six months to finalize the Memorandum of  
16 Understanding, and we completed it in two months.

17                   One reason we expedited it was because of the  
18 high natural gas prices that we're looking at for this  
19 Winter. Now, this MOU really formalizes a very close  
20 working relationship that we've developed with the CFTC in  
21 recent years, and I think the MOU will strengthen that  
22 relationship, but it was strong to begin with.

23                   The MOU will facilitate the transfer of  
24 information between FERC and the CFTC, and I think it will  
25 improve our ability to identify market manipulation.

1           Now, the last EPACT item I wanted to mention  
2 before I ask my colleagues to comment, is the Consolidated  
3 Record Policy Statement. Now, the Commission issued the  
4 Policy Statement interpreting the judicial review and  
5 consolidated record provisions of the Energy Policy Act.

6           Under these provisions, the developer of a  
7 pipeline or LNG project, can challenge the decisions of  
8 federal and state agencies in the U.S. Circuit Court, and  
9 the Courts can prevent unreasonable delays by setting  
10 deadlines for agency action.

11           The new law, however, does not clearly define the  
12 scope of those projects subject to the judicial review and  
13 consolidated record provisions. The Policy Statement  
14 indicates that the Commission believes the new law applies  
15 to the broadest scope of projects, including projects  
16 previously approved by the Commission but not yet  
17 constructed.

18           And, at this point, I'd like to ask my colleagues  
19 if they would like to comment on some of our EPACT work.

20           COMMISSIONER BROWNELL: I just wanted to take a  
21 moment to thank the Staff, who have really done an  
22 extraordinary job, I think, of addressing these issues in a  
23 speedy way.

24           I think there were some bets out there that we  
25 weren't going to make our deadlines, and I think that, under

1 your leadership, we've beat them.

2 A couple of points that I think are important to  
3 make: These, collectively, do substantively change the  
4 structure of the energy sector, and it's important that  
5 people be actively engaged, particularly as we look at new  
6 areas like the merger review policy.

7 The landscape is changing; the economics of the  
8 industry are changing, and we need to get that right. I  
9 think the cross-subsidization provisions are going to be a  
10 challenge. I look forward to hearing, particularly from the  
11 states, on that, because they've done a lot of work on that  
12 over the years.

13 But I would encourage people get engaged up  
14 front. The beauty, of course, the rulemakings, is that we  
15 can have discussions.

16 Too often, after the fact, we hear, I wish you  
17 would have done this or you missed that, and we're moving  
18 quickly, but I think we want to move with substance and  
19 create robust rules, so we need, collectively, for everyone  
20 to devote some attention to this. Thank you.

21 COMMISSIONER KELLY: Joe and Nora, I was thinking  
22 last night, what I could contribute to today's discussion of  
23 our EPACT implementation, and you've done an excellent job,  
24 Joe, of describing what our initiatives are.

25 So I realized that I had nothing, really,

1 meaningful to add, and so I should probably not make any  
2 comment and take up your time, but --

3 (Laughter.)

4 COMMISSIONER KELLY: I thought perhaps I could  
5 put FERC's efforts to date, into some perspective, and I was  
6 inspired by watching the Houston-St. Louis game last night.

7 (Laughter.)

8 COMMISSIONER KELLY: And it occurred to me that  
9 maybe providing some statistics would help to put things  
10 into perspective, and also, for those of us whose team  
11 didn't make it to the World Series, it would give us one  
12 last chance to talk about baseball statistics today. I was  
13 thinking of you, Joe.

14 (Laughter.)

15 COMMISSIONER KELLY: And I also knew that we were  
16 going to be in the company of some other baseball fans,  
17 disappointed baseball fans, Chairman Flynn from New York, my  
18 condolences; Chairman Alfonso, from Boston, similarly.

19 (Laughter.)

20 COMMISSIONER KELLY: Chairman Peevey from  
21 California, our last great hope.

22 (Laughter.)

23 COMMISSIONER KELLY: So I've calculated a few  
24 statistics on the efforts put out by the FERC team in the  
25 EPACT implementation series, and I'd like to share them with

1 you and with our fans in the audience.

2 To date, the team has had an impressive 14 at-  
3 bats and all have been successful; the first in the lineup  
4 was the LNG pre-filing NOPR that made it to base with a  
5 single. As you explained today, this batter has come home  
6 to score a run for the team with a full-fledged Final Rule.

7 Another run recently scored, the Memorandum of  
8 Understanding with the Commodities Futures Trading  
9 Commission, and the other run was the extension of the  
10 preliminary permit for the Flint Creek Hydro Project for a  
11 period of three years.

12 So, today's statistics are: Fourteen hits, three  
13 runs, but 11 still on base.

14 (Laughter.)

15 COMMISSIONER KELLY: In the field, the FERC team  
16 has fielded all balls and committed no errors, and in spite  
17 of some rain, the games have not been delayed, and the EPACT  
18 series is still scheduled to conclude on time, or perhaps  
19 early.

20 These statistics have also been posted on the  
21 FERC website.

22 (Laughter.)

23 COMMISSIONER KELLY: And, as you can see, the  
24 FERC team has been playing hard and has played strongly,  
25 without, I must say, the help of any anabolic steroids --

1 (Laughter.)

2 COMMISSIONER KELLY: -- although I have seen  
3 increasingly high piles of empty Starbucks cups in the  
4 morning when I arrive at work.

5 (Laughter.)

6 COMMISSIONER KELLY: We need to keep the team's  
7 energy up, and their enthusiasm, because there are still 18  
8 at-bats yet to come.

9 The team's stellar record is due in large part to  
10 the superb coaching of Commissioner Brownell. She's been  
11 regularly seen in the dugout and the bullpen --

12 (Laughter.)

13 COMMISSIONER KELLY: -- encouraging and  
14 energizing the staff, providing them with extensive and  
15 helpful advice. The team's stellar record is also due to  
16 your extraordinary skills, Joe, as the team manager, and, in  
17 fact, I recently learned that Joe's middle initial, T,  
18 stands for Tore.

19 (Laughter.)

20 COMMISSIONER KELLY: That you were officially  
21 christened Joe Tore Kelliher, so now it explains why you are  
22 such an avid Yankee's fan, and why you are such an effective  
23 and beloved manager.

24 You have not only lived up to the reputation of  
25 your namesake, but you have surpassed it, and we have every

1 expectation that the FERC team will end the season with a  
2 record even better than the Yankees. So, thank you for your  
3 efforts.

4 CHAIRMAN KELLIHER: I have to say that I don't  
5 know what to say now.

6 (Laughter.)

7 COMMISSIONER KELLY: As you can see, I didn't  
8 have a whole lot to do, as I was --

9 CHAIRMAN KELLIHER: Well, you have intimidated  
10 you with your baseball knowledge. I'm impressed.

11 (Laughter.)

12 CHAIRMAN KELLIHER: I wanted to touch briefly on  
13 a couple of non-EPACT notationals that we've dealt with  
14 since the last open meeting. And one is the Mid-American  
15 audit.

16 Now, in the Mid-American audit, we issued a final  
17 report that found that Mid-American had committed violations  
18 of the Open Access Transmission Tariff, the Standards of  
19 Conduct Rule, and OASIS requirements. Mid-American agreed  
20 to construct \$9.2 million in unplanned transmission upgrades  
21 that will benefit transmission customers.

22 Now, the Commission did not impose civil  
23 penalties for these violations, because they predated  
24 enactment of EPACT 2005, but these are the kinds of  
25 violations that would likely be subject to civil penalties

1 in the future.

2 Mid-American was very cooperative throughout the  
3 audit; I would like to point that out, and under the new  
4 enforcement policy that will be considered later today, that  
5 level of cooperation will be a mitigating factor that will  
6 be weighed by the Commission.

7 Now, we also issued an Order regarding PowerX.  
8 In that Order, we disclosed the results of an investigation  
9 into PowerX's marketing practices and whether those  
10 practices violated Market Behavior Rule 2, one of the Market  
11 Behavior Rules issued by the Commission two years ago.

12 Now, the Commission concluded that PowerX did not  
13 violated Market Rule 2, and that their practice was  
14 consistent with ISO rules, which were subsequently changed.

15 Now, Cal ISO has filed a complaint about the  
16 PowerX practice, and at the same time, the Cal ISO proposed  
17 rule changes, which the Commission approved. I think this  
18 really is an example of how the process is supposed to work.

19 If a rule produces a negative outcome, the  
20 logical course and the proper course is to change the rule,  
21 and that's exactly what occurred. And I'd like to ask my  
22 colleagues if they have any comments on Mid-American and  
23 PowerX or any other notationals that we've acted on.

24 (No response.)

25 CHAIRMAN KELLIHER: No? Okay. With that being

1 said, Madam Secretary, could we please have today's consent  
2 agenda?

3 SECRETARY SALAS: Of course. Good morning, Mr.  
4 Chairman and good morning, Commissioners.

5 The following items have been struck from the  
6 agenda since the issuance of the Sunshine Notice on October  
7 13th; they are: E-12, E-15, E-24, and H-1.

8 Your consent agenda for this morning is as  
9 follows: Electric Items - E-3, 5, 7, 8, 10, 11, 13, 16, 17,  
10 19, 20, 21, 22, and 25.

11 Gas Items: G-1, 2, 5, and 6.

12 Hydro Items: H-2, and 3.

13 Certificates: C-1, 6, and 7.

14 And Commissioner Kelly votes first this morning.

15 COMMISSIONER KELLY: Aye.

16 COMMISSIONER BROWNELL: Aye.

17 CHAIRMAN KELLIHER: Aye.

18 Let's move on to the discussion agenda. I'd like  
19 to call up our first panel and Chairman Flynn of the Empire  
20 State; Chairman Alfonso from Massachusetts; Commissioner  
21 Munns, President of NARUC; President Peevey from the  
22 California Commission; Don Santa, former FERC Commissioner;  
23 Al Bean, with the Southeast Alabama Gas District,  
24 representing APGA; and John Hritcko, representing Broadwater  
25 LNG Project.

1                   Thank you for joining us this morning, and I  
2 appreciate the indulgence of my colleagues from the states.  
3 Thank you for listening to us this morning. Let's start  
4 with Chairman Flynn.

5                   MR. FLYNN: Thank you, Mr. Chairman. Good  
6 morning. Thank you for having us here. I am a  
7 representative from the Empire State.

8                   Before I get into my prepared remarks, I'd just  
9 like to comment on some of the remarks that have been thrown  
10 towards New York regarding baseball. I did ask, and I  
11 leaned over and asked my colleague from Massachusetts, if he  
12 knew how the Major League from New Mexico did.

13                   (Laughter.)

14                   MR. FLYNN: And, he like, I, were unable to come  
15 up with the answer, so why don't I get into my prepared  
16 remarks at this point?

17                   Again, good morning, Chairman and Commissioners  
18 Brownell and Kelly. Thank you for the opportunity to  
19 discuss some of the steps we are taking in New York State to  
20 address the issue of rising natural gas prices and the  
21 impact of those prices on customer heating bills and  
22 electricity prices.

23                   This is a topic that we've been discussing  
24 internally since early Summer. At that time, New York's  
25 utilities began injecting gas into storage to meet

1        anticipated demand in the upcoming Winter heating season, at  
2        prices that were significantly higher than in years past.

3                The staff expressed concern to me on a number of  
4        occasions that, based on the price of gas going into  
5        storage, Winter heating bills would likely be significantly  
6        higher this year.

7                Over the course of the Summer, it has become more  
8        clear to us, how much higher those bills would be. At last  
9        month's Commission session, the Commission and I listened to  
10       presentations summarizing the current situation we are  
11       facing in terms of natural gas prices and their impact on  
12       electricity prices.

13               The typical residential gas heating bill in New  
14       York State will likely be 30 to 45 percent higher than it  
15       was last year, and last year's bills were already 25 to 30  
16       percent higher than the year before.

17               We expect to see increases in the price for  
18       delivered electricity by as much as 35 percent, depending on  
19       the specific fuel mix and hedging strategies employed by  
20       each of the utilities around the state.

21               While prices for natural gas had been trending  
22       upward over the past few years, Hurricanes Katrina and Rita  
23       caused immediate spikes in the price for gas on the futures  
24       market and cast some uncertainty over the adequacy of  
25       flowing supplies for the Northeast Region, due to the area's

1 reliance on the Gulf Region for much of its gas needs.

2 I have been receiving regular updates on the  
3 ability of the LDCs in New York to obtain adequate supplies,  
4 and it is clear that the damage to the infrastructure in the  
5 Gulf Region, impacts the supplies in New York for the coming  
6 Winter season.

7 The utilities are developing strategies, in case  
8 level supply disruption continues through the Winter,  
9 including assessing supplies from other regions or imposing  
10 more frequent interruptions for non-firm customers.

11 At the Commission, our immediate concern was how  
12 these unprecedented prices would impact New York's low-  
13 income and senior citizen population. The Commission voted  
14 unanimously last month to reallocate \$500,000 in our public  
15 benefit programs for energy efficiency, for the purpose of  
16 doubling our Winter outreach and education initiatives for  
17 the season.

18 We have now put in place, a \$1 million outreach  
19 plan in conjunction with the State's Consumer Protection  
20 Board and the New York State Energy Research and Development  
21 Authority, to help customers better prepare themselves for  
22 the Winter.

23 The effort will make use of radio, TV, and print  
24 advertising, direct mailings, and an aggressive public  
25 relations strategy to inform New Yorkers of the national

1       circumstances we are confronted with, and the steps they can  
2       take to mitigate the impacts of rising heating fuel prices.

3               Those steps include: Improving the efficiency of  
4       their homes, enrolling in budget-billing programs,  
5       contacting local service agencies for payment assistance,  
6       and shopping for a natural gas supplier that can offer the  
7       best pricing and service package to limit the impacts of  
8       volatile prices.

9               These outreach and education efforts are  
10       essential to equip customers with the tools they need to  
11       take control over their own heating bills, and to offer  
12       financial assistance to those low-income and senior citizens  
13       who are less able to absorb the impact of higher heating  
14       bills.

15               In addition to our own outreach efforts, I called  
16       on each of the New York LDCs to take similar steps to help  
17       their customers deal with these unprecedented price  
18       increases. National Grid, for example, approached the  
19       Commission earlier in the year, to use an additional \$5  
20       million in ratepayer funds, from a deferred account, to  
21       enhance the States's SBC efficiency efforts.

22               Their plan was to use this \$5 million to offer  
23       additional efficiency incentives for low-income customers in  
24       their territory. The Commission approved that request in  
25       August, and I held it up as an example of what I wanted the

1 other LDCs to consider as we entered this Winter.

2 We are still receiving ideas from the LDCs at  
3 this point, but I expect that the Commission will receive a  
4 complete report from Director for Consumer Services, at our  
5 monthly session meeting scheduled for next week.

6 In addition, my Consumer Services Director will  
7 report on our own efforts to encourage LDCs to be more  
8 flexible this Winter in dealing with issues like bill  
9 arrearages, service shutoffs, and flexible bill payment  
10 schedules.

11 At the start of my remarks, I mentioned that we  
12 saw early warnings that heating bills this Winter would  
13 likely be higher than normal, as a result of the price LDCs  
14 were paying for the gas they were injecting into storage.

15 Gas storage is one step that the Commission  
16 encouraged LDCs to take, in order to hedge against higher  
17 prices for natural gas in the Winter season.

18 Since 1998, we have had policies in place,  
19 designed to shield customers from the kinds of price spikes  
20 we are seeing today. The Commission policy statement  
21 encourages the LDCs to develop a diversified portfolio,  
22 using a variety of tools, including: Fixed-price purchases,  
23 storage, financial hedges, and market-priced supplies.

24 Prior to the '98 policy guideline, New York's  
25 LDCs purchased the vast majority of their flowing gas

1 through contracts that reset the price monthly, based on a  
2 specified market price index, which would not provide price  
3 diversity or protection against market volatility.

4 As a result of the Commission guidelines, LDCs  
5 have increasingly used various methods to price gas  
6 purchases. On average, about 35 percent of the New York  
7 LDCs projected 05/06 Winter supplies are from storage; 30  
8 percent are hedged, and 35 percent are market-priced.

9 The level of hedging outlined by the Commission's  
10 policy statement provides customers with some protection  
11 against fluctuating prices.

12 Additionally, a topic of utmost importance this  
13 Winter, is communication among all of the relevant  
14 government agencies and market participants.

15 Each year, the Public Service Commission  
16 participates in a Winter Fuels Outlook meeting with the  
17 other state agencies, LDCs, as well as home heating oil  
18 retailers, and others involved in the State's heating fuels  
19 industry.

20 The purpose of this meeting is to essentially  
21 ensure that everyone is on the same page and has the same  
22 understanding of the outlook for all heating fuels, going  
23 into the heating season. In fact, this meeting was held  
24 just yesterday in Albany.

25 This Winter, we are taking additional steps to

1 foster better communication in the New York City area, in  
2 particular. Given that most of the generators operating in  
3 New York City rely on an interruptible gas supply that could  
4 be curtailed due to supply constraints, there are obvious  
5 concerns about the price and availability of fuel to  
6 electric generators this Winter.

7 The staff of the Commission will be meeting next  
8 Monday with representatives of the LDCs serving New York  
9 City, as well as the New York ISO, the New York State Energy  
10 Research and Development Authority, the DEC, and various  
11 generators.

12 This meeting will focus on the impacts of the  
13 hurricanes on gas supply and operational issues related to  
14 supply interruptions and fuel-balancing for generators.

15 Where FERC may be of some assistance to the  
16 states and industry, is in the area of communications  
17 between LDCs and pipelines during times of emergency.  
18 Timely and complete communications are crucial to ensure the  
19 reliability of natural gas delivery systems.

20 As a result of FERC Rules, an electronic bulletin  
21 board has been established as a primary means of  
22 communicating information among pipelines and LDCs.

23 Under most circumstances, this is an appropriate  
24 means of communications, and it serves to protect the  
25 integrity of competitive markets by ensuring that all market

1 participants have access to the same level of information to  
2 maintain a fair and level playing field.

3           However, during emergency situations such as we  
4 have seen this Fall with Hurricanes Katrina and Rita, it is  
5 important to ensure that these rules do not present a  
6 barrier to the personalized and instantaneous communications  
7 that may be needed by individual market participants, to  
8 ensure safe and reliable natural gas service.

9           While I am not aware of any specific  
10 circumstances where safety and reliability were jeopardized  
11 in New York State as a result of communication difficulties  
12 following these hurricanes, the issue was brought to my  
13 attention that the bulletin boards, in and of themselves,  
14 may not be adequate during a crisis.

15           I believe it was brought to your attention also,  
16 last week, by representatives of Keyspan. I would  
17 respectfully urge FERC to review its rules concerning these  
18 types of communications, to ensure that the rules do not  
19 hinder LDC efforts to maintain safe and reliable operations  
20 during times of emergency.

21           Lastly, my staff has alerted me about  
22 inconsistencies in reporting shut-in production data for  
23 those facilities under state jurisdiction. At the  
24 appropriate time, I think that FERC could be helpful in  
25 working with the states and with the Federal Government, to

1 ensure greater market transparency by improving access to  
2 state-level data. Thank you for the opportunity, and I'll  
3 turn it over to my colleagues. Thank you, Mr. Chairman.

4 CHAIRMAN KELLIHER: Thank you, Chairman Flynn.  
5 Chairman Alfonso?

6 (Discussion off the record, Portuguese spoken.)

7 MR. ALFONSO: Thank you. Beginning on the  
8 baseball analogies, you'll have to permit me a personal  
9 privilege, again. You can imagine how difficult this would  
10 be, Mr. Chairman and Commissioners, for Brownell and Kelly  
11 to be sitting to my dear colleague to the left, uniquely, to  
12 my left, if, in fact, the Yankees had survived and the Sox  
13 had not. So, I'm pleased that we're both in the same boat,  
14 and there's always next year, ladies and gentlemen.

15 (Laughter.)

16 MR. ALFONSO: Mr. Chairman Kelliher and  
17 Commissioners Brownell and Kelly, I thank you for the  
18 opportunity to present our views of the Commonwealth of  
19 Massachusetts, and joining my colleagues, Chairman Flynn,  
20 President Peevey, and Commission Munns, President of our  
21 NARUC organization.

22 Mr. Chairman, your comments last week summed it  
23 up correctly, in that consumers will see higher natural gas  
24 prices this winter, and that, quote, "we must all work  
25 together, federal regulators, state regulators, and

1 consumers."

2 We in Massachusetts are grateful for you  
3 leadership here at the FERC in working with us in the states  
4 in coordinating these efforts for what undoubtedly will be a  
5 difficult Winter for all our families in Massachusetts and  
6 throughout the country.

7 These difficult situations came in a really vivid  
8 example to me this past Tuesday evening in a community in  
9 Chelsea, Massachusetts during several public hearings that  
10 the Commission is holding throughout the Commonwealth -- 16,  
11 in total -- to discuss these issues with our constituents.

12 Now, with petitions recently filed by these gas  
13 companies, we're holding 16 public hearings throughout the  
14 Commonwealth, as I mentioned, to firsthand hear about these  
15 difficult pricing situations.

16 An 83-year old consumer, who retired as a  
17 cleaning woman from Boston University, described to us, the  
18 impact of her limited Social Security payments, given rising  
19 utility bills, and the extent that she may have to, in fact,  
20 choose -- her words -- between prescription drugs and  
21 heating her modest apartment.

22 As you can imagine, Mr. Chairman and colleagues,  
23 this has a rather humbling effect on anyone who listens to  
24 these difficult stories, and it brings squarely home, in  
25 fact, that what we do or don't do, will have serious impacts

1 on our constituents.

2 I want to take a brief moment to outline some of  
3 our efforts back home, which, when combined with the  
4 important work here at the FERC, undoubtedly will help us  
5 serve our consumers so that we can best mitigate price  
6 impacts in this upcoming season.

7 Given New England's, as you know, unique location  
8 at the end of the pipelines, we, indeed, face unique  
9 challenges. To that end, some short-term strategies will  
10 need to be employed during this Winter season, as we  
11 continue to work towards more long-term, systemic solutions  
12 to our supply/demand balance for energy in New England.

13 In effort similar to my colleague, Chairman  
14 Flynn, to serve our most vulnerable populations, our seniors  
15 and those on fixed incomes and low-income families, we have  
16 moved aggressively to implement the current regulations --  
17 and, I repeat, current regulations on low-income discounts  
18 to eligible families.

19 What we have found, even today, is that consumers  
20 who are fully eligible for different discount programs, are  
21 not signed up for them. We have immediately leveraged our  
22 current technology with computer software so that entities  
23 and computers simply talk to each other within our own state  
24 government.

25 For example, if a single mom and her child have

1 already signed up for a program in our HHS Division, which,  
2 by definition means they are entitled to our Low-Income  
3 Discount Program, computers now talk to each other, so the  
4 data is immediately sent off to the distribution company,  
5 whereby the family is placed on the eligible program.

6 The fact is, as we know, every bit will help this  
7 year. We are working with our Legislature to increase funds  
8 for direct assistance to our vulnerable populations, in  
9 order to directly pay utility bills. In fact, I'll be  
10 appearing next week before the Legislature in Massachusetts,  
11 to continue that important dialogue.

12 Consistent with your theme, Mr. Chairman, of all  
13 the sectors working seamlessly together, we are working with  
14 our gas and electric companies to increase their  
15 communication efforts as to all available benefits to  
16 consumers, such as level billing programs, their own  
17 discount programs, low-income eligible programs during these  
18 various 16 public hearings.

19 We, in fact, have set up informational sections  
20 at these meetings, so that consumers who join us for that  
21 evening, can get help on the spot and immediately, and I am  
22 pleased to say that it is taking effect.

23 Programs also include weatherization assistance  
24 programs, heating emergency programs, and programs that  
25 themselves, with a little time and effort, can, in fact,

1 lower the individual bills to all consumers.

2 In addition, companies are working, as Chairman  
3 Flynn also mentioned, in New York, with their energy  
4 efficiency plans, so that consumers can better control their  
5 own destinies to bill impacts. These items, as you might  
6 imagine, include programmable thermostats, weather  
7 stripping, et cetera, and energy-efficient light bulbs.

8 As to hedging strategies, I'm pleased to say that  
9 it's permissible in Massachusetts to engage in strategies,  
10 as Chairman Flynn said, similarly to storage capacity, as  
11 well as other hedging and risk mitigation programs. I can  
12 give you a figure, in concrete terms, that this year, one of  
13 our largest companies, Keyspan, and many other companies,  
14 but Keyspan, in particular, given their strategies, will  
15 come up with about \$107 million in differentials that they  
16 would otherwise have been passing on to consumers. That's  
17 about between \$9 and \$100 difference to consumers this year,  
18 and, again, every bit helps.

19 Uniquely, though -- and I'd like to spend a few  
20 moments on this -- for New England, the impacts of gas  
21 supply will be immediately felt, because of our portfolio  
22 mix in our electric generation sector. To this end, Mr.  
23 Chairman, we're working closely with our colleagues at ISO  
24 New England.

25 Our preparations confirm possible shortfalls for

1 generators. The strategies to be employed by ISO New -  
2 England include: ISO New England to finance conversion of  
3 certain generating units to dual-fuel status ahead of the  
4 Winter season; extend ISO demand-side programs with enhanced  
5 financial incentives; implement new emergency operating  
6 procedures to optimize dispatch of generators around  
7 projected fuel shortages; with the assistance of state  
8 governments and PUCs, engage in pre-season publicity about  
9 the need for conservation.

10 Again, the important emphasis is, in a  
11 coordinated and intelligent fashion, to react in a timely  
12 way to the need for these possible contingencies. Let me  
13 add my gratitude to you, Commissioners Brownell and Kelly,  
14 as well as Staff, as ISO make these important filings in a  
15 rather short turnaround period.

16 Mr. Chairman, again, I thank you and your  
17 colleagues for this invitation, and, more importantly, the  
18 recognition of the important partnership that states will  
19 play with our federal colleagues in the service of our  
20 constituents.

21 As we go into this difficult Winter season, we  
22 should follow the example, really, as set out by the  
23 extraordinary people that have been affected by Katrina and  
24 Rita, the people of Louisiana, Mississippi, Texas, the Gulf  
25 Region, who, on their own, have faced such extraordinary

1       adversity, but have shown us the courage to, in fact, get  
2       back and begin their lives anew.

3               As we face undoubtedly something that is clearly  
4       not as difficult with our constituents back home, let's take  
5       that example of that courage, as we face the Winter season  
6       together, so that we can help our constituents. On behalf  
7       of Government Romney, thank you.

8               CHAIRMAN KELLIHER: Thank you, Chairman Alfonso.  
9       Commissioner Munns, President Munns.

10              MS. MUNNS: Thank you. I want to thank you for  
11       the opportunity to be here. I would like you to know that I  
12       am from the great state of Iowa, and we, like the great  
13       state of New Mexico, are free agents in our baseball  
14       allegiances.

15              (Laughter.)

16              MS. MUNNS: But I wanted to note that I will be  
17       talking about Iowa throughout my remarks. We are very, very  
18       affected by the price of natural gas. Most of our citizens  
19       use it as a home heating source, and, as you are well aware,  
20       we have some very cold Winters.

21              We believe that the impact of this Winter will be  
22       due not only to the price, but what the weather is,  
23       something none of us knows. We have, we think, avoided some  
24       of these issues in the past couple Winters in having warmer-  
25       than-normal Winters, but, again, that's not something that

1 we can count on as a way through this issue.

2 I very much appreciate the opportunity to talk to  
3 you. I know that in gas issues, you have less jurisdiction  
4 and less to do, but I very much believe that these gas  
5 issues are going to prove to be a challenge to all of us,  
6 and it will take national and state policymakers to come up  
7 with a plan for the short term, so that we can get to some  
8 of the longer-term supply issues and infrastructure  
9 improvements that we're going to have to work our way  
10 through, and through the natural gas pricing issue, which is  
11 before us today.

12 So, your question really is, I think, what is  
13 going on out there in the states? I was around in 2000 and  
14 2001; actually, I was around the decade before that, when  
15 natural gas prices were \$2 per Mcf.

16 In the Winter of 2000-2001, we saw them double to  
17 \$4 or \$4.50, and there were some spikes in there, but we  
18 thought it was outrageous. It caused all kinds of issues  
19 with our customers. Today, we would like to have that \$4.50  
20 gas available.

21 I think that that was the first year we had any  
22 inkling about what was happening in the natural gas markets.  
23 And then we had the increase -- and you all know this -- in  
24 the use of gas for electric generation. I'm not saying  
25 that's a bad thing or a good thing.

1           I think that that generation has a lot of  
2 attributes as far as environmental emissions, heat rate, and  
3 having the diversified portfolio, but it also had an impact  
4 on these supply issues that we're looking at.

5           Now we've had some inkling of just how tight this  
6 supply is with the Hurricanes Katrina and Rita, and what has  
7 happened to pricing since they went through.

8           I think we're in for, when we look at supply  
9 solutions to this market we're in -- we're in a long-term,  
10 we're in a least a five-year looking at LNG and getting  
11 those terminals sited and making the interoperability  
12 changes and, you know, you look at the other options,  
13 offshore drilling, Alaskan pipeline, any of those things are  
14 long-term supply options.

15           So we are in a very -- we're in a unique  
16 situation with these prices and how they're impacting us.

17           I want to go through some of the things that we  
18 have done in the states. Some of them have been talked  
19 about.

20           After the 2000-2001 Winter, we sifted through all  
21 our customer rules and customer relations. We found that we  
22 really had not had much of a need when we had \$2 gas, to  
23 focus on how these operated, but afterwards, we did.

24           We looked at budget billing, how it was done, to  
25 make sure that the opportunity was available. We looked at

1 all our disconnection and reconnection rules and how they  
2 were operating.

3 In Iowa, we have a moratorium that extends from  
4 November 1 to April 1, and if you are certified as eligible  
5 for LIHE heat funds, then you are covered by the moratorium  
6 and you cannot be disconnected during that period of time.

7 We looked at bad debt and the impact on the  
8 companies. We looked at LIHE heat eligibility, and as  
9 Chairman Alfonso said, participation. We have a lot of  
10 people who are eligible and not participating. We have a  
11 lot of senior citizens within the State of Iowa, and many of  
12 them do not like to take what they would deem to be welfare,  
13 so they have not gone to sign up for these programs.

14 We've had rules on hedging since 1994, but we  
15 really didn't get serious about it again until after the  
16 2000-2001 Winter. We have encouraged it for this Winter.

17 Some of our LDCs are hedged physically and  
18 financially at up to 75 percent, but as we all know, all  
19 hedging does, is reduce volatility, but not the overall  
20 price. I think we have concerns with where prices are,  
21 about -- we're happy that we have that amount hedged for  
22 this Winter, but as they inject next Summer for the  
23 following Winter, what are those prices going to be, and  
24 what are those instruments going to cost going forward, with  
25 the price trends that we've seen?

1           I know that there was some question about  
2 hedging. Is it allowed? Is it required? I asked the  
3 National Regulatory Research Institute, you know, what's  
4 going on across the United States? And, as it turns out, I  
5 believe it's the State of Oregon that did an informal survey  
6 that asked the states what they were doing.

7           And as Chairman, Flynn said, in most states,  
8 hedging is allowed, but it is not required, and what it is,  
9 I think that states require prudent management of gas  
10 supply. The LDCs make the decision on how they're going to  
11 do it, and I think a lot of states would say right now that  
12 if you're not hedging, that there would be questions as to  
13 whether or not you're being prudent in this market.

14           But hedging is not to be speculative; it's  
15 supposed to be a managed, consistent program that you carry  
16 out. Again, it is supposed to be directed at volatility and  
17 not at price.

18           I was -- I read the article in the Wall Street  
19 Journal this week, that had some discussion of hedging. I  
20 was sorry to see the word in there that was if the utility  
21 "guesses" wrong, because this is not supposed to be about  
22 guessing; this is, again, supposed to be about managing a  
23 portfolio so that there is diversity to manage volatility.

24           Across the United States, it appears that in  
25 almost all of the states, it is allowed to hedge, so I think

1        maybe there was some -- I don't know the way that the Wall  
2        Street Journal article read. It sounded like it was not a  
3        common practice, and I think it is more common than was in  
4        the article, and I would be happy to provide the survey  
5        results, if any of you are interested in it.

6                    Chairman Flynn talked about energy efficiency.  
7        Again, in Iowa, I'm very proud to say that since 1990, we  
8        have had an aggressive and consistent energy efficiency  
9        program, both on the gas and electric sides.

10                   This year, ratepayers will have spent about \$100  
11        million on both of those programs to bring energy efficiency  
12        forward. I am sorry to say that energy efficiency has not  
13        been aggressively pursued across the United States.

14                   I think that we saw some backing off on the  
15        effort, as states restructured during the '90s. There was  
16        some belief that it was difficult to manage those kinds of  
17        programs within a restructured environment, or that the  
18        market would take care of it.

19                   In other states, there were energy efficiency  
20        funds, but those funds were dipped into for other reasons  
21        than energy efficiency, so there's been a checkered record,  
22        and I think everyone is coming back to the place that energy  
23        efficiency is very important, and that there be energy  
24        efficiency funds.

25                   I'm pleased to say that President Peevey, on my

1 right, is going to receive an award tonight with respect to  
2 California's efforts, and I think it's going to be important  
3 for California to lead us all with respect to conservation  
4 and energy efficiency in the future, because it's going to  
5 be so important.

6 That gets me to my last point, which is that I  
7 don't think that at this point where gas prices are, that  
8 this is a low-income issue. Our low-income citizens are  
9 disproportionately impacted by the price of natural gas, but  
10 it is no longer a low-income issue. I will impact all of  
11 us.

12 It takes money out of our economy, as I have said  
13 to people before, and I think there was a report in the New  
14 York Times, an article a couple of weeks ago, that said that  
15 bills would be \$500 to \$700 more this Winter, and, again,  
16 none of us know. None of us will know until that weather  
17 comes, what are bills are going to be.

18 But I say to people, you know, I can afford \$500  
19 to \$700 more. I would suspect most people in this room can  
20 afford that. But that is money that leaves our local  
21 economy, that's money that we would have available to  
22 support our local businesses, both for leisure and for other  
23 goods and services that we will be sending away.

24 Our businesses will be having increased energy  
25 prices and probably decreased revenues, because there won't

1 be as much money in our economy. This will ripple through  
2 our economy with the size of these bills.

3 We will have more disconnections, as our  
4 moratorium comes off. I think that the companies are very,  
5 very concerned about bad debt, and whether or not they will  
6 be able to collect that bad debt, whether or not state  
7 commissions, with the size of bills that they are now, will  
8 want to defer collection of some of those expenses into the  
9 future. I think that they are very concerned about what  
10 impact that will have on their creditworthiness.

11 I'm concerned about demand destruction, as a  
12 result of these prices, and so I think that what that means,  
13 is that we're going to have to try to figure out how to  
14 manage the short term for the long term, and we're all going  
15 to have to do that together.

16 We're going to have to take care of our low-  
17 income customers; we're going to have to appropriate more  
18 money there, but I think what we're going to have to do, is,  
19 we're going to have to hit hard on conservation and energy  
20 efficiency.

21 As far as I can tell, it's the only way that we  
22 have to impact these prices, going forward. There's a study  
23 out of the American Council for an Energy Efficient Economy,  
24 that shows that if eight midwestern states would reduce  
25 their demand by one percent per year over five years, they

1       could impact price by 13 percent.

2                   We think that's worth going after.   Several  
3       governors within our region are taking a leadership role on  
4       those.

5                   We know it's ambitious, it may not work, but we  
6       think that it's worth a stretch to try it.   We think we have  
7       the technology to do it, and we're looking for the  
8       leadership to do it.

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1                   So that's what we're working on now and we  
2                   certainly hope that with the leadership of states like Iowa  
3                   who really help put a lot of money towards energy  
4                   efficiency, California with what they learned during the  
5                   California energy crisis that conservation can make a  
6                   difference and impact price. That we'll be able to take  
7                   that message forward and get people to change their behavior  
8                   and have some control over what happens to them in the  
9                   future with respect to these prices.

10                   Thank you for this opportunity. I did want to  
11                   say one other thing. I really do appreciate you looking at  
12                   what you can do on market monitoring in these markets. I  
13                   think there's a lot of people out there who believe that the  
14                   prices are due to market manipulation. It's very hard to  
15                   dispel that notion. Some of it is advanced by the popular  
16                   press. I think to the extent that there is an active  
17                   watchdog that we can point to we can let people understand  
18                   someone is watching this and that these prices are not going  
19                   to -- we're not going to be able to mitigate these prices by  
20                   waving a wand or saying somebody is cheating somebody or  
21                   making obscene profits. This is a market price and that the  
22                   obligation is on them to change their behavior so that we  
23                   can have some mitigation of that price.

24                   Thank you for this opportunity.

25                   CHAIRMAN KELLIHER: Thank you, Commissioner.

1                   I'd like to recognize President Peevey. And I'd  
2 first of all like to congratulate him on the honor he's  
3 receiving tonight and also applaud his state's efforts on  
4 conservation. President Peevey.

5                   MR. PEEVEY: Thank you very much, Chairman  
6 Kelliher.

7                   Let me first say to my colleague on the left,  
8 President Mumms that I appreciate the kind words about  
9 California's efforts and I hope that you will give that  
10 message to Warren Buffet as he goes forward looking at  
11 PacificCorp and as part of the California operation.

12                   Secondly, let me say that, in keeping with the  
13 baseball theme that seems to have rolling out here, that  
14 with all due regard to Chairman Kelliher and Flynn, that we  
15 took a certain amount of gratitude watching the California  
16 Angels best the New York Yankees.

17                   CHAIRMAN KELLIHER: Your times has expired, Mr.  
18 Peevey.

19                   (Laughter.)

20                   MR. PEEVEY: I thought I might hit a rough nerve  
21 here. I didn't think it would be quite so soon. But, of  
22 course, we found the angels in our midst were a lot fewer  
23 than we hoped when going up against the White Sox without  
24 use of a bullpen. But, in any case, I'm here to talk about  
25 California today and California utilities are forecasting

1 bill increases this year between 40 and 60 percent per  
2 residential customer this winter. Obviously, this is no  
3 secret now to California consumers. It's been a front page  
4 new story in all of our major newspaper and will continue to  
5 remain so as winter approaches.

6 For the past few months, the California Public  
7 Utilities Commission has been working to put in place what  
8 we hope are innovative programs. Commemorate the impacts of  
9 winter gas bills, particularly for low income residents.  
10 And today I'd like to share with you our progress thus far.

11 California Gas Utilities employ physical and  
12 financial hedges to protect against winter price spikes.  
13 Utilities procure gas supplies throughout the year under  
14 monthly contracts at a fixed price. Gas cost incentive  
15 programs put in place by the California PUC provide  
16 financial incentives for utilities to purchase gas at below-  
17 market prices. Utilities are free to employ limited  
18 financial hedges or fixed-price contracts to help them beat  
19 market prices.

20 In addition, our two major gas utilities, PG&E  
21 and SoCal Gas are required to inject into storage one third  
22 of their total core winter demand by November 1 of each  
23 year. For PG&E this is 33 Bcf and for SoCal Gas it is 70  
24 Bcf. On smaller gas purveyors -- San Diego Gas and Electric  
25 and Southwest Gas -- obtain storage from SoCal Gas. In

1 total, California utilities provide a total of about 200 Bcf  
2 in firm storage inventory. With this substantial storage  
3 portfolio and financial incentives to procure gas at below  
4 market prices, California utilities can in normal years  
5 protect their rate payers from undue prices shocks. But, as  
6 we know, 2005 has not been a normal year.

7 PG&E filed an emergency hedging petition with the  
8 Commission in mid-September asking approval to hedge much of  
9 its then current unhedged gas loads for the winter months.  
10 The hedges proposed by PG&E were to serve as insurance for  
11 tech rate payers. All benefits and costs from the  
12 additional hedging would accrue solely to PG&E core gas  
13 customers while the existing gas incentive procurement  
14 mechanism would remain in place.

15 PG&E residential customers would see their  
16 monthly bills rise under the PG&E proposals by about \$2 a  
17 month for this insurance. Put this in context, an average  
18 90 firm winter gas bill is expected to be \$140, so \$2 is a  
19 small price to pay to guard against additional bills or  
20 higher bills. We approved PG&E's petition on October 6th  
21 for additional hedging for this winter and for the next two  
22 winters. In our decision, we encouraged the other gas  
23 utilities to file similar petitions to increase their  
24 hedging for this winter. We now have before an application  
25 from SoCal Gas at STG&E to expand their hedging program for

1 this winter with similar bill impacts as that of PG&E. We  
2 expect to act on this request one week from on October 27th.

3 The events of this year forces all of us to be in  
4 a reactive mode. But going forward in an environment marked  
5 by volatile increasing gas prices, we need to be proactive  
6 and get ahead of the tread. To that end, we will be opening  
7 a rulemaking proceeding evaluating the current gas  
8 procurement incentive mechanisms now in place. We intend  
9 specifically to look at opportunities for utilities to enter  
10 into greater financial hedges and long-term contracts. We  
11 want to make sure the right incentives are in place to  
12 protect rate payers. Future gas supplies for California  
13 also will include LNG. To prepare for this, we have  
14 required all California natural gas utilities to file open  
15 access tariffs which provide firm access to natural gas  
16 supplies from LNG terminals or from pipelines which  
17 transport natural gas from LNG terminals, such as the  
18 receipt point from Southern California at Old Time Mesa in  
19 San Diego County.

20 Turning to energy efficiency and conservation,  
21 California's growing energy needs will be met, not only with  
22 increased supplies, but also through energy efficiency and  
23 conservation as Diane Muntz has pointed out. Our state's  
24 energy action plan requires that energy efficiency be  
25 required first before all other resources. Just last month

1 the Commission approved an unprecedented energy efficiency  
2 and conservation campaign by authorizing \$2 billion in  
3 funding for energy efficiency programs for the years 2006,  
4 2007 and 2008. These programs will cut energy costs for  
5 homes and businesses by more than an estimated \$5 billion,  
6 eliminate the need to build three large power plants over  
7 the next three years and reduce global warming pollution by  
8 an estimated 3.4 million tons of carbon dioxide by 2008,  
9 which is equivalent to taking about 650,000 cars off the  
10 road. In response to high natural gas prices, the  
11 Commission authorized the utilities to spend their 2006  
12 funds for natural gas efficiency programs immediately.

13 Now, turning to low income customers, no one will  
14 be impacted more by high winter gas bills than low income  
15 customers. Earlier this month, the Commission held a full  
16 panel hearing in Los Angeles to hear from our Low Income  
17 Oversight Board, from consumer and community groups, local  
18 elected officials, community leaders, utilities and  
19 individual consumers to help us better understand the impact  
20 of higher bills on customers and to identify the best ways  
21 to reduce these impacts. The next day we ordered our  
22 utilities to submit proposals on how best to lessen the  
23 impact of natural gas bills on low income consumers. We  
24 intend to expeditiously review the utility proposals and  
25 take action prior to December 1.

1           I am pleased with the utilities response to our  
2 call for action and I want to share with you some of the  
3 proposals we have before us, including an interesting  
4 cushion gas from SoCal gas that will significantly insulate  
5 their low income customers from any bill increase. For low  
6 income customers we have in place our California Alternative  
7 Rates for Energy or CARE Program. This program offers a 20  
8 percent discount to eligible customers on both the gas and  
9 electricity bills. Eligibility is limited to household  
10 income at or below 175 percent of the federal poverty level.

11           In addition to CARE, we have a Low Income Energy  
12 Efficiency or LIEE Program to provide qualified low income  
13 households with energy efficient appliances and  
14 weatherization measures at no cost to them. Both programs  
15 are administered by our utilities with oversight by the  
16 Commission. Proposals to change our CARE and LIEE Programs  
17 include (1) simplified enrollment and recertification; (2)  
18 enrollment by phone; (3) targeted phone campaigns for low  
19 income areas; (4) outreach campaigns via radio, print,  
20 television and bill inserts; (5) expanding the income  
21 eligibility from 175 percent of the federal poverty level to  
22 200 percent; (6) automatic enrollment in level bill payment  
23 plans; (7) no winter shutoff for minimum payments and  
24 increase bill payment assistance; (8) expansion of baseline  
25 quantities; and (9) quicker deployment of furnace

1 replacement and weatherization programs.

2 Currently, there is a one million customer gap  
3 between CARE eligible customers and those actually enrolled  
4 in the program. I'm hopeful that the proposals I just  
5 listed will close this gap. In addition, SoCal has recently  
6 filed a proposal which, if approved, which I believe it will  
7 be, will significantly mitigate the impact of the natural  
8 gas price increases to the SoCal Gas' CARE customers. SoCal  
9 Gas has requested authority to reclassify 4 billion cubic  
10 feet, 4 Bcf, of cushion gas to working gas and to make that  
11 gas available to be withdrawn from storage this winter.

12 SoCal Gas proposed to provide this 4 Bcf of gas  
13 in kind to CARE customers this winter at a very low book  
14 cost of -- are you ready for this -- \$1.5 million or 38  
15 cents per Mcf. By reworking existing wells in its elusive  
16 canyon in La Golita storage fields, SoCal Gas can  
17 essentially convert cushion gas to working gas. Drilling  
18 costs were proposed to be added to rate based and allocated  
19 across the entire customer base with minimal bill impacts.  
20 SoCal Gas estimates the CARE customer stand to gain upwards  
21 to about a \$50 million benefit. This translates to a  
22 roughly 20 percent decrease in CARE gas costs, combined with  
23 the 20 percent discount, CARE customers already receive,  
24 there is a potential to all but eliminate any price  
25 increases for CARE customers in Southern California this

1 winter. The Commission will consider SoCal's proposal at  
2 the Commission's November 18th meeting.

3 In summary, I'm pleased with the steps taken by  
4 California utilities and my Commission to lessen the impact  
5 of this winter's natural gas bills, especially in low income  
6 customers. But make no mistake, natural gas prices are  
7 increasing and there will be no easy solution to this  
8 difficult problem until more supplies come on line in the  
9 form of LNG or new discoveries. In our current environment,  
10 marked by increasing demand and reduced supplies, energy  
11 efficiency and conservation must become the dominant themes.  
12 As regulators, it's job to put in place policies and  
13 programs to ensure affordable energy for customers and  
14 businesses alike. I assure you that our efforts will  
15 continue this winter, next winter and winters after that.

16 Thank you. It's a pleasure to be here.

17 CHAIRMAN KELLIHER: Commissioner Santa.

18 MR. SANTA: Thank you, Mr. Chairman and  
19 Commissioner for the opportunity to participate in this  
20 panel on behalf of INGAA. Building on the baseball theme, I  
21 would have to say, given how many of INGAA's major pipelines  
22 are headquartered in Houston, it would be a career-limiting  
23 move if I was not cheering for the Astros.

24 (Laughter.)

25 MR. SANTA: Still, as someone who grew up in the

1 New York metropolitan area, I take some solace in the fact  
2 that former Yankees are the main stay of the Houston  
3 pitching staff.

4 MR. SANTA: My remarks today will build on some  
5 of the messages that were in Martha Wulsh's presentation on  
6 behalf of Duke Energy gas transmission as part of last  
7 week's state of the natural gas infrastructure conference,  
8 as Martha noted, workers from all segments of the natural  
9 gas industry, including many who have been personally  
10 affected by the tragedy of the hurricanes, are putting in  
11 extraordinary efforts to restore the industry's ability to  
12 delivery energy to consumers throughout the United States.

13 INGAA's member companies will continue doing all  
14 that is possible to maximize natural gas deliverability  
15 available for the winter heating system consistent with our  
16 obligation to provide non-discriminatory open-access  
17 service.

18 First, with regard to gas supply, it's important  
19 to distinguish between the aggregate estimates of  
20 anticipated supply and demand for the winter heating season  
21 and the challenging associated with meeting peak day  
22 demands. On a peak day, it's assumed that storage will be  
23 drawn to its full capability and that flowing pipeline gas  
24 will be required to meet the demands of the market.  
25 Therefore, the acknowledged fact that the market will be

1 short some increment of flowing natural gas originating in  
2 the Gulf of Mexico region during this winter is cause for  
3 concern about the ability to meet the peak day needs.

4 Of course, there could be some mitigating  
5 factors. Peak day conditions may not occur simultaneously  
6 on the entirety of the pipeline system. Perhaps it will be  
7 possible to supplement flowing Gulf supply with supply area  
8 storage or with gas originating in other supply areas  
9 through interconnects with pipelines that are not  
10 experiencing coincidental peak loads. Still, should  
11 pipelines experience peak loads for protracted periods, the  
12 ability to draw on supply area storage may be limited,  
13 particularly during the later winter months.

14 Conservation initiatives by distributors and  
15 supported by state public service commissions, as we've  
16 heard from the state commissioners this morning, can play an  
17 important role in mitigating peak day issues caused by  
18 diminished flow of gas supplies.

19 Second, let me comment briefly about pipeline  
20 tariffs and curtailment provisions. Due to the  
21 restructuring of the natural gas industry, interstate  
22 pipelines are no longer gas merchants and pipeline tariffs  
23 no longer address supply curtailment based on end use  
24 priority. Pipeline tariffs now address capacity allocation  
25 that may be necessitated by incidence that diminish a

1 pipeline's ability to transport natural gas.

2           General speaking, should capacity be reduced for  
3 some reason, the remaining capacity is allocated based on  
4 the category of service -- firm transportation services  
5 scheduled ahead of interruptible service. And, should it be  
6 necessary, firm transportation between primary receipt and  
7 delivery points is scheduled ahead of service between  
8 secondary points. These allocation of capacity do not look  
9 behind the shipper to consider how a shipper or its  
10 customers use the natural gas. These tariff-based capacity  
11 allocation procedures do not take effect if there is a gas  
12 supply shortfall. Rather, supply shortfalls are dealt with  
13 through denomination, confirmation and scheduling process.  
14 Again, end use is not a consideration. Regardless of the  
15 end use, receipts and deliveries must be confirmed by point  
16 operators before a pipeline could provide transportation  
17 under a shipper's contract.

18           Third, it's important to emphasize that customers  
19 are responsible for gas supply. With the pipeline exit from  
20 the merchant function, there no longer is a regulated  
21 aggregator of supply on behalf of wholesale customers and  
22 large end-users. These customers are responsible for their  
23 own supply arrangements. Therefore, we can take some  
24 comfort in aggregate assessments that gas supply will be  
25 adequate for the winter. It is important that individual

1 customers consult with their providers and confirm that  
2 providers are in a position to meet their obligation.

3 Furthermore, some states have restructured retail  
4 gas markets such that retail customers have opted for third-  
5 party supplier in lieu of incumbent LDC providers. Once  
6 again, confirmation that suppliers are able to delivery  
7 natural gas to meet their obligations would be approved at  
8 staff.

9 Fourth, I'd like to talk about the critical link  
10 of gas processing. The hurricanes exposed the critical role  
11 that gas processors play in the supply chain. As we know,  
12 some processing has come back. Other processing likely will  
13 be out of commission for the entire winter heating season  
14 and so other processors will come back, albeit with  
15 diminished capability to process gas to the same degree that  
16 existed prior to the hurricanes.

17 Without getting into technical detail, in some  
18 cases the flooding of processing facilities has caused  
19 significant damage to the turbines that powered expander  
20 units at such facilities. We've been told that the way to  
21 get the turbines back online could be between four and six  
22 months. What does this mean? First, such processors will  
23 not be able to perform the second type of gas processing  
24 needed to get the gas down to low, hydrocarbon dew point  
25 levels. The first cut can get it down to about 30 degrees

1 Hdp.

2 Second, the pressure of gas at the outlet end of  
3 the processing plant where it enters the transmission  
4 pipeline will be reduced, thereby creating the need for  
5 pipeline compression where compression is not available,  
6 reducing the capacity of the pipeline at that location. The  
7 industry is working on solutions to this dilemma. In some  
8 case I'm told the use of portable refrigeration units is  
9 being considered. This would allow for more complete  
10 removal of natural gas liquids and would alleviate some of  
11 the pressure reduction problem.

12 In other cases, the industry is exploring the  
13 opportunities to blend incomplete processed gas with other  
14 gas that has been more thoroughly processed. And, as we  
15 know, in other cases, there have been facility modifications  
16 to work around disabled processing plants and transport  
17 natural gas to under-utilized capacity elsewhere in the  
18 region. In that regard, we thank the Commission for its  
19 prompt action on the discovery and stingray orders that has  
20 made it possible to reroute shut-in supply to processing  
21 plants.

22 The point here is that there remains significant  
23 challenges in addressing the gas processing situation. A  
24 pipeline cannot facilitate greater blending by compelling  
25 someone to process its gas beyond what is otherwise required

1 in the tariff. Any such overprocessing will need to occur  
2 pursuant to commercial arrangements between gas suppliers  
3 and processors. There will be limits to what can be  
4 accomplished by make-shift solutions at processing plants  
5 and by rerouting gas. And, at some point, suppliers to  
6 pipelines and customers may need to address the tolerance  
7 for accepting and delivering gas that will not be processed  
8 to the quality that it historically has been processed.  
9 Pipelines will work closely with customers to explore the  
10 options that customers have for maintaining gas quality as  
11 they manage their gas supply and storage.

12 If pipelines will be compelled to enforce their  
13 tariffs, as was noted in Martha Wulsh's presentation, there  
14 may be times this winter when pipelines will be compelled to  
15 enforce their tariffs to the letter in order to maintain  
16 system integrity and prevent customers from taking more gas  
17 than has been received by the pipeline on their behalf.  
18 This will be particularly important should pipeline face  
19 peak day conditions when it will be important to safeguard  
20 the pipeline and its customers from heavy hydrocarbon  
21 dropout and from the chaos that could result if customers  
22 resort to self-help remedies during a supply shortfall.

23 Some pipelines may choose to update their penalty  
24 provisions in order to maintain the price signals needed to  
25 discourage customers from helping themselves or someone's

1 gas. In that regard, I shared with INGAA's members the  
2 encouragement last week from Commissioner Brownell to make  
3 such filings, if needed. In fact, Texas Eastern made such a  
4 filing on October 14th.

5 Finally, along the lines the comments from  
6 President Mumms of NARUC, do not forget the big picture.  
7 All of us are intently focused on steps that can be taken in  
8 advance of the winter to maximize gas deliverability and to  
9 mitigate the cost to consumers and the economy. Still it's  
10 important that we not forget the long-term issues that have  
11 been highlighted by the hurricane's effect on our nation's  
12 natural gas supply and infrastructure. Some issues such as  
13 access to federal lands onshore and offshore are beyond the  
14 Commission's influence. Other issues associated with  
15 authorizing natural gas transmission and storage  
16 infrastructure and establishing rate and tariff policies  
17 that create the appropriate incentives for capital  
18 investment and for customer support for such infrastructure  
19 are squarely within the Commission's sphere of influence.  
20 There's not the time to delve into these issues today. We  
21 only ask that they not be forgotten.

22 A robust natural gas infrastructure capable of  
23 delivering natural gas from diverse sources of supply is of  
24 great value in bringing down natural gas commodity prices  
25 and mitigating price volatility. Thank you.

1                   CHAIRMAN KELLIHER: Thank you, Commissioner Santa  
2 -- former Commissioner Santa.

3                   Mr. Bean.

4                   MR. BEAN: Thank you very much for inviting me.  
5 This is a tremendous honor. I'm a small local distribution  
6 company in South Alabama and to be here is a major honor for  
7 me. Thank you.

8                   As I said, my name is Al Bean. I'm Director of  
9 Gas Management for the Southeast Alabama gas district and  
10 I'm here representing the APGA. APGA is 600 public gas  
11 systems in 36 states. Nationwide, Public Gas represents  
12 about 5 million customers. I'm also president of the  
13 Alabama Natural Gas Association and we have 70 members there  
14 -- 70 member systems -- and we represent about 800,000  
15 residential customers.

16                   Southeast Alabama Gas serves 32 communities in  
17 the southeastern quadrant of the State of Alabama and 16  
18 counties. We're municipally owned. We have a transmission  
19 system that's about 730-miles long. We have some of our own  
20 production. We represent about 30,000 commercial customers.  
21 Our annual throughput is about 9 Bcf. Our primary function  
22 in life is that of an LDC and we're extremely concerned  
23 about the impending winter. We estimate that on average our  
24 residential customers bills will increase approximately 40  
25 percent this year over last winter.

1           As all local distribution companies or LDCs,  
2           we're at the end of a natural gas delivery chain. We're the  
3           ones in the natural gas industry that matches faces with  
4           molecules. And these faces that we're looking at right now  
5           are the faces of the elderly and the working poor and these  
6           are the faces of the people who are going to ultimately bear  
7           the brunt of these high prices of natural gas. Natural gas  
8           prices are too high.

9           I was asked to come here and tell you what do we  
10          do at Southeast Alabama Gas District. Well, we've done some  
11          things toward notifying the customer that you need to  
12          conserve and you need to help out. But what our main stay  
13          is -- the way we try to take the sting out of what happens  
14          to those customers is through our Hedge Program. This  
15          allows us to better manage our price risk and we will hedge  
16          our customers based on the elasticity of demand. Why do  
17          they buy gas? If it's an industrial customer, they pretty  
18          much buy gas because it's the cheapest thing among all the  
19          substitutes that they can use, so we put them on a market-  
20          based rate when we hedge them. That way we've eliminated  
21          our price risk by about 50 percent to our entire company.

22          The residential and commercial customer -- that's  
23          a little tricky. They only use this when they're cold or  
24          when they want hot water. So it's kind of hard to determine  
25          how to hedge for those guys. And what we've done at

1 Southeast is we've set up a hedge program where we will buy  
2 gas periodically through the year -- a certain percentage --  
3 and as we approach winter we finalize those purchases. We  
4 look at what our rates and where that number is and we'll  
5 establish a weighed average cost of gas for the upcoming  
6 winter. We will also include optionality in there because  
7 we do not want the market to fall away from us if we're  
8 holding \$10 gas and the market goes to \$5. That is  
9 basically our Hedge Program in a nutshell.

10 Our aim is not to beat the market. It's only to  
11 try to smooth out the jagged sawtooth edges. We want to  
12 take a sawtooth bar curve or bar chart that NIMEC prints out  
13 and turn it into a sine wave so it's not this. It's kind of  
14 this. And that's what we try to do. Some years better than  
15 others, to be quite honest with you. Right now this move  
16 that we had, and I think it was somebody from New York who  
17 was saying, last May there was probably a buck 70 or buck 80  
18 differential between May and the winter. How can you go to  
19 your people and say we're going to guarantee you a \$2 rate  
20 increase? It's kind of tough. So a lot of people did not  
21 catch this move as much as they would have caught it in  
22 years gone by.

23 I was asked to relate what FERC could do to help  
24 us. First of all, I want to thank the Commission for it's  
25 commitment to watch over this market exploitation issue.

1 That's huge with us. This winter FERC can also help by  
2 communicating to Congress, the White House and anyone who  
3 will listen, the problems that we're having at the LDC level  
4 or in our entire industry with this natural gas crisis that  
5 we're facing right now.

6 Also, I think in the short term, like any  
7 emergency responder, we don't want you to do any harm. For  
8 example, this issue of gas quality, please be careful not to  
9 make a hasty rulemaking on that. We can't handle 30 degree  
10 hydrocarbon dew point -- not this winter.

11 We'd like to also thank you and we're very proud  
12 of what you did with the stingray and dynege free inventive  
13 processing plant. That was great. Another thing we'd like  
14 to see you do is to work with the CFTC and alert them to the  
15 fact that they need to be more vigilant in enforcing their  
16 rules with regard to the commodity market. As more and more  
17 money leaves the stock market and goes into commodities,  
18 their oversight becomes more and more important. We're also  
19 concerned with the over-the-counter market. There's no  
20 transparency or very little transparency there. I don't  
21 know what you can do, but anything you can do would help us  
22 there.

23 Lastly, I would say as an LDC we are worried.  
24 It's going to be an uphill tug all winter. For everything  
25 that everyone has said here, we don't know if we're going to

1       have gas, where the gas is going to come from. Is it going  
2       to be clean gas? How bad is the winter going to be? But  
3       we've done it before. We'll make it through. We'll take  
4       care of those spaces because primarily that's our job.  
5       That's what we're here for.

6                 Again, I want to thank you for this honor and  
7       thank you for your time.

8                 CHAIRMAN KELLIHER: Thank you, Mr. Bean.

9                 Mr. Hritcko.

10                MR. HRITCHO: Thank you very much, Chairman  
11       Kelliher, Commissioner Brownell, Commissioner Kelly.

12                I guess, finally, in keeping with the theme --  
13       the baseball theme -- I am the cleanup batter of the panel  
14       today.

15                (Laughter.)

16                MR. HRITCHO: I have to tell, though, I am  
17       personally gratified that my hometown team, the Astros -- if  
18       they can play in the World Series, I'm am buoyed with  
19       optimism that there's no reason to believe that an LNG can't  
20       be sighted in a challenging area such as Long Island Sound.

21                (Laughter.)

22                MR. HRITCHO: As the panel says here, I am Senior  
23       Vice President and Regional Project Director for Broadwater  
24       Energy, which is a joint venture between Shell and  
25       TransCanada Pipeline to bring a large use supply of natural

1 gas to the New York/Connecticut market region via a new WE  
2 gas terminal that would be sited in Long Island Sound to  
3 serve this region.

4 What I want to talk to you today about, however,  
5 is more of the prospects of LGN for this winter and also  
6 looking out a little bit more into the future longer term.  
7 The prospects for LNG imports, which I think people are  
8 looking at, particularly in light of the market conditions  
9 today, remain good. LNG, by all measures, will appear to be  
10 available on a spot basis coming through the existing  
11 terminals.

12 On the positive side we have existing re-gas  
13 capacity, which is online and it available. Shipping  
14 capacity, the LNG carriers that would deliver the cargoes to  
15 these terminals are also available this year. On the  
16 somewhat negative side is that there is strong competition  
17 for spot cargoes in the worldwide LNG market. We aren't the  
18 only ones out there looking for cargoes. And, even at the  
19 high prices that we're facing today and looking out  
20 forecasting into this winter, there's still a great deal of  
21 competition for those cargoes.

22 This is somewhat characteristic of the LNG  
23 industry in general worldwide. This is an industry that is  
24 characterized and dictated by the need for large capital  
25 investments all up and down the chain, whether it be from

1 the liquid faction production, shipping, regasification and  
2 delivery. You also have to have underpinning those  
3 investments transactions that are between strong --  
4 financially strong, reliable counter-parties. The good news  
5 is that those parties that are in the market such as Shell  
6 and others that do have capacity that are involved in long-  
7 term supply, that do have the financial wherewithal are, in  
8 fact, buying spot cargoes and we would anticipate continuing  
9 to do so throughout this winter.

10           Unfortunately, the amount of volume that we can  
11 bring into the U.S. this winter will not be enough to  
12 appreciably impact the marketplace. My messages here today  
13 are fairly simple and straightforward. While we cannot  
14 overcome the shortfall in supply for this winter with LNG,  
15 we are on the correct path, I believe, in developing new  
16 import capacity so that we can, in fact, continue to tap  
17 into the vast worldwide supply of natural gas. This  
18 capacity must be developed throughout the United States and  
19 I think this is where it is clearly indicated the need to  
20 expand the options of not only having these terminals built  
21 within the Gulf Coast region, but also in the market regions  
22 as well and that includes the northeast projects such as  
23 Broadwater and also on the west coast as well.

24           This capacity has to be cost-effective and  
25 efficient. While there are large dollars being spent and

1 re-gas capacity is actually one of the smaller portions of  
2 the investment in the LNG chain, it still must be efficient  
3 as must be the downstream pipeline capacity that will have  
4 to go along with the development of these terminals and  
5 storage capacity to move this gas to market. We are  
6 competing, as I said before, on a global basis and we cannot  
7 afford to become out of line or overly dependent on over-  
8 priced or cost inefficient facilities because we must  
9 maintain our competitive marketplace throughout the global  
10 competition for supply.

11 Long-term contracts will continue to underpin the  
12 industry, both on the supply and sales side of the business.  
13 Companies such as Shell have taken the lead and stepped up  
14 to enter into these long-term contracts. We continue to  
15 take the substantial risk of bringing supplies of LNG into  
16 the U.S. without comfort of a long-term 20-year contracts on  
17 the sales side. Part of that is embedded in the market  
18 development and we've heard some of the speakers talk before  
19 about how some of the downstream markets, particularly LDCs  
20 and others, have looked to shorter and shorter term  
21 contracts. But, with the advantage of having strong  
22 financially fit and well-positioned players to be able to  
23 cover that, we've been able to overcome some of that burden.  
24 However, it would benefit the market and our supply  
25 situation if we could see more long-term sales contracts

1 embedded in this marketplace.

2 And then, finally, as several of the speakers  
3 have mentioned, the development of supply through such  
4 activities as LNG must also be coupled with the continued  
5 development and pursuit of efficiency and conservation.  
6 We're not going to be able to continue to provide the  
7 plentiful and robust supplies at affordable prices to the  
8 marketplace without using those assets and energy supplies  
9 efficiently and so we must not lose sight of that.

10 We are on track. I think the activities the that  
11 Commission has undertaken over the past several years now  
12 are going in the right direction. Unfortunately, as I said  
13 before, they won't be appreciably felt for this winter.  
14 But, as we continue on this path of development of import  
15 capacity and participate in the global market supply, things  
16 do, in fact, do look promising for the U.S. consumer.

17 With that, I thank you.

18 CHAIRMAN KELLIHER: Thank you, Mr. Hritcho.

19 I'd like to make some comments in response to the  
20 panel's comments.

21 First of all, as I mentioned earlier, Hurricanes  
22 Katrina and Rita have caused significant damage to the  
23 infrastructure and we've lost a significant portion of our  
24 supply. In comparison to Hurricane Adam last year, the  
25 supply lost this year is much greater than the lost

1 resulting from Hurricane Adam last year and the recovery of  
2 production has been much slower than in response in the wake  
3 of Hurricane Adam last year. So it really stands to reason  
4 that the price effects will be greater. And one of the  
5 first questions that really comes to mind is can imports  
6 make up the difference? We've lost domestic gas production.  
7 Can imports make up the difference? And the answer to that  
8 is no. I mean Canadian imports cannot offset lost of  
9 domestic gas production and LNG imports can't offset that  
10 lost. So we have lost supply and it seems clear gas prices  
11 will be higher as a result.

12 Now right now gas prices seem to be driven by  
13 fundamentals. I want to respond to Mr. Bean's comments as  
14 well as Diane's that the Commission is ready to act to  
15 exercises its authority under the Energy Policy Act with  
16 respect to market manipulation and later today we will take  
17 the first step to establish rules to prevent market  
18 manipulation of gas prices as well as electricity. So we do  
19 recognize that responsibility and we are going to act.

20 Right now it appears that prices are being driven  
21 by fundamentals -- the lost of supply. And, if prices are  
22 going to be higher this winter, the question is how much  
23 higher? And there are a couple of variables. One is what  
24 is the rate of recovery be of production offshore. If that  
25 rate is greater than it has been recently, then prices will

1 be effected to the benefit of consumers. The second  
2 variable is conservation. What are the efforts of consumers  
3 to conserve? And that relates largely to efforts that can  
4 be taken at the state level. We don't regulate retail  
5 sales. You all do. The effectiveness of your programs  
6 really will be crucial in determining what the level of  
7 conservation is this year and what the effect of that will  
8 be on prices.

9 Diane emphasized short- and long-term measures.  
10 It seems to me a short-term measure is the conservation  
11 efforts -- the efforts by individual consumers. There are  
12 some things we can do at our level to effect prices on the  
13 short-term. We're doing some with respect to  
14 infrastructure. We're acting on the emergency filings to  
15 maximize the efficiency of the use of the existing  
16 infrastructure. That will help in the short term. That  
17 will certainly increase supply. But a lot of the short-term  
18 measures are at your command.

19 Now another variable is, of course the weather  
20 which you all don't regulate and we don't regulate either.  
21 So I'll leave that to a higher authority. And you talked  
22 about some of your consumer education programs. One reason  
23 we've emphasized gas this week as well as last week at the  
24 infrastructure panel was to, in part, provide some consumer  
25 education. Normally, consumers get a price after

1 consumption when they get the bill -- after consumption. So  
2 price signals in that manner are not terrible effective in  
3 influencing behavior. So New York and other states have had  
4 significant efforts on information education programs and we  
5 wanted to emphasize gas prices this week, last week and  
6 we'll continue to do so just so consumers recognize prices  
7 will be higher and their actions can also offset some of  
8 that.

9 Now some of the states have very impressive  
10 programs and conservation. I just don't -- I encourage you  
11 to try to share best practices as much as possible and as  
12 quickly as possible so that the best practices you develop  
13 can be disseminated among your colleagues.

14 I also want to point out the composition of this  
15 panel was deliberate. We have state regulators from New  
16 York, New England, the Midwest, California and consumers  
17 from the South because the Commission recognizes that high  
18 natural gas prices are a national problem and we are  
19 treating it as such.

20 Now, I point out how we're acting on emergency  
21 filings. We're trying to make the maximum use of the  
22 existing infrastructure. We're also going to look at some  
23 reforms to storage pricing policy. Diane and others have  
24 talked about volatility of gas prices. That's one rationale  
25 for state hedging programs is to limit the exposure of

1 consumers to that volatility. We can act at our level also  
2 to help reduce price volatility if we can expand gas storage  
3 capacity.

4 Gas storage capacity, since 1988, has increased a  
5 total 1.4 percent. So at the same time gas demand has  
6 increased 24 percent. So we saw an interesting phenomenon  
7 last year. We saw record levels of gas in storage and we  
8 also saw very high levels of volatility. So one conclusion,  
9 not the only conclusion, is that we need to expand storage  
10 capacity and I do -- I'm going to ask a question at the end  
11 of my statement. This is somewhat of a statement in the  
12 guise of a question. But I will have a question at the end,  
13 asking that if we were to engage in reforms and encourage  
14 expansion of storage capacity, would state commissions  
15 require support long-term contracts sufficient to support  
16 that expansion of capacity? I'd like for you all to answer  
17 that in a few moments.

18 And I mentioned what we're doing on gas storage  
19 capacity. We're doing that with a eye to volatility. We're  
20 trying to maximize the efficient use of our current  
21 capacity. We're acting to prevent manipulation of prices  
22 through issuing proposed rulemaking today. I think it's  
23 important, though -- you've mentioned a lot of the state  
24 hedging programs. Some of them are very successful and your  
25 states seem to have very successful programs, but a NERUC

1 survey from this summer, I believe -- I believe August --  
2 concluded that states need to really take greater steps in  
3 the area of encouraging hedging and there's a AGA survey  
4 that concluded that most states have very permissive  
5 policies, but not necessarily provide clear enough guidance  
6 that LDCs have comfort in hedging without risk from their  
7 point of view -- without risk of second guessing. And, as a  
8 result, your states seem to have very strong programs.  
9 That's not necessarily the rule across the nation and any  
10 additional efforts you can make to disseminate best  
11 practices quickly among your colleague would, I think, help  
12 this winter.

13 The tools at the command of state regulators and  
14 federal regulators are different, but I think they really  
15 are complimentary. We can both act in the area of  
16 volatility, for example. We can act to reduce the risk to  
17 consumers. And I think, acting together, we really can make  
18 the most of our respective jurisdictions.

19 But I would like to ask that question now about  
20 gas storage additions. And, if the Commission were to -- I  
21 think we've seen some recent cases where we've authorized  
22 gas storage facilities and they have not been fully  
23 subscribed. Now states can help by requiring or supporting  
24 LDC contracts that would support the development of those  
25 projects, and would you like to see more of that? Would you

1 support LDC contracts that could help finance storage  
2 expansion?

3 MR. PEEVEY: Yes.

4 CHAIRMAN KELLIHER: Okay. Great.

5 MR. AFONSO: I would say, as a good lawyer, Mr.  
6 Chairman, you put the question out, but you also know what  
7 the answer should be. My sense the short answer is yes  
8 because, part and parcel of expanding the storage capacity  
9 as part of that overall strategy and that seems to be  
10 something that needs to ride as an incentive to, in fact,  
11 more at the local level. So I think, speaking for myself,  
12 as you know, I have four other colleagues back home -- but,  
13 generally speaking, we would favorably look upon that to  
14 fulfill this piece of that overall strategy.

15 CHAIRMAN KELLIHER: Bill.

16 MR. FLYNN: From New York's perspective, we have  
17 history with long-term contracts that was there before I,  
18 and I think we have a mixed bag of results at the Commission  
19 with long-term contracts. But we have a policy in place  
20 that neither encourages nor discourages long-term contracts  
21 and I've had lengthy conversations with the utilities over  
22 this issue and I think were we are is we take it on case-by-  
23 case basis.

24 But I go back to the situation that we're in  
25 today, whether it be the upcoming winter or the summer we

1 had before. We're looking at everything. There's nothing  
2 that we should be dismissing outright. We are not in a  
3 position of wealth in this area. So an issue like this  
4 needs to be deeply looked at. And I can pledge, too, from  
5 New York State's perspective, that whatever this Commission  
6 does do, we will be one first states to work with you very  
7 closely in analyzing on whether or not it makes a good fit  
8 for the State of New York. Thank you.

9 CHAIRMAN KELLIHER: Pam.

10 MS. MUNNS: Let me say this. When you talk about  
11 support or encourage from the state's perspective, I think  
12 most states -- mine included -- have very limited ability  
13 to do pre-approval on facilities. So, if you're asking for,  
14 if we authorize it now, will it go in -- will it be  
15 recoverable by the time that it's built, I don't have the  
16 authority to bind future commissions on decisions and I  
17 think that's the way the law, except for limited instances.

18 That being said, I think we have had a very good  
19 history of supporting the decisions that we've made. We've  
20 had a good history of saying what we look at is the analysis  
21 that was done at the time that the decision was made, not  
22 looking at it afterwards to see whether it worked out or  
23 didn't work out. And I think that certainly with respect to  
24 hedging we have a lot of communication back and forth. We  
25 have the companies come in and we go over their hedging

1 program -- what was the analysis that the did? What lead  
2 them to the diverse portfolio, the decisions with respect to  
3 hedging and we have not had disallowances. So I think a lot  
4 of it is communication and trust in a good analysis being  
5 made. But I think that if you're asking for pre-approval, I  
6 think that's a different issue and may need to be taken up  
7 by state legislatures. In my state we have pre-approval  
8 authority with respect to certain generating facilities, but  
9 that would be a legislative change, I think, in a number of  
10 state statutes.

11 CHAIRMAN KELLIHER: Okay. Thank you.

12 MR. PEEVEY: Another thing I would add to what I  
13 said -- a very quick answer earlier -- is that, as I think  
14 all of you know, but historically in California gas storage  
15 was solely the province of the LDCs. That's changed in the  
16 last several years and we've stimulated -- Wall Street and  
17 promoted the Public Utilities Commission, working with  
18 others, independent storage facilities like Load I gas  
19 fields and expansion of Wild Goose Field, and we would look  
20 positively on further augmentation of those kinds of  
21 efforts.

22 CHAIRMAN KELLIHER: Any regrets?

23 MR. PEEVEY: No.

24 CHAIRMAN KELLIHER: Great. One question. I  
25 wanted to follow up on Mr. Bean's comments about gas

1       quality. I just want to be clear. You would urge that we  
2       not act on gas quality this winter. Is that what you're  
3       saying? We not change on gas quality. I don't say "not  
4       act" because we act on most cases --

5               MR. BEAN: It all depends on what you're going to  
6       do when you act.

7               (Laughter.)

8               MR. BEAN: I just don't want you to be hasty  
9       about it. That's the main thing. I mean it's an economic  
10      choke point or it could be. You've got gas coming to the  
11      beach and you've got to go through that process to get to  
12      the pipeline and we're not set up as LDCs, at least in my  
13      neck of the woods, to handle a 30 degree hydrocarbon dew  
14      point. What happens is it's just too much trash that's in  
15      there that it'll end up freezing the regulators up. We have  
16      problems with small space heaters in tight houses. The  
17      possibility of generating carbon monoxide or out of spec gas  
18      -- we don't know what it will do to our oderization rate --  
19      all those type things. It's just a lack of knowledge that  
20      we have.

21              If this were to change, it just doesn't -- I  
22      can't argue that point. That's for another day as to what  
23      that hydrocarbon dew point is. If it comes to us right now,  
24      I'm just telling you we can't handle it. We're not in a  
25      position to handle it.

1                   CHAIRMAN KELLIHER: Thank you.

2                   Colleague, do you have any questions?

3                   COMMISSIONER BROWNELL: I have a bunch of  
4 questions.

5                   Don, I think your members have been very creative  
6 and responsive to finding work-arounds, but we still have 16  
7 or so processing plants out of commission. How many more  
8 work-arounds can we do responding to that?

9                   MR. SANTA: Commissioner Brownell, I don't know  
10 the answer to that question. I can ask our members and see  
11 what I can get you for answer in terms of what may be in the  
12 works in terms of the potential there to take advantage of  
13 over-utilized capacity.

14                  COMMISSIONER BROWNELL: Okay. I think in the  
15 desire for all of us to have as much information as we can  
16 that would be helpful, understanding that what might happen  
17 might not necessarily happen for other circumstances. So  
18 thank you.

19                  Diane, you talked about the number of states that  
20 allow hedging, and most do, the surveys to which the  
21 Chairman alluded would suggest that merely having a policy  
22 in place to allow it doesn't necessarily mean that people  
23 would use it. It might be interesting to look at those  
24 surveys and look at the best practices. But it might also  
25 be interesting to do a survey about how many disallowances

1 or after-the-fact prudence reviews are happening state-by-  
2 state -- maybe starting last year, do this year and last  
3 year because what we hear is that, in fact, that does  
4 prevent people from exercising their options. And I think,  
5 as Mr. Bean wisely pointed out, sometimes you do better than  
6 others. So I don't think you guess, but I think managed in  
7 speculative there's a huge gap in between there and we need  
8 to get a better understanding of that. So I'd love to get a  
9 better understanding and maybe Chairman Flynn and Chairman  
10 Afonso, by the way, who are the vice chairmen of the  
11 Economic Dispatch Joint Board. And for which I congratulate  
12 them. We won't be playing baseball, but we are having wine  
13 tasting in Boston on November 29th.

14 COMMISSIONER KELLY: Shouldn't that be beer?

15 COMMISSIONER BROWNELL: No, because I'm also a  
16 chairman.

17 (Laughter.)

18 COMMISSIONER BROWNELL: Prerogatives.

19 MS. MUNNS: If I could respond to the hedging  
20 question. I think, as Chairman Flynn said earlier, most of  
21 the states have a permissive standard. We allow it but  
22 don't require it. I think this gets to the point that I  
23 said we don't have authority to pre-approve decisions. We  
24 should not be second guessing based on results afterwards.  
25 So that gets to, I think, the situation we're in. And that

1 is there needs to be communications between the companies  
2 and their regulators so that there is understanding at the  
3 time that you're doing this, while you're doing it and the  
4 comfort level with the analysis that's behind it.

5 As I said, we've been doing it for a number of  
6 years. Because of all the different variables do they win  
7 every year or come out ahead. No. We ask for an analysis  
8 afterwards, but just so that we can look to see whether or  
9 not there are changes that need to be done going forward. I  
10 don't know how else -- I think oftentimes the companies has  
11 good reason, based on some fact, in the past that if you  
12 rely on the market how can you be criticized for the  
13 decision that you made? So I think that there needs to be  
14 responsibility on both sides as to how we go forward with  
15 this and that a prudently-managed portfolio means a diverse  
16 portfolio in today's market volatility.

17 COMMISSIONER BROWNELL: I don't disagree. In  
18 fact, I agree with that. But I'm not sure who's  
19 responsible, but there's a perception that, in fact, that in  
20 many states, as I said, the rules are pretty fluid and your  
21 states are obviously doing a good job. I think more  
22 information is needed. I think the initial survey, which is  
23 good, needs a lot more work to see what happens in practice  
24 -- what's on the books and what happens in practices are  
25 often two very different things. I don't know if either of

1 the chairmen would like to talk about that.

2 MR. AFONSO: I assure you I will be briefer than  
3 my colleague here. Practically, in Massachusetts, our  
4 largest LDC, KeySpan, has its own program in the smaller  
5 companies. So, in essence, the majority of our customers  
6 participate with that company, obviously, and some risk  
7 mitigation strategy. And also, in light of Katrina and Rita  
8 -- because of that and because of the diverse portfolio  
9 management standards they themselves have supplied. When  
10 the Governor ask us what's the impact on Massachusetts on  
11 our LDC, the question was it a manageable problem because  
12 percentages on peak days as a colleague said it was not  
13 significant, so that the what if scenario if we don't get  
14 that's applied as Chairman Kelliher has mentioned. Those  
15 alternative supply routes have been identified and are being  
16 identified, so the scope of the problem is rather manageable  
17 because of these diverse portfolio techniques.

18 MR. FLYNN: The only comment that I would make is  
19 that now more than ever in the short period of time that  
20 I've been on the Commission, is the fact that these  
21 geographic borders we have no longer exists when we are  
22 talking about these issues. The fact that companies like  
23 National Grid and KeySpan are in both of our states in two  
24 different ISO's. We have to along with you, do a better job  
25 with communicating and we talk about this at maybe you

1 recall a time in the electricity committee. And the fact  
2 that Congress has identified it and put it into law and we  
3 are doing these economic dispatch joints more than others.

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1           And it feeds right into what Chairman Kelliher  
2           said before about, you know, not being able -- you know, we  
3           don't have the jurisdiction over retail; you do, so there's  
4           not a lot we can do.

5           But the optics of the situation, quite frankly,  
6           are, everybody thinks you do. You know, the common person,  
7           the general public, thinks we're all in this together, and  
8           they don't differentiate between FERC versus the New York  
9           PUC, versus the Massachusetts PUC.

10          They believe we're all here today, all talking  
11          about the same situation, and that we should come out of  
12          here with some sort of cooperative decision on how we can  
13          help them this coming Winter, and, more importantly, beyond.

14          So, when we do discuss these issues such as  
15          hedging, or whether it be long-term contracts or whether it  
16          be transmission or energy efficiency, I think we all need to  
17          do a better job of working together on these issues, so that  
18          when we do -- we're going to have our differences; there's  
19          no doubt about that, but when we walk out these rooms and we  
20          go to the press, or if we -- because they can play a large  
21          part in this also, is that we need to do a better job of  
22          working on this together.

23          It's great that we're able to come down. You did  
24          it last week and this week. You know, you're doing your  
25          public awareness outreach today.

1           This is great, and the more that we can get the  
2 message out and educate ratepayers and consumers about these  
3 issues, they can start taking some ownership of their  
4 decisions like we're pushing them towards. They have to  
5 feel like they're a part of the process.

6           So, if we first start doing it on these big-  
7 ticket items, whether it be up in Massachusetts or  
8 elsewhere, then I can only imagine that it's going to  
9 trickle down and be to the benefit of all us.

10          So, I mean, I don't want to get into all the  
11 details of the hedging programs and all of those, but  
12 surveys, sharing of information, coming to New York State to  
13 meet with energy officials like you two have -- and there is  
14 always an open invitation to you and the Chairman -- that  
15 stuff, you cannot imagine how important that is.

16          Then we, on the state level, say we have direct  
17 communications with the federal regulators, we understand  
18 where they're coming from, and we're working on this  
19 together. And then it makes the companies less risk-averse,  
20 more apt to partner and do something about solving the  
21 problem, other than always worrying about the bottom line.

22          So I did talk longer.

23          (Laughter.)

24          COMMISSIONER BROWNELL: You lead me to one more  
25 question, and I have about 50, but I'll turn it over to my

1 colleagues. We're talking here today about short-term  
2 responses to what might be termed, and, when history looks  
3 at it, I'm sure it will be as not a particularly good job at  
4 long-term planning.

5 Is NARUC, are the regional bodies looking at more  
6 regional planning? Your Governors in the Northeast have  
7 talked a lot about it, but, Paul, as you point out, you're  
8 at the end of the pipe, and I haven't seen that issue  
9 addressed.

10 What is happening in regional planning? What can  
11 we all do to make what isn't happening, actually happening,  
12 and work, and lay out that plan for the next 20 years, so we  
13 don't have this every year?

14 MR. ALFONSO: If I may, I have a couple thoughts:  
15 One example, in real time, our colleague, the Governor of  
16 Maine, has sent a letter to all his colleagues on the gas  
17 situation, on the consumption issue, on the conservation  
18 issue, of indicating, listen, we in Maine are a smaller  
19 state, and we can do our conservation program all we want,  
20 but if you all in the other five states, if we're not  
21 working together, will it really have any impact for us  
22 here?

23 And he's correct. So he's asked the Governors  
24 and his PUC Chairs to work together in terms of working on  
25 consumption issues in the short term. So I think that's a

1 positive step.

2 One thing, in briefing Governor Romney, for  
3 example, to give you another example, on the impacts of Rita  
4 and the other hurricanes, one item we never leave the room  
5 without talking about is, okay, we're focused on the short  
6 term and we go through the fire drill today, but where is  
7 the long-term? Where is the medium-term?

8 And that really has had us thinking in our state,  
9 of an integrated energy plan, which means all these  
10 different sectors, one, either energy efficiency,  
11 conservation, but infrastructure, transmission, LNG, given  
12 the Distrigas facility. We know what that's like, and the  
13 significance on peak days where 60 percent is necessary  
14 coming from LNG on a peak day.

15 So we live on these difficult days and we're  
16 going to live it again, so that's important. And there  
17 rarely is an understanding, I think, in Massachusetts and in  
18 New England, that the word, "integrated" is crucial, which  
19 is each sector, in and of itself, won't get us there, but in  
20 combination of important transmission facilities, of  
21 important capacity markets, that function, that important  
22 LNG policies, that function, that, in the aggregate --

23 And that does go to the regional policy. That's  
24 more difficult. It's a work-in-progress, I would say, but  
25 there's a real understanding that, in fact, setting issues

1 and other issues, where it affects Connecticut, affects me,  
2 and we do have an understanding of that.

3 MR. FLYNN: From New York's perspective, as you  
4 know, Commissioner Brownell, it was not too soon that I came  
5 on the job and you and I had a conversation, and I asked  
6 you, how can I help? I'm the new guy on the block, and as I  
7 sit here today, you know, it's coming up on three years in  
8 February, so I haven't been around that long.

9 And you asked me at that time, if you could do me  
10 one thing, get the ISOs, the New York ISO and the New  
11 England ISO, and the PJM, get them talking to each other,  
12 because, right now, they're not.

13 And, well, about what issues? It doesn't matter.  
14 They're not even talking, so let's get them talking first,  
15 and then we'll get into the issues.

16 And so in terms of regional planning, I took you  
17 up on your challenge, and I think we've done a good job with  
18 having you as the hammer behind me, if they wouldn't talk to  
19 me. So, yeah, you --

20 So, from a regional perspective, whether it's  
21 rate pancaking, markets, and, most importantly, reliability,  
22 now, you know, the blackout in 2003, you know, it didn't  
23 stop, you know, in one state, and say, I'm not continuing.

24 I mean, when that 2,000 megawatts went, it went.  
25 It didn't care where it went, into what territory.

1           So it said to me that there are real important  
2 issues, some of which we've talked about today -- market,  
3 but in terms of reliability also -- that we have to take the  
4 responsibility of talking with each other.

5           So, from the regional perspective, I know  
6 Governor Pataki has always said, in terms of keeping the  
7 lights on, if we're going to be affected by other states,  
8 then start communicating with the other states and the other  
9 ISOs, to make sure that the next time this thing happens,  
10 the lights aren't out in New York State, even though we  
11 didn't cause it, for 29 hours.

12           So I've always kept that in the back of my mind  
13 as we look into these other issues, whether they be at NARUC  
14 -- and NARUC has done a wonderful job, whether it be on a  
15 national level or regional level, of doing the  
16 communicating. I think it's even gotten that much better,  
17 even in the short period of time that I've been there.

18           MS. MUNNS: Let me just say this -- I'll talk  
19 about the natural gas situation first. As I said before, we  
20 are, within the Midwest -- in fact, I think that the letter  
21 that we sent out, went to Maine and they said, gee, this is  
22 a good idea, let's try it here --

23           MR. ALFONSO: I should announce that it was her  
24 idea.

25           MS. MUNNS: That we need to deal with this. You

1 know, as I said, I think we have very good energy efficiency  
2 and conservation programs in Iowa, but we don't have very  
3 many people and we can't have much impact on the market.

4 California, however, showed, with the number of  
5 people they have, that you can have an impact, and that we  
6 really need to go at this on a regional basis. It's much  
7 too difficult to try to organize it nationally, and our  
8 markets are much different.

9 The use of natural gas in the Northeast is  
10 different than the way that we predominantly use it in the  
11 Midwest, and we need to approach it -- and, as I said, we  
12 need to come up with a plan for managing the short-term  
13 natural gas situation, on a regional basis.

14 I'm happy that New England is getting together to  
15 do that, and I certainly wish them luck.

16 With respect to long-term planning, what you're  
17 talking about, I think the states have begun doing that  
18 through forming regional and state committees. We have the  
19 issues that are inherent in the way that government is set  
20 up in the United States, and that there are federal  
21 responsibilities and state responsibilities, and there's no  
22 regional approach.

23 And we now have regional markets, and we have to  
24 figure out a way to come together and deal with that, and  
25 we've been talking a lot about that, and to the extent that

1 we can make that a little more transparent to everybody, I  
2 think will take some of the uncertainty out of these changes  
3 in markets that are taking place.

4 COMMISSIONER BROWNELL: You've done a great job  
5 in advancing metering, by the way, which we didn't talk  
6 about.

7 MR. PEEVEY: Just a couple of points: In 2001  
8 and 2002, because we were faced in California with a very  
9 severe electricity crisis, we adopted something called the  
10 20/20 program. It was a very simple concept, and it was, if  
11 you reduced your usage as a consumer, by 20 percent, you got  
12 a 20-percent rebate, plus whatever savings you got by  
13 reducing your usage. The combined was like 38 or 40 percent.

14 .  
15 One-third of all residential customers in  
16 California and the utilities, met the 20-percent target for  
17 the four summer months of 2001 and 2002. Another third  
18 missed the 20 percent, but reduced their usage, so you had -  
19 - and the purpose of this was to have price impacts.

20 We probably ought to consider something similar  
21 on the gas side -- maybe not 20/20, maybe 10/10 or 15/15,  
22 something of that type. I plan to talk about that back in  
23 San Francisco.

24 That's number one; that's something that can be  
25 done. Number two, it seems to me that you have a

1       unprecedented responsibility here at FERC, to work with the

1 National Advertising Council and others, to have public  
2 service announcements on a scale heretofore unseen, about  
3 this Winter and what people can do.

4 Third, I would say to FERC, that looking at it on  
5 a regional basis, that I see no reason why you can't, with  
6 your staff, develop some sort of programs that you urge the  
7 states to adopt, and use your spot as a bully pulpit to do  
8 that.

9 Now, it doesn't mean that you have to --  
10 recognize that there are regional differences, but that's  
11 leadership, and that's what you should be doing on a  
12 national basis, and have credible spokespeople talking about  
13 what Katrina and Rita and whatever else we're getting now --  
14 is it Wilma -- is coming, and all that, and what it really  
15 means, and how people can act and behave in a way that is  
16 responsible to the society and on their own behalf.

17 And so I put the challenge back to you, to step  
18 up to the plate, with another baseball analogy.

19 COMMISSIONER BROWNELL: My challenge back is,  
20 we've got a bunch of LNG proposals and pipeline proposals  
21 that probably ought to get looked at very seriously.

22 MS. MUNNS: That reminded me of something that  
23 the EPA is putting together, which is an effort to put  
24 together best practices in energy efficiency, the kind of  
25 thing you just talked about. We'll be meeting in the next

1 couple of months, and Jim Rogers from Cinergy and myself  
2 have agreed to take leadership of that, so that we can get  
3 those successful programs out to be implemented to deal with  
4 the natural gas situation.

5 COMMISSIONER KELLY: First, I want to thank you  
6 all for being here, and it's been very gratifying to hear  
7 about the leadership that you are exhibiting, both states  
8 and industry, in helping to ensure that there are adequate  
9 gas supplies this Winter, and in helping consumers help  
10 themselves to reduce demand.

11 I've appreciated learning about some of the  
12 specific efforts that you're undertaking, and the efforts to  
13 conserve natural gas leads me to a question regarding the  
14 integration of gas and electricity and their prices.

15 As you are well aware, in excess of 20 percent of  
16 our gas consumption today, goes to fuel gas-fired electric  
17 generation, and so as the price of gas goes up, so does the  
18 price of electricity. And that's particularly true as we  
19 approach the Winter and look for peak days, because most  
20 peakers -- many peakers are gas-fired.

21 So, in your conservation efforts, is the price of  
22 -- the impending price increase in electricity being  
23 emphasized, and is there -- are consumers aware that as they  
24 conserve and use less gas, they shouldn't be trying to make  
25 it up with electricity? For example, turning you heat down,

1 but then plugging in the electric heater, isn't going to  
2 help matters; is that being taken into account, and are  
3 consumers aware that gas prices are affecting electricity  
4 prices, too?

5 MR. PEEVEY: Yes, but to much less of a degree;  
6 there's no question about that. I think it's a much lesser  
7 degree, and because, even in California, where, you know,  
8 gas is the predominant fuel for electricity generation, we  
9 do have still quite another mix, and, frankly, a lot of the  
10 electricity prices are somewhat hedged where the generators  
11 are taking the hit on this, rather than the consumers under  
12 the state's DWR, Department of Water Resources contracts.

13 But, yes, it's a tougher story to tell, I think,  
14 than it is solely about gas, though, Commissioner Kelly.

15 COMMISSIONER KELLY: Well, I think it is, too,  
16 and so to the extent that you have suggestions for us, or to  
17 the extent that you're working on telling that story, we'd  
18 appreciate hearing about it, and I hope that we can also do  
19 a better job of getting that information out to consumers,  
20 that conservation involves electric conservation, as well.

21 MR. PEEVEY: All the programs that I listed  
22 earlier, our CARE program and other programs, all apply to  
23 electricity as well as gas, and we asked, and when we had  
24 our hearing a week or two weeks ago, in Los Angeles, the  
25 electric utilities also came in and -- like Edison -- and

1 pledged their various programs to do that.

2 COMMISSIONER KELLY: Thank you.

3 Regarding hedging, I was a state regulator, too,  
4 and I know that it's difficult in many states, if not  
5 impossible, to do pre-approval, but I thought that New  
6 York's idea of having a policy in place -- and I haven't  
7 read your policy statement, but I assume that it provides  
8 guidelines to utilities, without giving a pre-approval, but,  
9 nevertheless, provides guidelines to utilities about hedging  
10 practices that would be acceptable?

11 MR. FLYNN: That's correct, and it's laid out in  
12 a policy that we've had since 1998, and it's an ongoing  
13 practice that we have at the Commission, and one that is  
14 paralleled with the supply aspect on the hedging.

15 So it's worked well, and that's what's allowed us  
16 to have, as I stated the specifics before of 30 to 35 in  
17 terms of hedged market, so it's worked out quite well, and  
18 the diversification has insulated us from some tougher  
19 problems that, quite frankly, they have in New England.

20 COMMISSIONER KELLY: There was an article  
21 yesterday in the Wall Street Journal, that talked about the  
22 fact that a lot of utilities didn't use hedging or didn't  
23 use it to the extent they could, just out of uncertainty  
24 about knowing whether regulators would later approve it. It  
25 seems that having a policy in place, would help limit some

1 of that uncertainty.

2 MS. MUNNS: And we've had -- as I said, we've had  
3 rules since '94. Nobody really used them, though, until the  
4 last five years.

5 We allowed our General Counsel to give an opinion  
6 letter on use of certain financial instruments, that I think  
7 was helpful. I mean, you go as far as you can go.

8 I think there is -- you want the utilities to  
9 have the flexibility when conditions change, to change the  
10 mix, without coming back through again, because you can miss  
11 opportunities when things are moving quickly. So I think  
12 that there's some tension there in what you do, and  
13 thinking, gee, you know, I got an okay on this; that looks  
14 good, but I know I'm safe over here, so I think you have to  
15 be careful.

16 COMMISSIONER KELLY: President Peevey, I was very  
17 interested in hearing about SoCal Gas's cushion gas  
18 proposal, and I look forward to learning the details about  
19 it, but if you can take your existing supply and sell it at  
20 38 cents an Mcf, it sounds like a good trick to know about.

21 And I hope that you could facilitate a meeting  
22 between the CEO of SoCal Gas and Mr. Steinbrenner, to see if  
23 there is some way that he can take his budget and cut it  
24 down, and then use that excess to maybe strengthen the  
25 bullpen.

1 (Laughter.)

2 COMMISSIONER KELLY: Regarding what FERC can do  
3 and not do, it's been very helpful to hear your opinions,  
4 and they're constructive. As Joe has said, we are going to  
5 take more initiatives today to strengthen our market  
6 monitoring program and our enforcement.

7 Regarding gas quality, Mr. Bean, I think that  
8 what I heard you say is that we should be concerned about  
9 gas quality, but we shouldn't act in a way that assumes that  
10 one size fits all, that a dew point for one area of the  
11 country or even one pipeline, may not -- probably will not  
12 work for another pipeline.

13 MR. BEAN: We're probably getting into a little  
14 more than I know about, if you're going to go pipe-specific.  
15 I can only talk to you about the two pipes that we're on,  
16 and that's Florida Gas and Southern.

17 COMMISSIONER KELLY: Well, I just wanted to let  
18 you know that I think we agree with you that --

19 MR. BEAN: Thank you very much.

20 COMMISSIONER KELLY: -- that working on a  
21 pipeline-by-pipeline system basis, to maximize the  
22 throughput and yet still maintain gas quality, as INGAA has  
23 been doing in working with producers, especially in the  
24 aftermath of Katrina and Rita, is the way we want to go,  
25 rather than mandating one standard for everyone. Thanks.

1           I have one last issue that I wanted to raise, and  
2           that's about contracting practices. We've seen contracting  
3           practices change dramatically over the last 20 years in the  
4           gas industry.

5           Do you foresee that an increase in long-term  
6           contracts for gas, for storage in the future, with the price  
7           of gas going higher, or is your current portfolio mix, your  
8           utilities' portfolio mix, of long-term, short-term, spot  
9           supplies, adequate to get you through the next five or ten  
10          years?

11          MS. MUNNS: I think they need to do more long  
12          term. I've heard from our utilities that there's not a lot  
13          of long-term out there, that there is much price  
14          differential. I can tell you one of our LDCs brought a 14-  
15          year contract to us last year to look at, and we said, yeah,  
16          we'll look at it, bring it in and show us.

17          And during that period of time, things changed in  
18          the market enough that they said, we don't want to do it;  
19          it's just -- it's too close to the line.

20          But I think that we're willing to look at it.  
21          I'm just not sure that the markets are differentiated enough  
22          right now to have the kind of impact that you're talking  
23          about, there's so much uncertainty. I don't know how far  
24          out people are going.

25          MR. PEEVEY: I honestly don't know the answer to

1       that question. I mean, we go back and forth. On the  
2       electric side, we signed all kinds of long-term contracts  
3       after the California energy crisis. We thought it was a  
4       great deal, broke the back of the high prices, and then  
5       prices went like this, and then everybody was critical.

6                You can even say that one chief executive was a  
7       contributing factor in his losing his job, so, I mean, these  
8       things get very, very complicated and very tricky.

9                You know, it's a constant monitoring job, with  
10      the right mix of long- and short-term, interim-term, whether  
11      it's gas or electricity. I frankly don't know, and I can't  
12      sit here today and say that at the peak of the market, we  
13      ought to be going long. I mean, that sounds intuitively  
14      unwise.

15               I'd rather see us do things that curtail demand,  
16      and, therefore, increase supply and then put pressure on a  
17      more moderate pricing structure, as we bring units back, as  
18      we said earlier. It seems to me a wiser course, but, you  
19      know, I think we all have to work very closely together to  
20      figure all this out.

21               MR. BEAN: Did you say the market is at its peak?

22               MR. PEEVEY: I don't know if it's at its peak or  
23      not. If I knew, I'd make much better decisions.

24               (Laughter.)

25               MR. BEAN: Anytime you can own molecules, I think

1       you're in good shape.

2                   MR. PEEVEY:  Yes.

3                   COMMISSIONER KELLY:  The concern about long-term  
4       contracts or how much of the supply should be under longer-  
5       term contracts, does that apply to storage as well, at this  
6       point?

7                   MR. PEEVEY:  Yeah.

8                   COMMISSIONER KELLY:  Okay, than you.

9                   CHAIRMAN KELLIHER:  I want to thank the panel.  
10       It's been very helpful to hear, particularly from the state  
11       regulators, what's happening at the state level.  I think  
12       there's been -- President Peevey just made the same comment,  
13       that there's recognition that we have different regulatory  
14       tools, and if we use them in a complementary way, we can  
15       make a big difference.

16                   So thank you very much for your time today, and I  
17       appreciate it.  Thank you.

18                   Madam Secretary?

19                   SECRETARY SALAS:  Thank you, Mr. Chairman.  And  
20       now, following the presentation by the members of the gas  
21       industry, we now have a FERC Staff presentation.  This is  
22       the Number A-3 on your agenda, the Winter Energy Market  
23       Assessment for the Years 2005 through 2006, and it's a  
24       presentation by Tom Pinkston, John Kroeger, and, I believe  
25       Steve Harvey will also be assisting.

1                   CHAIRMAN KELLIHER:  Why don't you proceed,  
2                   please.

3                   MR. PINKSTON:  Good morning, Chairman and  
4                   Commissioners.  We are pleased to present Item A-3, the  
5                   Winter Energy Market Assessment for 2005 and 2006.  This  
6                   assessment will outline market issues for both gas and  
7                   electric and conclude with the details on how we will be  
8                   monitoring this winter's market.  The presentation will be  
9                   made available on the FERC website.

10                   (Slide.)

11                   MR. PINKSTON:  Before proceeding to the  
12                   assessment, I'd like to establish some context, namely, as  
13                   we've heard this morning, that markets are anticipated to be  
14                   under very tight supply and demand conditions with the full  
15                   extent of hurricane damage still unknown.  By complete  
16                   recovery, estimates are as much as 650 Bcf of production  
17                   will have been lost and that almost 2 Bcf will remain shut-  
18                   in during the November to March winter period.

19                   Oversight released a report last week that  
20                   details the factors that have driven the winter strip to the  
21                   13 to \$14 range.  At that range, even small changes in  
22                   supply and demand can have disproportionate price effects.  
23                   In response to these conditions, we will be reviewing daily  
24                   a variety of data, including supply and its role as a price  
25                   driver, energy trading, it's price effects, liquidity and

1 any potential for manipulation, the adequacy of  
2 infrastructure and its response to stress and the effects of  
3 fuel costs on electricity prices.

4 (Slide.)

5 MR. PINKSTON: Let's begin with prices. We've  
6 shown in previous assessments that gas prices react to  
7 supply stress and also follow oil prices. For example, as  
8 shown in this graph, the limit to New York City gas traded  
9 between No. 2 heating oil and No. 6 fuel oil for several  
10 years with occasional higher levels during periods of  
11 intense demand. Most recently gas prices have moved toward  
12 the higher end and could exceed that price range this winter  
13 under conditions of supply stress and strong weather-related  
14 demand.

15 Fortunately, storage inventories have remained  
16 adequate despite strong summer demand and supply losses due  
17 to the hurricanes, which have reduced the surplus to the 5-  
18 year average.

19 (Slide.)

20 MR. PINKSTON: This chart shows the surplus over  
21 the 5-year average over time on the left vertical axis, and  
22 also with the vertical bars compares actual inventory for  
23 2005 to the 5-year average with the right vertical axis as  
24 the scale. Working gas, as of October 7th, was estimated at  
25 just under 3 Tcf, slightly above the 5-year average, but

1 below year-ago levels. Expectations are that we will go  
2 into the winter at approximately 3.1 Tcf. Again, slightly  
3 above the 5-year average of just over 3 Tcf and likely  
4 adequate for a normal winter.

5 (Slide.)

6 MR. PINKSTON: The natural gas production or the  
7 status of natural gas production is uncertain. This graph  
8 compares outlooks for 2005 gas production, including  
9 estimated shut-in supplies. The left vertical axis is dry  
10 gas production with the red bars being EIA actuals and their  
11 2005 estimates. The blue and green bars are 2005 estimates  
12 from -- and Lehman, respectively, adjusted by staff to  
13 account for lost production. The right vertical axis is the  
14 gas rate count represented by the solid line. Even prior to  
15 the hurricanes, there was concern about gas supply  
16 deliverability.

17 Over the last few years the country has seen  
18 higher decline rates and fewer reserves added per well,  
19 meaning less added deliverability despite an increasing rate  
20 count. Prior to the hurricane, projections for changes in  
21 dry gas production ranged from flat to a negative 2.1  
22 percent. Now, including lost production, the country is  
23 likely to see declines of 3 percent to more than 5 percent  
24 as compared to 2004. Greater LNG imports are expected to  
25 compensate for some, although not all of the production

1 declines.

2 (Slide.)

3 MR. PINKSTON: This chart compares historical LNG  
4 sent out to projections for this winter. Estimates vary.  
5 But, if consensus of forecasters and LNG analysts anticipate  
6 that LNG imports this winter will average between 1.9 Bcf a  
7 day and 2.7 Bcf a day. This is an increase of approximately  
8 10 to 15 percent more than last winter's imports.  
9 Uncertainties that may affect U.S. import levels include  
10 potential supply disruptions at global liquification  
11 terminals, and more economically, the LNG requirements in  
12 competing global markets in the resulting netbacks or prices  
13 that the LGN buyers would be willing to pay to attract LNG  
14 in the various markets. High natural gas prices at Henry  
15 Hub have attracted spot cargoes recently, but buyers in  
16 other global markets this winter may be willing to pay even  
17 more.

18 (Slide.)

19 MR. PINKSTON: The next chart will attempt to tie  
20 together some of the observations from the previous slides.  
21 It will be a winter year-on-year change in supply demand in  
22 Tcf, assuming normal weather and approximately 2 Bcf a day  
23 of shut-in supply. This chart demonstrates how the market  
24 could stay in balance. Beginning on the left, production,  
25 assuming the shut-in gas of 2 Bcf a day, on top of ongoing

1 declines approaching 2 percent, is down just over .4 Tcf.

2 Moving left to right, the next three green bars  
3 show that net pipeline imports, LNG imports and greater  
4 storage withdrawals will add back .23 Tcf such that the  
5 total supply shortfall compared to last winter will be  
6 roughly .2 Tcf. As a consequence, demand to balance will  
7 have to decline about the same amount or 1.4 percent in  
8 total winter-to-winter. That reduced demand is likely to be  
9 primarily industrial and due to high gas prices.  
10 Residential/commercial use is actually expected to increase  
11 with the return to normal weather.

12 As always, in our business, weather does play a  
13 large role and the final two bars show the increase in  
14 demand for winters 10 percent warmer or colder than normal  
15 or the change in demand for winters 10 percent warmer or  
16 colder than normal. It's a static representation because in  
17 reality the gaps between supply and demand created by  
18 changing weather would result in different price levels that  
19 would, in turn, further influence demand. Nevertheless, the  
20 swings in demand, on average more than 3.5 Bcf a day,  
21 illustrate the crucial effects of weather.

22 (Slide.)

23 MR. PINKSTON: Staff continues to be concerned  
24 with regional prices, especially as you would expect, in the  
25 Northeast and Mid-Atlantic. This slide shows forward prices

1 for New York City delivery this year -- the blue bars --  
2 compared to actual prices last years -- the green bars.  
3 Further, the bars are divided into the Henry Hubb price, the  
4 lighter shading, and the transportation to cost to New York,  
5 the darker shading. That transportation cost is the forward  
6 market showing potential congestion pricing most  
7 significantly into the Northeast this winter we don't really  
8 see in other reasons. Infrastructure has proved adequate  
9 but tight in the past, notably, in 2003, severe cold. Since  
10 that time there have been 11 Northeast projects completed  
11 adding over 2 Bcf a day equal to almost 20 percent of load  
12 for the region.

13 (Slide.)

14 MR. PINKSTON: Turning to electricity, prices are  
15 expected to rise in response to increased fuel prices.  
16 We've looked at regionally the fraction of electricity from  
17 gas and forward prices for this winter compared to the prior  
18 two winters. Forward contracts indicate increases of 95  
19 percent to approaching 200 percent. We should point out  
20 that the forward pricing aren't exactly comparable to the  
21 day-ahead prices that we've shown for the past two winters.  
22 They're packages for a month or more. And also, in the  
23 markets that we observed, they aren't traded as often  
24 compared to day-ahead contracts, but still they do provide  
25 us some directional guidance.

1 (Slide.)

2 MR. PINKSTON: Other electric winter issues  
3 include how cold weather can stress the electric markets and  
4 systems. Severe cold can also cause mechanical problems.  
5 ISO New England developed cold weather procedures to reduce  
6 such problems, but those haven't been extensively tested  
7 yet.

8 Further, many gas-fired generators don't have  
9 firm capacity and may be unable to get gas when it become  
10 scarce. Pipelines to maintain pressure may limit their  
11 flexibility adding to supply difficulties for interruptible  
12 generators. Generators burning gas face financial risks if  
13 gas is unable in the time power is required or is only  
14 available at higher intra-day prices and if their gas  
15 consumption rates exceed reduced pipeline tolerances. ISO  
16 New England's cold weather procedures attempt to make  
17 generator schedules early in the day to reduce that  
18 availability risk for fuel for generators.

19 Some generator, finally, particularly in New York  
20 and New England, can switch between gas and oil. They are  
21 important reliability assets. With the availability of  
22 alternate fuels to protect generation, severe weather can  
23 interfere with oil deliveries by truck or barge and can  
24 cause coal piles to freeze. So that's another issue.

25 Given this context, tight supply and demand with

1 the market challenge to achieve equilibrium, we will closely  
2 monitor gas and power this winter. And more specifically,  
3 we intent to continue our longstanding monitoring storage  
4 levels and available information and also a part of that and  
5 also separate, when observations warrant on any type of  
6 transaction, we will request transactional level data, if  
7 necessary. Further, we will closely follow pipeline  
8 utilization and tolerances relative to regional prices and  
9 regional price differentials.

10 And, finally, we will continue to obtain timely  
11 information and quickly respond to complaints via the  
12 hotline or industry tips.

13 That concludes our presentation. John and I,  
14 along with Steve Harvey, will be happy to take any of your  
15 questions.

16 CHAIRMAN KELLIHER: I have a number of questions  
17 based on -- I'm not sure which slide number it was -- but  
18 the year-on-year change slide.

19 MR. PINKSTON: Yes.

20 CHAIRMAN KELLIHER: Pipeline imports and LNG  
21 imports, you show that could offset some of the loss of  
22 domestic supply -- domestic production. What is the  
23 constraint on pipeline imports? Is it pipeline capacity or  
24 is it Canadian gas production levels?

25 MR. PINKSTON: This is, again, the change year-

1 on-year. So the constraint is really pipeline capacity.  
2 The increase has been done to increasing production or the  
3 increase that we're now seeing is due to increasing Canadian  
4 production.

5 CHAIRMAN KELLIHER: What I don't understand,  
6 though, is Canadian pipelines are only about 75 percent  
7 capacity.

8 MR. PINKSTON: I think they're largely driven  
9 really by the construction constraints. Certainly, during  
10 extreme times we've seen in the past there have been supply  
11 constraints that have limited -- in the case of New England  
12 a couple of winters ago, there were supply constraints more  
13 than capacity constraints that actually created some  
14 difficulties during that period of time. So it's a bit of a  
15 mix. There's a limit, obviously, as to how much physical  
16 capacity is available from different places. But I think  
17 generally, over this kind of time period, it's a production  
18 issue more than it's a capacity issue.

19 CHAIRMAN KELLIHER: Have Canadian gas imports  
20 increased since Hurricane Katrina?

21 MR. PINKSTON: They've been up this year in  
22 general. I believe they have increased mildly. No, they  
23 haven't been huge increases, but it has been mildly up from  
24 last year, I believe.

25 CHAIRMAN KELLIHER: But since Katrina have they

1 increased?

2 MR. PINKSTON: I don't know the answer to that  
3 question.

4 CHAIRMAN KELLIHER: But, if they've increased,  
5 it's not a large increase.

6 MR. PINKSTON: In order to balance the system, it  
7 isn't close to enough to really balance the system.

8 CHAIRMAN KELLIHER: Now you also project  
9 increased LNG imports, but I thought LNG imports at this  
10 point were actually lower than last year.

11 MR. PINKSTON: I believe the increase, though,  
12 projected forward is based on the new higher prices we've  
13 seen post-hurricane that will attract imports, even given  
14 global competition.

15 CHAIRMAN KELLIHER: But, if we're going to see a  
16 short-term increase in LNG imports, doesn't that mean prices  
17 here have to be higher than they are in Europe, for example?

18 MR. PINKSTON: Yes. There have been some studies  
19 that have come out recently that said we needed to see at  
20 least a dollar differential at Henry Hubb.

21 CHAIRMAN KELLIHER: But aren't European prices  
22 higher? I thought that short-term LNG shipments were  
23 tending to go to Europe, not the United States.

24 MR. PINKSTON: Currently, our prices have been  
25 higher sort of post-hurricane and late in the summer. The

1 forward prices would indicate that they're going to come  
2 closer to parity as we go into the winter and so it's not  
3 completely clear. I do think that many of studies, and I  
4 think we refer to the CERA in here and we refer to the Water  
5 Broad LNG report expect a fairly high level, which assumes  
6 we will compete and, in fact, win some of those -- many of  
7 those cargoes this winter.

8 MR. HARVEY: Yes. I think if you look at the  
9 price projections -- the futures prices, you can see early  
10 in the winter they're quite high and I believe it was CERA  
11 saying that they participate minimal problems attracting  
12 cargoes early in the winter. Later in the winter, we may  
13 then have the more price competition.

14 CHAIRMAN KELLIHER: Right. But CERA also  
15 acknowledged that imports cannot offset the loss of domestic  
16 production.

17 MR. PINKSTON: Right.

18 CHAIRMAN KELLIHER: There's no question about  
19 that.

20 MR. PINKSTON: Right. I think the year-on-year  
21 change shows that. That the pipeline LNG and even harder  
22 pulls on storage doesn't compensate for the lost production.

23 CHAIRMAN KELLIHER: Now this same chart suggests  
24 that weather alone, putting conservation to the side, can  
25 either almost double the effects of lost production or

1 offset it.

2 MR. PINKSTON: Right. On average, the plus or  
3 minus 10 percent means 3.5 Bcf per day of increase or  
4 decrease with the lost production being 2 Bcf. So were we  
5 to have a very warm winter there should probably be very few  
6 problems.

7 CHAIRMAN KELLIHER: I didn't quite appreciate the  
8 magnitude of that. It can either double the problem or  
9 erase, it perhaps.

10 COMMISSIONER BROWNELL: What are the weather  
11 predictions?

12 MR. HARVEY: They're still, I guess, a bit  
13 squishy at this point. I believe the last NOAA forecast  
14 expected perhaps colder weather just along the east coast  
15 mainly and the rest was either warmer than normal or closer  
16 to normal. I believe there is suppose to be a NOAA update  
17 here in the next few days maybe even as well and we'll be  
18 watching that closely.

19 CHAIRMAN KELLIHER: Thank you very much.

20 Any other questions?

21 COMMISSIONER BROWNELL: I just wanted to add. I  
22 think we need to watch very carefully those European prices  
23 because I actually have heard from one importer that they've  
24 already seen a reduction because of pressure from European  
25 prices. So you may be correct, but in practice, something

1 else may be going on.

2 The other thing I would suggest is Chairman  
3 Flynn, and I meant to ask him this question, alluded to  
4 different ways of collecting data at the state level on  
5 storage, I think, and asked that we might look at that. We  
6 should figure out what that's all about and see what, if  
7 any, help we can offer in harmonizing whatever data  
8 collection is going on.

9 MR. PINKSTON: Good point on the LNG. I guess we  
10 could go on a long time, but there are other non-economic  
11 factors that involve a lack of alternatives in some European  
12 countries and drought conditions and that type of thing that  
13 can also interfere with our imports.

14 COMMISSIONER KELLY: Good point. I just wanted  
15 to add to that comment the fact that we do have different  
16 types of LNG operations occurring in the United States and  
17 some of them like the ones, for example, that Cheniere's  
18 developing is more are more tolling operations that are  
19 effected day-to-day, week-to-week, month-to-month by the  
20 international price. However, others, for example,  
21 Distrigas in Boston are secured with long-term contracts and  
22 so the supply is locked in. The price might float. So  
23 supply and delivery to the U.S. depends, in part, of course,  
24 on the international price and demand in Europe. But also  
25 some of that volatility is taken away from by the existing

1 LNG facilities -- Cove Point, -- Island with their long-term  
2 contracts.

3 MR. PINKSTON: Right. That's a good point. And  
4 on those facilities, also, because of where they're  
5 situated, they receive quite a bit more attractive pricing  
6 and there's very minimal additional shipping cost, so  
7 they're going to continue to attract cargoes. A lot of the  
8 comments we're making would apply more to Lake Charles  
9 probably as kind of a swing terminal.

10 COMMISSIONER KELLY: Right. But, again, it is an  
11 interesting issue and a good issue to bring up because it  
12 also impacts the issue that the earlier panel talked about  
13 and that Joe talked about, which is the nature of  
14 contracting and whether we're going to see more long-term  
15 contracting practices in the future versus the past.

16 CHAIRMAN KELLIHER: Thank you. That was a very  
17 good presentation. We appreciate it. And this will be  
18 available on the website?

19 MR. PINKSTON: Yes.

20 CHAIRMAN KELLIHER: Thank you.

21 COMMISSIONER BROWNELL: I have one more question.  
22 Are you going to update this pretty regularly during the  
23 winter since everybody talked about the need for good  
24 information?

25 MR. PINKSTON: Yes. The supply/demand balance at

1 the top of the thing?

2 COMMISSIONER BROWNELL: Yes.

3 MR. PINKSTON: We certainly can. There's a lack  
4 of real-time information often regarding, especially the  
5 decline in supply, but the demand and weather-related  
6 storage information and also shut-ins.

7 COMMISSIONER BROWNELL: Great.

8 SECRETARY SALAS: Next for discussion is a joint  
9 presentation of the three M items on the agenda for today.  
10 These are M-1, Prohibition of Energy Market Manipulation  
11 rulemaking; M-2, Policy Statement on Enforcement of  
12 Statutes, Orders, Rules and Regulations; and M-4, Rulemaking  
13 on procedures for this position of contested audit matters.  
14 And it's a presentation by Ted Gearden, who is accompanied  
15 by Bob Pease, Lianne Watson, Christopher Wilson, Janice  
16 Garrison-Nicolas, Brian Craig, John Kroger, Mike Higgins and  
17 Frank Carabesto.

18 MR. GEARDEN: I'm Ted Gearden with the Office of  
19 Market Oversight and Investigations. And with me today are  
20 Robert Pease, Lianne Watson, Brian Craig, Janice Garrison-  
21 Nicolas, John Kroger, Mark Higgins from the Office of Market  
22 Oversight and Investigations. Frank Carabeso and  
23 Christopher Wilson from the Office of General Counsel.  
24 Other members of staff who contributed to these agenda items  
25 are Mark Close and Roger Moore of the Office of Market

1 Oversight and Investigations.

2           Agenda Items M-1, M-2 and M-4 are matters related  
3 to the Commission's enforcement authority and policy and  
4 audit compliance program. M-1 is a notice of proposed  
5 rulemaking to implement authority given to the Commission by  
6 the Energy Policy Act of 2005 which added Section 4(A) to  
7 the Natural Gas Act and Section 222 to the Federal Power  
8 Act. These parallel sections prohibit the use or employment  
9 of any manipulative or deceptive device or contrivance in  
10 connection with the purchase or sale of natural gas,  
11 electric energy or transportation or transmission services  
12 subject to the Commission's jurisdiction.

13           Because Congress specified that the terms  
14 "manipulative or deceptive device or contrivance" have the  
15 same meaning as in Section 10(b) of the Securities Exchange  
16 Act, the proposed rule closely tracks the language of Rule  
17 10(b)(5) -- the rule adopted by the Securities and Exchange  
18 Commission to implement Section 10(b) of the Exchange Act.

19           The rule proposed today makes changes from Rule  
20 10(b)(5) only where necessary to reflect the character of  
21 the energy industry to which the new rule will apply. There  
22 is large body of caselaw under the Exchange Act and the  
23 SEC's Rule 10(b)(5) interpreting Section 10(b), including  
24 the meaning of "manipulative or deceptive device or  
25 contrivance." That body of law will provide guidance to the

1 Commission and the industry in implementing and enforcing  
2 the Energy Policy Act's prohibition on energy market  
3 manipulation. Guidance that is not typically available when  
4 implementing a new rule.

5 In addition, the NOPRA notes that, while Market  
6 Behavior Rule 2 dealing manipulation remains in effect, the  
7 Commission intends in the near future to seek comments on  
8 whether Market Behavior Rule 2 should be revised or repealed  
9 once rules implementing the anti-manipulation provisions of  
10 the Energy Policy Act are in place.

11 Agenda Item M-2 is a policy statement on  
12 enforcement. The Energy Policy Act expanded the  
13 Commission's enforcement authority by extending civil  
14 penalties to all of Part 2 of the Federal Power Act and by  
15 giving the Commission civil penalty authority under the  
16 Natural Gas Act for the first time. The Energy Policy Act  
17 also increased the maximum penalty to \$1 million per day per  
18 violation.

19 Pursuant to statute, the Commission must consider  
20 both the seriousness of the offense and steps the violator  
21 takes to remedy matters in a timely manner. In order to  
22 provide guidance and more certainty about the enforcement  
23 process, the policy statement discusses the factors the  
24 Commission will consider in deciding on the appropriate  
25 remedies given the seriousness of a violation, including the

1 level of civil penalties to be assessed.

2 In addition to discussing the factors to be  
3 weighted in determining the seriousness of the violation,  
4 the policy statement also addresses the considerations to be  
5 given for steps taken to remedy violations. These  
6 mitigating factors include strong compliance efforts by  
7 companies voluntarily reporting violations and full  
8 cooperation with the Commission in ending, disclosing and  
9 remedying violations. Mitigating factors may, in  
10 appropriate cases, reduce or even eliminate a civil penalty.  
11 The factors identified in the policy statement are similar  
12 to those used by other federal agencies, including the  
13 Securities and Exchange Commission, the Commodity Futures  
14 Trading Commission and the Department of Justice.

15 As a result, the policy statement draws upon  
16 familiar principles of administrative enforcement in  
17 providing guidance to entities subject to the Commission's  
18 jurisdiction.

19 Finally, Agenda Item M-4 is a notice of proposed  
20 rulemaking to apply the existing procedures for challenging  
21 staff audit findings in financial audits to all audits,  
22 including operational audits. Current regulations provide  
23 entities being audited with an opportunity to challenge  
24 staff's proposed factfindings resulting from financial  
25 audits before the Commission issues an order on the merits

1 with respect to disputed findings. In such cases the entity  
2 can select shorten procedures, that is a paper hearing, or a  
3 trial-type hearing before an administrative law judge if  
4 there are material facts in dispute.

5 As operational audits have grown in number and  
6 importance, the lack of specified procedures to permit  
7 timely challenges to staff's proposed findings and remedies  
8 before the Commission issues an order on the merits of the  
9 disputed findings has become apparent. The new rule would  
10 address this by extending the existing choice of shortened  
11 or full hearing procedures where material are in dispute to  
12 issues arising in other audits, including operational  
13 audits.

14 Taken together, M-1 and M-2 give form and  
15 substance to the Energy Policy Acts prohibition on market  
16 manipulation and to the exercise of the Commission's  
17 enhanced enforcement powers. M-4 provides entities subject  
18 to audit with procedures to challenge staff findings  
19 resulting from any audit. Entities subject to the  
20 Commission's jurisdiction will be on notice, both of the  
21 serious consequences of violating the statutes administered  
22 by the Commission and the order's rules and regulation of  
23 the Commission. But also will be assured that the  
24 Commission will exercise its enforcement powers and audit  
25 authorities in a fair, objective and even-handed manner.

1                   We will be pleased to respond to any questions on  
2 these items.

3                   CHAIRMAN KELLIHER: Thank you for that  
4 presentation. It was an excellent presentation and I very  
5 much like these orders. I guess that's obvious or it  
6 wouldn't be up for voting today. But these are important  
7 orders. So I thought I would explain a little bit, at least  
8 my reasoning and my support for them, and then ask my  
9 colleagues to offer their views.

10                  We've talked today and we talked last week about  
11 the effect of Hurricanes Katrina and Rita, how we've lost  
12 significant gas supply and that prices will be higher this  
13 winter. What the Commission can do, in part, is to act to  
14 make sure that prices don't go higher still because of  
15 manipulation. Now we have authority, under the Energy  
16 Policy Act of 2005, to issue rules to prevent market  
17 manipulation and today we're acting to exercise that new  
18 authority. And we've been very careful in our approach. We  
19 took the model -- Congress told us to adopt the statutory  
20 model in Section 10(b) of the Securities and Exchange Act of  
21 1934 and that's just what we proposed to do. We studied  
22 that model and studied how the SEC has implemented it over  
23 the years and we adapted it where necessary to meet our  
24 legal construct.

25                  We also studied the anti-manipulation provisions

1 in the Commodities law, which, in turn, are also modeled on  
2 the Securities and Exchange Act of 1934 and our anti-  
3 manipulation proposed rule is modeled closely on the SEC  
4 rules that implemented Section 10(b) of the 1934 Act.

5 Now we think this approach will provide benefits  
6 to regulated utilities since there is a substantial body of  
7 precedent applying the comparable language in the 1934 Act.  
8 Now, under the proposed rules, it shall be unlawful for any  
9 entity, directly or indirectly in connection with the  
10 purchase or sell of electric energy or transmission services  
11 subject to the jurisdiction of the Commission for the  
12 purchase or sell of natural gas or transportation service,  
13 subject to the jurisdiction of the Commission to (1) use or  
14 employ any device, scheme or artifice to defraud; (2) to  
15 make material false statements or omit material facts or (3)  
16 engage in any act, practice or course of business that would  
17 operate as a fraud or deceit upon any person.

18 True to the Energy Policy Act of 2005, these  
19 rules apply to any entity, not just public utilities and  
20 natural gas companies. These anti-manipulation rules will  
21 apply to entities that are not otherwise subject to the  
22 Commission's jurisdiction, such as governmental utilities  
23 and other market participants. Now we've proposed to apply  
24 the manipulation rules consistent with SEC precedent and  
25 that includes the intent requirement, which is an intent to

1 deceive or manipulate or reckless action.

2 Now the proposed rule also clarifies that nothing  
3 in the proposed rules create a private right of action. Now  
4 I want to be clear. This is not the first step the  
5 Commission has taken to prevent market manipulation. That  
6 step was taken nearly two years ago when the Commission  
7 issued the Market Behavior Rules in November 2003 designed  
8 to prevent market manipulation in electricity and gas  
9 markets. Those rules have been subject to a legal  
10 challenge. That was one reason I asked Congress to  
11 establish an expressed prohibition of market manipulation to  
12 guard against this legal challenge.

13 Now we are moving swiftly to -- we intent to move  
14 swiftly to issue a final rule to implement the anti-  
15 manipulation provisions of the Energy Policy Act of 2005.  
16 In the meantime, before these rules become final, I want to  
17 remind regulated entities that the Market Behavior Rules  
18 issued by the Commission remain in effect. However, the  
19 proposed rule does recognize that with the new authority  
20 granted by Congress the Commission should consider whether  
21 to revise or appeal Market Behavior Rule 2 and other Market  
22 Behavior Rules. Now we intend to initiate such an inquiry  
23 in the very near future and to swiftly resolve that issue.

24 Now it's important to recognize that Congress  
25 gave us a specific model to work from -- the one in the

1 Securities and Exchange Act of 1934. That is different from  
2 the Market Behavior Rules. It's different in a number of  
3 respects. First, with respect to scope, under the Market  
4 Behavior Rules they apply -- on the electricity side, the  
5 apply to public utilities. Congress, in the new law,  
6 established a much broader universe that the manipulation  
7 revisions would apply to -- any entity. So it includes  
8 wholesale sellers that are not public utilities.

9 The Market Behavior Rules, in turn, would apply  
10 to only public utilities and only apply to market-based rate  
11 sales by public utilities. The new rules would apply to all  
12 wholesale sales, whether they are market-based rates or  
13 cost-based rates, whether they're made by public utilities  
14 or non-public utilities. The Congress also was more clear  
15 on the intent requirement. They want us, obviously, to use  
16 the Securities model. The intent standard in the Securities  
17 model is different than the intent standard in the Market  
18 Behavior Rules.

19 Now the Commission does have discretion, though.  
20 the Energy Policy Act of 2005 did not overturn the Market  
21 Behavior Rules. It did not repeal the Market Behavior  
22 Rules, but it also clearly didn't ratify the Market Behavior  
23 Rules. Congress knows how to ratify a Commission policy.  
24 They did it in the -- when the ratified our approach in the  
25 Hackberry Doctrine toward LNG projects. They also ratified

1       our approach on jurisdiction of LNG import facilities. So  
2       Congress didn't reverse the Market Behavior Rules. They  
3       didn't ratify them either. So we do retain discretion on  
4       how to proceed.

5               Now we also act today to clarify our enforcement  
6       policy. We have been careful in this area as well. We've  
7       studied how other regulatory bodies with enforcement  
8       authority have implemented their authority and we propose to  
9       apply that experience in our domain. And the policy  
10      statement draws from the experience of other agencies such  
11      as the FCC and CFTC. We're also guided by the Thompson Memo  
12      issued by the Department of Justice in January 2003 that  
13      established principles to guide federal prosecutions of  
14      business organizations.

15             Our purpose here is firm but fair enforcement of  
16      our rules and regulations. And I want to be clear that the  
17      Commission's goal is compliance. We recognize that we have  
18      a duty to be clear on what the rules are. Compliance should  
19      not be allusive. It should not be subjective. It should be  
20      objective to the greatest extent possible. In a perfect  
21      world the Commission would be clear on what the rules are  
22      and there would be universal compliance. In a less perfect  
23      world the Commission's clear on what the rules are, there is  
24      near universal compliance and violations are quickly  
25      identified and sanctioned.

1           I also recognize that in many instances our rules  
2           are not perfectly clear and in such instances we must work  
3           with the regulated community to resolve ambiguities. And to  
4           this end the Commission intends to consider in the near  
5           future new processes such as no action letters for  
6           addressing such ambiguities in our rules. Our goal is to  
7           facilitate compliance and quickly identify and sanction non-  
8           compliance. The enforcement policy statement encourages  
9           compliance by making plain the factors that will be  
10          considered in applying remedies for violations, including  
11          the position of the Commission's enhanced civil penalty  
12          authority. And we encourage regulated entities to develop  
13          and maintain strong compliance programs and to develop  
14          strong compliance cultures.

15                 Among the factors that we consider by the  
16          commission under the enforcement policy statement are the  
17          existence of effective compliance programs, self-reporting  
18          of violations, the level of cooperation and Commission  
19          enforcement actions, the company's compliance history,  
20          whether the violation is related to actions by senior  
21          management of a company. Whether the violation was willful  
22          and the harm caused by the violation.

23                 Now under the enforcement policy statement, if  
24          two different entities commit the same violation and one  
25          entity has an effective compliance program, self-reported

1 the violation, to remedial action, cooperated with the  
2 Commission investigation and the violation was an isolated  
3 instance and the second entity had no compliance program.  
4 It's senior management learned of the violation, but took no  
5 action. The entity has a history of violation and failed to  
6 cooperate with the investigation, civil penalties levied  
7 would likely be dramatically different, and depending on the  
8 violation, perhaps the first entity would pay no penalty at  
9 all above the discouragement of illegal profits. But,  
10 again, depending on the nature of the violation, perhaps the  
11 second entity would pay the maximum penalty that's allowed  
12 under the law.

13 Now our goal is firm but fair enforcement and  
14 we're guided by the experience of other agencies and draw on  
15 their experience. But my hope is that the enforcement  
16 policy statement will encourage regulated entities to  
17 establish and maintain effective compliance programs. Now  
18 related order, M-4 amends the Commission rules to permit any  
19 person subject to a Commission order to challenge audit  
20 findings and proposed remedies.

21 Currently, only persons subject to financial  
22 audits have the right to challenge audit findings. The  
23 proposed rule would extend that right to person subject to  
24 operational audits under the Natural Power Act designed to  
25 determine compliance with standards of conduct, code of

1       conduct, Market Behavior Rules and other Commission  
2       requirements as well as persons subject to audit under the  
3       Natural Policy Act 1978 and the Interstate Commerce Act.  
4       The goal of this order is to show fairness towards persons  
5       subject to Commission and I support the orders and look  
6       forward to voting on them.

7                     Do my colleagues have comments?

8                     COMMISSIONER BROWNELL: I do, although you have  
9       done a wonderful job of summarizing what I think are very  
10      comprehensive sets of rules.

11                    I am pleased to join you in your support because  
12      this creates the certainty that the industry has been crying  
13      out for. It says that we are clearly interested in clarity  
14      in transparency, in consistency. It harmonizes with both  
15      practice and precedence of other agencies. It says that  
16      while we care about enforcement, enforcement is not a game  
17      of gotcha. We are interested in compliance and we are  
18      interested in enforcement that allows the due process that  
19      is alluded to in M-4 that will be anticipated in more  
20      rigorous procedures for our own staff that is anticipated in  
21      the non-action letter and a better dialogue and  
22      communication in terms of clarifying ambiguous areas that  
23      we've heard a lot about.

24                    I also thinks it's important that we have  
25      recognized that there may be overlap, and during this

1 interim period, we'll certainly be cautious of that. But we  
2 do anticipate, if necessary, repealing Market Rule 2 or at  
3 least amending it so that we don't have overlap and  
4 inconsistencies. So I think we've made enormous progress.  
5 I thank everybody for their patience because Sudeen and I  
6 heard a lot in Chicago and have talked consistently about  
7 that and I think we have begun to really address those  
8 issues here. I also think that it restores credibility to  
9 the agency in the industry at a time of very, very high  
10 stress.

11 We're going to see high prices this winter.  
12 We're going to see volatility this winter and we will be  
13 challenged to ensure, both to Congress and to customers,  
14 that we're on top of it. And I think this helps us and it  
15 helps the industry comply and assure that we addressing the  
16 issues appropriately. We can't avoid high prices, but we  
17 can make darn sure that we understand what's --

18 COMMISSIONER KELLY: Thank you.

19 I wanted to make two points -- highlight two  
20 points regarding the market manipulation. And Joe mentioned  
21 it and I want to highlight that these proposed regulations  
22 implement authority, in fact, it's beyond any authority we  
23 had before. Congress gave us the expanded authority over  
24 market manipulation in the recent bill. In particular, the  
25 proposed regulations will apply to any entity not just

1 jurisdictional market-based rates sellers, natural gas  
2 pipeline or holders of blanket certificate authority.  
3 Specifically, and the entity includes, as our draft  
4 explains, not only regulated entities but also governmental  
5 utilities and other market participants.

6 The second point I wanted to make was that for  
7 the time being these proposed regulations will co-exist with  
8 Market Behavior Rule 2. However, as Norm mentioned, we are  
9 aware that many members of industry have suggested ways to  
10 improve the administration of our existing Market Behavior  
11 Rules and we will be promulgating new rules as Joe  
12 mentioned. And I want to give assurance that we have heard  
13 and taken seriously the comments that we received regarding  
14 our existing rules. And, with this in mind, we have a  
15 number of additional initiatives underway that are designed  
16 to give some regulatory certainty to the industry. We have  
17 established a taskforce to consider suggestions and comments  
18 regarding our Market Behavior Rules and we will undertake a  
19 review of Market Behavior Rules in our future.

20 Also we will not seek duplicative sanctions in  
21 the same conduct in the event that particular conduct  
22 violates Market Behavior Rule 2 and proposed market  
23 manipulation rules. Along those lines I want to thank staff  
24 for putting together this draft and also for the efforts  
25 that you went to, to promulgate, or allow us to promulgate

1 the enforcement policy statement. It's well designed and  
2 provides much needed guidance and certainty to the industry  
3 regarding our rules by providing information about the  
4 factors that we will take into consideration, particularly  
5 when determining remedies for violations of our rules.

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1           And then two points regarding our proposed  
2           contested audit procedures: That NOPR seeks to close a  
3           regulatory gap that has arisen as our audit program has  
4           expanded from previously being concerned with mostly  
5           financial matters, to now including many operational  
6           matters, including compliance with tariff provisions. And  
7           this NOPR, like the first one, seeks to give respondents to  
8           operational audits, the same process protections that  
9           respondents to financial audits have long had.

10           However, I recognize the possibility that  
11           respondents to operational audits, may require different and  
12           perhaps enhanced process rights than respondents to  
13           financial audits. Clearly, being the subject of an audit  
14           into whether you properly accounted for costs, carries a  
15           much greater stigma than being the subject of an audit into  
16           whether you properly adhered to the requirements of your  
17           tariff.

18           And so I would ask industry to pay particular  
19           attention to the process that we have proposed, and to give  
20           us your feedback on whether it responds to your needs. And  
21           then, as Joe mentioned, and I'd like to emphasize it, we  
22           will consider implementing a no-action letter process.

23           The SEC and the CFTC follow that process. I  
24           think that process is good government, and would provide  
25           guidance, needed guidance on whether particular transactions

1 or practices will be subject to Commission enforcement.

2 As Nora said, what we're interested in is  
3 compliance. We hope we don't have to institute enforcement.  
4 Thank you.

5 CHAIRMAN KELLIHER: Are we ready to vote?

6 COMMISSIONER KELLY: Aye.

7 COMMISSIONER BROWNELL: Aye.

8 CHAIRMAN KELLIHER: Aye.

9 SECRETARY SALAS: And, finally, for discussion,  
10 we have a joint presentation of E-1, the Cleco Companies,  
11 and E-2, Kansas City Power and Light Company, and it's a  
12 presentation by Jamie Chabinsky, Eugene Lee, Carrie Tucker,  
13 Michele Barnaby, Julie Lake, and Steve Rodgers.

14 MS. CHABINSKY: Good afternoon, Mr. Chairman,  
15 good afternoon, Commissioners. The Draft Order before you  
16 in Item E-1, addresses the market-based rate authority of  
17 Cleco Power, Cleco Evangeline, Perry Energy Partners, and  
18 Acadia Power Partners, collectively referred to as the Cleco  
19 Companies.

20 The Commission previously issued an Order on the  
21 Cleco Companies' updated market power analysis, which  
22 instituted a proceeding pursuant to Section 206 of the  
23 Federal Power Act, to investigate generation market power  
24 issues in the Cleco Power home control area.

25 The second Order before you in Item E-2,

1 addresses the market-based rate authority of Kansas City  
2 Power and Light Company and Great Plains Power, collectively  
3 referred to as KCPL. Like the Commission's Order on the  
4 Cleco Companies updated power analysis, the Commission also  
5 previously issued an Order on KPCL's updated market power  
6 analysis and instituted a Section 206 proceeding.

7 The Section 206 proceeding was instituted to  
8 investigate generation market power issues in the KCPL and  
9 the Board of Public Utilities of Kansas City control areas.

10 The Draft Orders address delivered price tests  
11 analyses submitted by KPCL and the Cleco Companies. The  
12 results of the Cleco Companies' analyses for the Cleco Power  
13 home control area and the results of the KCPL's analysis for  
14 the KPCL control area, vary, depending on whether the  
15 economic capacity or available economic capacity measure is  
16 used to perform the analysis.

17 However, the Draft Orders recognize that even if  
18 a company fails either of these two measures, the company  
19 does not necessarily fail the delivered price test, as a  
20 whole; rather, the Commission weighs the results of both  
21 measures and considers the arguments of the parties.

22 Both Draft Orders before you, find the companies  
23 in E-1 and E-2, have rebutted the presumption of market  
24 power. Specifically, E-1 finds that the Cleco Companies  
25 have rebutted the presumption of market power in Cleco

1 Power's home control area, and satisfy the Commission's  
2 generation market power standard in that control area.

3 E-2 finds that KPCL has rebutted the presumption  
4 of market power in the control areas under investigation, as  
5 well. Accordingly, both Draft Orders terminate the Section  
6 206 proceedings previously instituted by the Commission,  
7 however, E-1 has a distinction that is worth noting.

8 While the Draft Order terminates the Section 206  
9 proceeding with respect to the Cleco Power home control  
10 area, it institutes a new Section 206 proceeding with  
11 respect to two of the Cleco Companies' first-tier control  
12 areas.

13 The new Section 206 proceeding is instituted  
14 because the Cleco Companies failed to comply with the  
15 Commission's previous directive to file data and workpapers  
16 supporting a simultaneous transmission import capability  
17 study for two of their first-tier control areas, the City of  
18 Lafayette Power Authority and the Louisiana Energy and Power  
19 Authority control areas.

20 Therefore, the new Section 206 proceeding is  
21 instituted to investigate whether the Cleco Companies may  
22 continue to charge market-based rates in these two control  
23 areas. In particular, the Cleco Companies are once again  
24 directed to file the required workpapers and supporting  
25 documents, so that the Commission can make a determination

1 with respect to these two control areas.

2 The team would be happy to answer any questions  
3 you might have about E-1 and E-2. Thank you.

4 CHAIRMAN KELLIHER: Thank you. I want to thank  
5 you for that presentation and make a few comments on these  
6 Orders.

7 These also are significant Orders, because they  
8 mark the first time the Commission has accepted a showing by  
9 companies that failed one of the interim screens that it  
10 lacks generation market power, and the first time that  
11 companies have rebutted the presumption established by a  
12 screen failure, based on a delivered price test submission.

13 When the Commission established the interim  
14 generation market power test in April of 2004, it was clear  
15 that we were raising the threshold for measuring generation  
16 market power. Under the discarded hub-and-spoke test, the  
17 bar was set too low. Virtually every applicant passed under  
18 the test, even those with very large market shares.

19 And although it was clear in the April 2004 Order  
20 that the threshold was higher than under the hub-and-spoke  
21 test, I was concerned that the rebuttable presumption -- if  
22 the rebuttal presumption proved -- if the rebuttable  
23 presumption proved irrebuttable, we would have set the bar  
24 too high. Today we proved that the presumption actually can  
25 be rebutted.

1           These Orders also properly reflect the importance  
2 of serving native load. The Commission recognizes that not  
3 all generation capacity is available all the time to compete  
4 in wholesale markets, and that some accounting for native  
5 load requirements is warranted.

6           The Commission's analysis, as Staff has  
7 suggested, relies on both economic capacity and available  
8 economic capacity, and concludes that, after weighing all  
9 the relevant factors, the applicants have rebutted the  
10 presumption of market power.

11           The 206 investigation of Cleco's generation  
12 market power in the first-tier markets, continues, because  
13 Cleco has failed to provide the information sufficient for  
14 the Commission to do otherwise, despite Commission Orders  
15 directing it to provide this information, so I don't see  
16 that we had a choice in the matter.

17           I do support the Orders and look forward to  
18 voting on them. Do my colleagues have comments?

19           COMMISSIONER BROWNELL: I would simply say that  
20 we didn't have a choice, but the Company did, and they could  
21 have submitted the information, as directed, as could a  
22 number of other companies.

23           It strikes me as wasteful and inefficient for  
24 companies to continue to file just a part of what they need,  
25 knowing quite clearly that they have other responsibilities.

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I think boards of directors probably ought to start taking a look at the waste that occurs when companies fail to do the complete task. So, I'm pleased to support the Order, and hope that this will be a demonstration to others, that this just isn't a very good way to do business.

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COMMISSIONER KELLY: Thank you, Joe and Nora. I want to thank Staff for the work that they did on these cases. The Draft Orders contain extensive analyses of the competing measures of market power that were considered, and of the balance struck among those measures that results in a passing grade for these applicants.

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These Orders are very well reasoned. I support their findings. There are two findings: One is the termination of the relevant 206 proceeding, and the second is the granting of continued market-based rate authorization.

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My second comment regards the same topic that Nora raised, and that's the process that led here. I do support the process that the Commission undertook here.

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Even though these companies were ultimately shown to lack market power, there was nothing inappropriate about the fact that the initial screens, which are much simpler, by design, returned failures. As our prior Orders have essentially stated, the screen process should be viewed as a

1 means of simplifying the market-based rate review process  
2 for those entities who clearly lack market power.

3 On the other hand, when it is less clear that the  
4 applicants lack market power, as when they fail the screens,  
5 it is entirely appropriate for the Commission to require, as  
6 we did here, a more detailed analysis. The cost in time  
7 and expense of these reviews, has been well worth the  
8 benefit of permitting us to carry out our statutory  
9 responsibility to protect the public interest and to ensure  
10 that these applicants do not exert market power.

11 I am pleased that these two applicants have been  
12 able to prove that they continue to qualify for market-based  
13 rates, and I am very supportive of the process that led us  
14 to this result.

15 CHAIRMAN KELLIHER: Shall we vote?

16 COMMISSIONER BROWNELL: Aye.

17 COMMISSIONER KELLY: Aye.

18 CHAIRMAN KELLIHER: Aye.

19 Any other further items, Madam Secretary?

20 SECRETARY SALAS: No, sir; that's it.

21 CHAIRMAN KELLIHER: This meeting is adjourned.

22 (Whereupon, at 1:05 p.m., the meeting was  
23 adjourned.)

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