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BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION

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IN THE MATTER OF: :  
CONSENT MARKETS, TARIFFS AND RATES - ELECTRIC :  
CONSENT MARKETS, TARIFFS AND RATES - GAS :  
CONSENT ENERGY PROJECTS - HYDRO :  
CONSENT ENERGY PROJECTS - CERTIFICATES :  
DISCUSSION ITEMS :  
STRUCK ITEMS :  
- - - - -x

899TH COMMISSION MEETING

OPEN MEETING

Hearing Room 2C  
Federal Energy Regulatory  
Commission  
888 First Street, N.E.  
Washington, D.C.

Thursday, December 15, 2005

10:10 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 DAVID L. HOFFMAN, Reporter

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

2 (10:10 a.m.)

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

8 Please join us in the Pledge of Allegiance.

9 (Pledge of Allegiance recited.)

10 CHAIRMAN KELLIHER: I want to start with some  
11 very brief comments about the year 2005, since it is the  
12 last meeting of the year. And I'm improvising to some  
13 extent, so the Commission Staff may look alarmed, and if  
14 they are, you'll know why.

15 I think 2005 was an important year. First of  
16 all, there was a change in leadership, and it was peaceful  
17 and nonviolent.

18 (Laughter.)

19 CHAIRMAN KELLIHER: There were no tanks in the  
20 street on First Street. The Energy Policy Act was enacted,  
21 and that gave the Commission significant new  
22 responsibilities and significant new authority.

23 I think this new law shows a great deal of  
24 confidence in the Commission. I think we're proving  
25 ourselves worthy of that confidence in the way we're going

1 about implementing and executing the Energy Policy Act.

2 That was noted just this week by Chairman  
3 Domenici in a press release; that we've issued every action  
4 required, including the PUCHA final rule last week.

5 The Commission has also continued to handle a  
6 tremendous workload. In calendar year 2005, through this  
7 date, we've issued 1,477 Orders.

8 I think that's very impressive production. I  
9 think that's a tribute to the professionalism and dedication  
10 of the Commission Staff.

11 I think the Commission Staff are model public  
12 servants, and I wish the employees of the DMV would study  
13 our methods here. I'll probably have a long wait the next  
14 time I get my license.

15 (Laughter.)

16 CHAIRMAN KELLIHER: I also want to credit the  
17 leadership of the Program Offices, the big four offices of  
18 the Commission.

19 The four principal offices of the Commission have  
20 three new leaders. I think they have all performed in an  
21 outstanding way this year, as has Mark, of course.

22 (Laughter.)

23 CHAIRMAN KELLIHER: And, Mark, you're secure. I  
24 just want to say that I have great confidence in the new  
25 leadership of the big four offices at the Commission.

1                   We've also been able to turn out this kind of  
2 workload because of the commitment of my colleagues. We  
3 have covered a lot of ground in the last few months, and  
4 it's because we're all committed to doing the public's  
5 business in an efficient way.

6                   So I want to say that I am very happy to be a  
7 part of this Commission.

8                   Over the past year, we've lost some of our own  
9 and we've lost family and friends, but despite these  
10 personal tragedies, we continue to do the people's work, and  
11 I'm honored to be the FERC Chairman. I just wanted to say  
12 that.

13                   COMMISSIONER BROWNELL: And we're glad you are.

14                   CHAIRMAN KELLIHER: Thank you. Let me start off  
15 with some announcements, and we'll review some of the good  
16 work we've done over the past month, before we get to  
17 today's business.

18                   First of all, the Combined Federal Campaign --  
19 I'm proud to announce that the Commission has once again met  
20 its target for the Combined Federal Campaign. All in all,  
21 the Commission raised \$347,197.25, which is 121 percent of  
22 this year's goal of \$285,000.

23                   The Commission's participation rate was 74  
24 percent, which is far higher than the participation goal of  
25 60 percent. That, in turn, is twice as high as the

1 governmentwide participation levels, so we are, if not the  
2 best in the Federal Government, we are competing to be the  
3 best when it comes to the Combined Federal Campaign.

4 I'm also proud to announce that here at the  
5 Commission, we have 101 Eagle Donors and 25 Double-Eagle  
6 Donors, which far exceeds the governmentwide average by two  
7 or three, I believe.

8 Perhaps the greatest accomplishment to report, is  
9 that all offices at the Commission, for the second year in a  
10 row, earned the highest award, the Presidential Plaque, for  
11 100-percent participation and for exceeding their dollar  
12 goals.

13 I'd like to recognize Ed Gingold. Where is Ed?  
14 If you could stand up? Ed has been our general of the  
15 Combined Federal Campaign.

16 (Applause.)

17 CHAIRMAN KELLIHER: I wanted to publicly thank  
18 him for his success this year, and all of his hard work.  
19 The events were actually really great; we really liked  
20 those. Thank you for all of your work, Ed.

21 Now, I want to also thank the hard work and  
22 dedication of all of the Commission Staff who helped to  
23 organize the events and helped to execute this.

24 Secondly, I'd like to take a moment to introduce  
25 our Chief Accountant, Janice Garrison Nicholas. Janice,

1 thank you.

2 (Applause.)

3 CHAIRMAN KELLIHER: In this position in the  
4 Office of Market Oversight and Investigations, Janice will  
5 have responsibility for financial and operational audits and  
6 accounting matters. Ms. Nicholas has held various executive  
7 management and Staff positions during her 26-career with the  
8 Commission.

9 Prior to her appointment as Chief Accountant, she  
10 served as Director of the Division of Financial Audits in  
11 OMOI, since August 2004. In that position, she was  
12 responsible for developing and leading the Commission's  
13 audit program of financial issues for jurisdictional  
14 electric, natural gas pipeline and oil pipeline companies.

15 From 2000 to 2004, she served as a policy advisor  
16 on various positions within the Office of Markets, Tariffs,  
17 and Rates, providing guidance on a number of rates and  
18 tariff matters.

19 Prior to joining OMTR, Janice worked for over 20  
20 years in the Commission's Office of Chief Accountant. I'm  
21 confident that Janice will bring her experience and  
22 dedication to her new position, and I want to congratulate  
23 her.

24 I just want to discuss a Winter Outreach Plan  
25 that the Commission is launching. The Commission is

1 particularly concerned about the potential for even higher  
2 natural gas and electricity prices in the Northeast this  
3 Winter.

4 We're also keeping an eye on the rest of the  
5 nation. Accordingly, we're launching a web page to follow  
6 the Winter energy situation.

7 In addition, we will be contacting key energy  
8 decisionmakers and making Commission Staff available to  
9 brief them and to listen to their concerns.

10 It's our hope that these activities will enhance  
11 the public's understanding that appropriate steps are being  
12 taken to monitor natural gas prices and the impact of tight  
13 natural gas supplies on electric generation, and to detect  
14 and to address attempted market manipulation.

15 I'd also like to review the technical conferences  
16 that the Commission has held on electric reliability over  
17 the past month. We continue to work on timely and effective  
18 implementation of the Energy Policy Act of 2005.

19 One areas where we've been very active since the  
20 November open meeting, is on implementation of the  
21 reliability provisions. Since the November open meeting,  
22 we've held two technical conferences, October 18th and  
23 December 9th.

24 Perhaps the most difficult part of our new EAct  
25 responsibilities, is the implementation of the reliability

1 provisions. EPCRA gave the Commission responsibility for  
2 assuring reliability of the bulk power system by certifying  
3 an electric reliability organization, establishing  
4 reliability standards, and assuring that those standards are  
5 properly enforced.

6 We're committed to faithfully executing these  
7 responsibilities. The first technical conference, held on  
8 November 18th, focused the process that the ERO will use in  
9 proposing mandatory reliability standards, the role of  
10 regional entities in that process, and how reliability  
11 standards can be improved over time.

12 This technical conference is part of our effort  
13 to prepare, to review, and establish reliability standards.

14 In anticipation of the filing of Version 0  
15 Standards, the Commission is conducting a constructive  
16 review of existing reliability standards, both the North  
17 American standards and regional standards.

18 The second technical conference continued the  
19 examination of how reliability standards will be established  
20 and improved, and probed the role of states and Canadian  
21 Provinces in reliability.

22 This technical conference also focused on  
23 compliance and enforcement, which included hearing how  
24 federal agencies and self-regulating organization in the  
25 securities and nuclear industries, assure compliance and

1 conduct and coordinate enforcement actions.

2 Both reliability conferences were very  
3 informative and useful to the Commission, and improved our  
4 ability to make important decisions in the coming months.

5 Let me turn to notational Orders and just review  
6 some of the good work we've done over the past month.

7 Since the November 17th open meeting, the  
8 Commission has issued 70 notational Orders, including some  
9 very significant Orders. Let me just review a few and then  
10 ask my colleagues to comment, as well.

11 First of all, there is the PUCHA final rule. We  
12 continue to be on track with EAct implementation, and, last  
13 week, the Commission issued the final rule on repealing the  
14 Public Utility Holding Company Act of 1935, and implementing  
15 a new law, the Public Utility Holding Company Act of 2005.

16 We met the statutory deadline. This final rule  
17 is a significant milestone in carrying out the objectives of  
18 EAct. The PUCHA final rule is the second final rule issued  
19 by the Commission, related to EAct implementation, the  
20 first being the LNG Prefiling Rule.

21 The PUCHA repeal should open the electric and gas  
22 industries to new sources of investment in badly needed  
23 energy infrastructure.

24 The new rule achieves a fine balance between  
25 reducing regulatory burdens on public utilities, while

1 protecting consumers.

2 It was no mean feat, meeting the deadline set by  
3 Congress on PUCHA repeal. Altogether, Congress gave the  
4 Commission four months to repeal a 70-year old law and to  
5 implement a new law in its place, PUCHA 2005.

6 Issuing the PUCHA repeal and final rule involved  
7 making a host of difficult decisions regarding the scope of  
8 the reporting requirements in PUCHA 2005, and the scope of  
9 entities subject to those reporting requirements.

10 The final rule modified the scope of the proposed  
11 rule limiting the filing requirements to those needed to  
12 protect against improper cross subsidies and granting  
13 exemptions and waivers for persons and transactions not  
14 relevant to jurisdictional rates.

15 It's important to recognize that PUCHA 2005  
16 reporting requirements supplement the extensive reporting  
17 authority the Commission has under the Federal Power Act and  
18 the Natural Gas Act.

19 The primary means for regulating jurisdictional  
20 companies remains the Federal Power Act and the Natural Gas  
21 Act. These laws grant the Commission ample authority to  
22 prevent affiliate abuse and preferential self-dealing.

23 The Commission is also working on regulations to  
24 implement merger review provisions of the Energy Policy Act,  
25 which amended Section 203 of the Federal Power Act.

1           Section 203 requires Commission authorization for  
2 mergers and acquisitions, and disposition of jurisdictional  
3 facilities.

4           The fact that we were able to issue the final  
5 PUCHA rule on time, is a credit to the quality of the  
6 Commission's Staff and to their dedication.

7           I particularly want to thank the PUCHA Team, and,  
8 in particular, I'd like to recognize our general of EPAct  
9 implementation, Cindy Marlette, for her leadership.

10           I also want to recognize Brandon Johnson, Larry  
11 Greenfield, Jim Guest, Rosemary Womack, and Jim Ackers, for  
12 their tremendous efforts.

13           This included not only drafting the final rule,  
14 but also preparing the Congressional report and coordinating  
15 with the SEC on the transfer of Books and records from the  
16 SEC to the Commission.

17           Another action the Commission took on a final  
18 notational Order, was approval of the New England Winter  
19 Package.

20           On November 30, the Commission approved the ISO  
21 New England Winter Package, a contingency plan designed to  
22 ensure continued electric system reliability in New England,  
23 to limit the exposure of New England consumers to price  
24 volatility this Winter.

25           The Winter Package promotes conservation by

1 communicating the need to reduce consumption in all hours,  
2 encourages the utilization of dual-fuel generating  
3 capability, expands demand-side management programs in New  
4 England, to help maintain necessary operating reserves, and  
5 develops emergency energy procedures and market rules.

6 The tariff provisions approved by the Commission  
7 address the prospect that severe cold weather conditions  
8 this Winter in New England may exacerbate fuel supply and  
9 pricing issues for New England's generating resources.

10 Another important notational Order was approval  
11 of the Enron Salt River settlement. The Commission approved  
12 a settlement between Enron and the Salt River parties.

13 This is only the latest in a series of  
14 settlements that the Commission has approved or facilitated,  
15 and adds to the approximately \$6 billion settlements the  
16 Commission has approved or facilitated to date.

17 We've also taken some action to strengthen energy  
18 infrastructure. The Commission issued an Order regarding  
19 Liberty Gas Storage, an Order which authorized the  
20 construction and operation of a large natural gas storage  
21 project in Louisiana.

22 The Liberty Gas Storage Project is a large  
23 project and high-deliverability facility, holding 17.6 Bcf  
24 in working gas and capable of delivering gas at the rate of  
25 one Bcf per day.

1                   In another notational, Southern Natural Gas  
2                   Company, the Commission granted a waiver of tariff  
3                   provisions to allow shippers to temporarily shift their  
4                   primary resource receipt points from points that are out of  
5                   service due to disruptions caused by Hurricanes Katrina and  
6                   Rita, to points where capacity is available.

7                   This is another example of how the Commission is  
8                   acting swiftly to authorize more efficient use of our  
9                   existing energy infrastructure in response to the  
10                  hurricanes.

11                  With that, I'd like to ask my colleagues if they  
12                  want to comment on some of our work over the past months.

13                  COMMISSIONER BROWNELL: Just very quickly, I  
14                  prefer to think of Cindy as the empress, or perhaps I'll  
15                  share my title, the tzarina of implementation, because we're  
16                  doing so it so peacefully.

17                  I think that is perhaps a gender difference, but  
18                  in any event, I really do want to thank her. It's an  
19                  incredibly difficult challenge.

20                  Cindy is particularly well suited, because she's  
21                  been working on these issues, and, I think, has the  
22                  confidence, not only of the Commission, but Congress. So I  
23                  know there's a whole team, but teams work only when leaders  
24                  are as good as Cindy is, so thank you.

25                  On PUCHA, I just want to comment, because we got

1 a lot of input that people were alarmed by the draft, that  
2 we had been too expansive, that we were reaching, and I  
3 think that the days when the draft replicates exactly what  
4 we'll do in the final rule, without listening the input, are  
5 long gone.

6 I think it's particularly appropriate,  
7 particularly in this arena, to be as expansive as possible,  
8 to raise as many issues as possible, so that we get what we  
9 did get, which was a very substantive and expansive set of  
10 comments by people who took a lot of time and were  
11 thoughtful, and for that I am grateful.

12 But I think we need not to have narrow early  
13 drafts, because we won't do as good a job as we possibly  
14 can, so I would remind people of that as we're doing more  
15 and more NOPRs on the New England Winter Package.

16 Once again, I want to do the broken record thing  
17 and say that I think these are short-term fixes, but do not  
18 address the longer-term issue, which is that they need more  
19 infrastructure and they need more access to supply.

20 I really hope that with all the work we're doing  
21 on infrastructure, as we demonstrated in the other Orders,  
22 the policy leaders in New England will continue to focus on  
23 what the real needs for their economic development and  
24 social wellbeing are.

25 So I think that we are doing a good job for New

1 England, trying to communicate.

2 We'll hear more today about what the gas  
3 situation is, but we learned in California and we've learned  
4 in other parts of the world, nothing beats adequate supply-  
5 and-demand balance.

6 Let's stay focused on that. Thank you.

7 COMMISSIONER KELLY: Nora mentioned that some  
8 commenters thought our PUCHA rule was too expansive, and  
9 some commenters -- that's correct, some commenters thought  
10 that it wasn't expansive enough.

11 In particular, a number of commenters are  
12 concerned about a predicted avalanche of consolidation in  
13 the industry, and those commenters were primarily the public  
14 utilities, the publics and the coops and some of the states.

15 And they asked us to enact, as a matter of rule,  
16 certain structural limitations to upcoming mergers.

17 We declined to do that, which I think was  
18 appropriate at that time, but I want to point out what we  
19 did do, was to say that we will hold a technical conference,  
20 and we pledged to hold a technical conference within the  
21 year, to look specifically at the merger and acquisition  
22 activity that has taken place recently, and that likely will  
23 take place within the coming year, to determine more  
24 specifically and with facts, rather than hypotheticals,  
25 exactly how the industry is changing and whether the

1 Commission needs to do anything more in its regulations to  
2 alleviate concerns, in particular, about the potential for  
3 cross-subsidization or encumbrances of utility assets.

4 I'm very pleased that we pledged to do that. I  
5 think that's a responsible way to take a look at that issue.

6 I'd also like to point out that we did not adopt  
7 the SEC's Uniform System of Accounts and record retention  
8 rules into our regulations at this time, but we will  
9 initiate a separate rulemaking to address how the  
10 Commission's Uniform System of Accounts and records  
11 retention rules should be modified, as necessary.

12 On the New England Winter Package, I just want to  
13 thank ISO New England and its stakeholders for being so  
14 proactive and for looking down the road at the potential  
15 that Hurricane Katrina and Rita visited upon us, the  
16 potential for reduced gas supplies and putting together a  
17 very thoughtful, reasonable, and, I think, very protective  
18 plan in case we do run into a shortfall in supply in New  
19 England.

20 The Liberty Gas notational, I think that's  
21 another success story. It is a reflection, I think, that  
22 the Commission in 1996, appropriately adopted an alternative  
23 rate policy and since 1996, the Commission has received  
24 about 40 requests for market-based rates under this policy.

25 We have only denied three of those. Of the three

1 that we denied, only one proposed storage facility was not  
2 built, so I think that Liberty Gas stands for the  
3 proposition that our policy is working well.

4 We are, later on in this meeting, going to talk  
5 about some proposed changes to the policy, which, hopefully,  
6 will make it work even better, but I think we have a good  
7 story to tell in getting gas storage built.

8 COMMISSIONER BROWNELL: Could I just add one more  
9 thing? Suedeem, you bring up a good point about the  
10 concerns of the publics and the coops.

11 Our focus ought to be not so much on mergers, but  
12 on creating new opportunities that both associations have  
13 talked a lot about here, which is to allow them to  
14 participate with IOUs and with other partners, private  
15 equity partners, in developing infrastructure, which I think  
16 is a wonderful opportunity.

17 I was thrilled that the munis and the coops  
18 expressed a desire to Entergy, for example, to help them  
19 rebuild the system. That could be a wonderful partnership.

20 I hope we'll see more of those and we'll look at  
21 our rules, whether they be in the merger policy, more likely  
22 in transmission incentives, and other kinds of treatment  
23 that we have of new business models, to make sure that we're  
24 eliminating barriers to entry.

25 COMMISSIONER KELLY: Thank you.

1                   CHAIRMAN KELLIHER: Before we turn to the consent  
2 agenda, I'd like to ask Mark Robinson to give us an update  
3 on the dam breach at the Tom Sauk Project.

4                   MR. ROBINSON: Thank you, Mr. Chairman.  
5 Yesterday, we had a major incident at the Tom Sauk Project.  
6 It's a pump storage project, a little upstream from  
7 Lesterville, Missouri.

8                   The upper reservoir had a major breach,  
9 approximately 400 feet along the crest and about 80 to 90  
10 feet deep, which discharged about 4,000 acre feet of water  
11 down the mountainside, across a county road, through a park,  
12 and into the Black River.

13                   The breach flow then proceeded down the river  
14 through the lower reservoir, over the spillway at that  
15 reservoir, and down the Black River, where it resulted in  
16 about a two-foot surge at Lesterville.

17                   That stayed within the banks. There was no  
18 damage in Lesterville. Our emergency action plan was  
19 implemented. Everybody was notified, warned, moved out of  
20 the way of the breached flow, and that occurred effectively.

21                   We had people onsite yesterday. It happened in  
22 the morning at about 5:00. We had people onsite about 3:00,  
23 I believe, that afternoon, including our regional engineer  
24 from Chicago, who is in charge of the onsite investigation.

25                   Their first action was to ensure that the lower

1 reservoir of the Tom Sauk Project, was, in fact, safe, and  
2 had passed those breach flows. That has happened, and that  
3 dam is considered safe in protecting the public downstream.

4 They've now turned their attention to the  
5 investigation of the breach in the upper reservoir. They  
6 will be looking at that, both from an operational and a civil  
7 perspective.

8 We are collecting information on that breach.  
9 When we have all the facts, the data, and we have applied  
10 the appropriate engineering technology, engineering  
11 intelligence to that data, both from an internal  
12 perspective, our internal engineers, as well as independent  
13 consultants, we will provide the public with the results of  
14 that investigation on what we believe caused that breach and  
15 the loss of that upper reservoir.

16 We can't, however, in looking at this from a  
17 technical standpoint, forget the human aspect of this, as  
18 well. There were three children that were hospitalized as a  
19 result of this.

20 They were airlifted to St. Louis. We understand  
21 this morning that two of them seem to be doing better. One  
22 of them is, however, still in very serious condition.  
23 Certainly our prayers are with them. That's the status as  
24 of this morning.

25 CHAIRMAN KELLIHER: Do you have any questions on

1 this?

2 (No response.)

3 CHAIRMAN KELLIHER: Thank you, great. Before we  
4 turn to the consent agenda, I'd like to point out that since  
5 the Sunshine Act Notice was issued, I think we've had a  
6 grand total of one strike in the Orders that were sunshine'd  
7 last week.

8 I think that shows the value of a Thursday  
9 meeting, versus Wednesday. One day can make all the  
10 difference sometimes in working things out on Orders.

11 With that, Madam Secretary, let's turn to the  
12 consent agenda.

13 SECRETARY SALAS: Good morning, Mr. Chairman and  
14 Commissioners. As you have just indicated that's exactly  
15 right, that since the issuance of the Sunshine Notice on  
16 December 8, we have one struck item. That is H-5.

17 Your consent agenda for this morning is as  
18 follows: Electric Items - E-7, 8, 9, 10, 11, 14, 16, 17,  
19 18, 19, 21, 22, and 26.

20 Miscellaneous Items: M-1.

21 Gas Items: G-1 and G-2.

22 Hydro: H-1, 2, 3, and 4.

23 Certificate Items: C-2.

24 The specific votes for some of these items are as  
25 follows: E-16, Commissioner Kelly dissenting, in part, with

1 a separate statement; E-22, Commissioner Kelly dissenting,  
2 with a separate statement; M-1, Commissioner Kelly  
3 dissenting, with a separate statement; and H-4, Chairman  
4 Kelliher dissenting, in part, with a separate statement.

5 Commission Kelly votes first this morning.

6 COMMISSIONER KELLY: With the exception of my  
7 dissents, in part, on E-16, E-22, and M-1, I vote aye. I'd  
8 like to note for the record, that although three dissents  
9 may imply a bah-humbug attitude, I do not have a bah-humbug  
10 attitude.

11 (Laughter.)

12 COMMISSIONER BROWNELL: And I, with no dissents,  
13 partial or otherwise, vote aye.

14 CHAIRMAN KELLIHER: Nora is the big winner at the  
15 meeting today.

16 (Laughter.)

17 CHAIRMAN KELLIHER: Aye, noting my partial  
18 dissent on H-4.

19 SECRETARY SALAS: The first item for discussion  
20 this morning is A-3. This is a market update. It's a  
21 presentation by our Office of Market Oversight and  
22 Investigations by Steve Harvey and Jeff Wright.

23 MR. HARVEY: I should point out that Jeff Wright  
24 of the Office of Energy Projects, is with me.

25 Good morning, Mr. Chairman and Commissioners.

1 Today I'd like to update you quickly on conditions in U.S.  
2 natural gas markets, as we finish the Fall of 2005 and enter  
3 the Winter itself, and then Jeff and I would welcome your  
4 questions.

5 At the time of the last Commission meeting, we  
6 were enjoying what the National Oceanic and Atmospheric  
7 Administration has found to be the ninth warmest November  
8 since 1895, with temperatures averaging three degrees above  
9 normal.

10 (Slide.)

11 MR. HARVEY: Over the past few weeks, however, we  
12 have seen a shift to colder than normal temperatures across  
13 much of the U.S. Consistent with this weather pattern,  
14 recent U.S. natural gas prices have increased to post-  
15 hurricane highs.

16 (Slide.)

17 MR. HARVEY: You can see that in this graph of  
18 next-day spot prices at Henry Hub, Louisiana. Overall,  
19 prices appear to be reacting much as we indicated they would  
20 in prior briefings, with cold weather resulting in  
21 immediate, sharp increases in spot prices.

22 (Slide.)

23 MR. HARVEY: Before discussing the drivers of  
24 these high prices, I'd like to consider regional variations  
25 in natural gas prices across the U.S. We tend to use the

1 Henry Hub price as a national standard, particularly for the  
2 production area, but gas prices vary geographically.

3 The colored dots on this map represent how much  
4 higher or lower average prices at those locations have been,  
5 compared to the Henry Hub price, on average, for the two  
6 months after Hurricane Rita.

7 Rita was particularly disruptive of gas delivery  
8 facilities in the Gulf area. This map shows the  
9 implications of those disruptions on prices.

10 Red dots represent prices that are the highest,  
11 compared to Henry Hub. Since the hurricanes dominate the  
12 East Coast of the U.S., including Florida and even areas of  
13 Alabama and Louisiana, most of the prices in producing areas  
14 of Louisiana are orange; the second highest pricing level on  
15 the map.

16 In contrast, the lowest prices relative to Henry,  
17 are shown by the blue dots. These cluster in the producing  
18 areas of the Rockies, the Southwest, the Mid-Continent and  
19 Western Canada.

20 Intermediate prices are colored green and yellow  
21 on the map, and they cover consuming areas in California and  
22 the upper Midwest, as well as the producing areas along the  
23 coast of Texas. The price distinctions between East and  
24 West are significantly more pronounced than before the  
25 hurricanes, particularly in the striking differences between

1 prices on either side of the Texas-Louisiana border.

2 The market appears to be signalling, as markets  
3 will do, a difference in supply-and-demand balances, as they  
4 have been affected by the facilities disruptions due to the  
5 hurricanes.

6 In effect, what prices are showing us, is more  
7 tightness in that balance in Eastern U.S. markets, and  
8 significantly less tightness in the West, with the  
9 demarcation defined in the Gulf region, by where the Sabine  
10 River separates Texas and Louisiana.

11 Staff is spending considerable time and energy to  
12 understand how gas is flowing in the Gulf producing region,  
13 in order to verify that prices there are the result of  
14 legitimate post-hurricane facilities outages.

15 To date, the prices appear largely to be related  
16 to these outages.

17 (Slide.)

18 MR. HARVEY: Switching now to some of the key  
19 metrics we use to assess the gas supply/demand balance, we  
20 see on this graph that U.S. storage inventories, the end of  
21 the red line, have begun to drop, due to the withdrawals  
22 reported over the last few weeks by the Energy Information  
23 Administration.

24 The tan band is the range between highs and lows  
25 for the last five years, and the blue lines shows

1 inventories for the last year.

2           Until today, we've been close to five-year highs  
3 in last year's inventories. While there is some variation,  
4 this is generally true for all regions reported by the EIA.

5           The colder weather of last week, has resulted in  
6 significant additional withdrawals, just reported as 202  
7 Bcf. Expectations for the report today were around 185 Bcf.

8           With colder than normal weather expected for the  
9 Northeast and Midwest over the next two weeks, we should  
10 expect large withdrawals to be reported for the near future.

11           (Slide.)

12           MR. HARVEY: Recovery in Gulf production  
13 continues to be steady and strong, with remaining shut-in  
14 gas reaching 2.3 Bcf this week, as you can see on the red  
15 line on this graph. This pace of recovery is well ahead of  
16 the three Bcf a day we initially anticipated would still be  
17 shut in at this point.

18           Continued improvement in reducing Gulf shut-in  
19 gas, is the single best thing that could happen at this  
20 point to moderate prices, short of milder weather.

21           (Slide.)

22           MR. HARVEY: Also, on a positive note, with  
23 recently increased weather-related demand and higher prices,  
24 we have seen a supply addition of a different type,  
25 increased imports from Canada. This graph plots recent

1 imports from Canada into the Midwestern and Eastern United  
2 States.

3 Over the past few weeks, we've seen these  
4 Canadian imports surge by two Bcf per day. Western Canadian  
5 imports are down, but, as I explained earlier, the demand in  
6 the West is already in far closer balance with supply and  
7 additional Canadian imports are not needed there.

8 Overall, for December, to date, Canadian imports  
9 into the Eastern and Midwestern U.S., are up by  
10 approximately one billion cubic feet a day, a substantial  
11 help at this time.

12 In addition, U.S. exports to Mexico, to date, in  
13 December, are down by approximately 300 million cubic feet a  
14 day, also helping the overall balance.

15 (Slide.)

16 MR. HARVEY: By contrast, LNG imports remain  
17 below earlier expectations, as well as last year's  
18 experience. This graph shows recent LNG sendout in the  
19 U.S. on a daily basis.

20 As you can see, sendout is averaging only about a  
21 Bcf and a half per day, far less than the two to two and a  
22 half Bcf per day indicated in the forecasts by CERA and the  
23 waterborne LNG report that we showed you during the Winter  
24 assessment.

25 So far in December, LNG is delivering about 160

1 million cubic feet a day less than last year. There are  
2 many reasons for this level of LNG delivery, but a major  
3 driver over the past few weeks has been weather-related  
4 demand in Europe.

5 Recently, however, prices for gas in England, due  
6 to cold weather, have fallen back below U.S. prices.

7 (Slide.)

8 MR. HARVEY: Consistent with prices and market  
9 conditions over the past few years, natural gas drilling  
10 rigs operating in the United States remain at recent highs.

11 This graph shows the number of gas rigs operating  
12 in the U.S. since 1998. Note that the hurricanes disrupted  
13 drilling to some degree, but overall rig usage remains quite  
14 high and has grown in the most recent weeks.

15 This rig graph helps underscore an important  
16 point. In markets, there are both supply and demand  
17 responses over time to high prices.

18 Today in the U.S., supply responses require  
19 investment in drilling and, increasingly, an import capacity  
20 like LNG terminals. The importance of supply responses to  
21 the prices we face, cannot be overstated at this point.

22 Staff will continue to monitor available  
23 information related to these kinds of investments.

24 (Slide.)

25 MR. HARVEY: I'd like to close with this slide, a

1 graph of forward prices at the close of the NYMEX futures  
2 market last Monday. What you see is prices for delivery at  
3 Henry Hub by month, running into the future, until December,  
4 2009.

5 This pattern of prices falling on a seasonally-  
6 adjusted basis over time, is known as backwardation. While  
7 no one should ever use futures prices as a forecast, they do  
8 indicate certain market expectations.

9 In this case, expectations appear to be that the  
10 current tightness in supply and demand will fall over time.  
11 That conclusion is consistent with the belief that there  
12 will be continued progress in reducing shut-in gas from the  
13 Gulf, as well as, for example, that additional LNG capacity  
14 will be built in the more distant future.

15 That concludes my presentation. Jeff and I will  
16 be happy to take questions.

17 CHAIRMAN KELLIHER: I have a few questions. Your  
18 graph points out that offshore Gulf production has been very  
19 strong and actually better than projected back in October.  
20 What about onshore production in Louisiana? Has that been  
21 recovering? Is that recovering apace with projection, or a  
22 little bit behind?

23 MR. WRIGHT: I don't think the onshore production  
24 had as much difficulty due to the hurricanes, as the  
25 offshore. It was the offshore that was really taken out by

1 the two hurricanes.

2 MR. HARVEY: I don't know any specific statistics  
3 with regard to that number. It's a little hard to keep up  
4 with it.

5 The MMS does a great job keeping up with the  
6 offshore.

7 CHAIRMAN KELLIHER: Information on Canadian  
8 imports is a little surprising. Why have imports increased?  
9 Has production increased in Canada? Has their demand  
10 decreased?

11 MR. HARVEY: Actually, that kind of movement over  
12 periods of sort of intense demand in the U.S., isn't really  
13 uncommon.

14 There's a certain amount of flexibility around  
15 that. What's nice about that picture, is that it really  
16 shows the nice Canadian supply response to obvious demand  
17 within the U.S.

18 It's actually not really that far outside of our  
19 expectations or experience.

20 MR. WRIGHT: I'd just add, too, that they are at  
21 a very high level of drilling in drilling the existing  
22 reservoirs, getting as much gas out as they can.

23 The only caution I would say, going forward in  
24 the future years, is that you may not see that level of  
25 imports. Well, they will probably decline over the next few

1 years.

2 CHAIRMAN KELLIHER: The LNG information is pretty  
3 disappointing. Our capacity is four Bcf a day, and we are  
4 importing one and a half? So we're a little bit more than a  
5 third of capacity.

6 A month ago, we were operating at half capacity.  
7 Now we're under 40 percent.

8 We've talked about how Spain sets their price at  
9 Henry Hub, plus a dollar. Do the other European import  
10 facilities have the same approach? Do they somehow key it  
11 off Henry Hub, plus something, or is that something unique  
12 to Spain?

13 MR. WRIGHT: We're seeing more in the Atlantic  
14 Basin, which is the U.S., Europe, and Africa, with Henry Hub  
15 becoming more and more the benchmark for setting contract  
16 prices.

17 You see a lot of contracts now negotiated as  
18 Henry Hub, plus. The U.S. people holding the LNG capacity,  
19 have not, as I mentioned last month, entered into  
20 significant long-term contracts.

21 However, that's expected to change next year, so  
22 we should see the utilization rate of the existing LNG  
23 capacity in the U.S. go up.

24 In addition, just at the end of last month, a new  
25 production train came on in Nigeria, which is expected to

1 supply the Atlantic Basin, and early next year, a fourth  
2 train, Trinidad, is expected to come online, which will also  
3 add to the supply equation in the Atlantic Basin.

4 MR. HARVEY: When I went through the discussion,  
5 I mentioned the market in England for natural gas. Spain  
6 does operate differently.

7 England would operate more like we do, with a  
8 market, where the competition head-on-head in those markets,  
9 determines where the cargo is going. I believe at least one  
10 cargo actually was delivered into England during their  
11 recent cold weather that really forced their prices up  
12 fairly high.

13 Spain, where most of, I think, spot cargoes have  
14 gone over the last couple of months, if we've lost them in  
15 the process, does have a different system that way. It  
16 isn't as much of a market system that way, so they can  
17 determine, in effect, the prices, competitively, with Henry  
18 Hub, but Henry Hub is very much the benchmark, I think, for  
19 spot prices on LNG.

20 I will say that I saw this morning, some  
21 statistics that look like utilization rates, on average, for  
22 2005, will be very close to the same as utilization rates  
23 were, on average, across the year for 2004 at this point.

24 CHAIRMAN KELLIHER: So the good news is that  
25 Canadian imports are up and the rate of recovery of offshore

1 production is better than projected, and that weather for a  
2 two and a half month period was warmer than average.

3 But it's recently turned colder and LNG imports  
4 are down. Thank you.

5 Any questions or comments?

6 COMMISSIONER KELLY: I know you don't like to  
7 make price predictions, but I'm going to ask you anyway.  
8 Based on your experience in the past, when you see a  
9 withdrawal higher than expected, what kind of volatility do  
10 you see in the short-term gas market?

11 The question is related to the fact that we had  
12 withdrawals this past week, in what, 17 Bcf greater than  
13 expected amounts? Do you anticipate volatility in the gas  
14 market in the future, because of that?

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1                   MR. HARVEY: Unfortunately, the timing of this  
2 presentation and the timing of the storage report is right  
3 on top of each other. So we kind of scrambled when I asked  
4 Staff--when they slipped me that letter, whether they had  
5 seen anything. They ran it down here too quickly to know,  
6 so I can't answer that question. I don't know off the top  
7 of my head.

8                   But normally a deviation on the high side will  
9 pull up at least the futures market for some period of time.  
10 It gets reflected very quickly in the futures market. Then,  
11 as people absorb that during the day, it may continue to go  
12 up. It may go down based on that.

13                   So, there probably was an effect within the first  
14 maybe three to five minutes after that report, at 10:30 this  
15 morning.

16                   Then we will see during the course of the day as  
17 people sort of readjust their view of the way things are  
18 working--202 Bcf is pretty high.

19                   That's a one-in-ten kind of storage withdrawal  
20 over the course of the entire winter. So it's on the higher  
21 end of the range. And being higher than where the  
22 expectations seem to have come out would suggest probably  
23 upward pressure.

24                   There has actually been a little bit of downward  
25 pressure the last couple of days in markets. We had intense

1 cold that kind of came off a little bit. I hesitate to say  
2 prices softened from the \$15.40 per MmBtu to about the  
3 \$14.00 level, because that doesn't seem--we're still talking  
4 \$14.00 at the end of that. But it may well push that back  
5 up again.

6 But we are sort of hovering in that range, very  
7 close to where things got right after the hurricanes. My  
8 guess is that that's probably where we will be for a little  
9 while.

10 COMMISSIONER KELLY: It's interesting that Henry  
11 Hub is setting LNG prices. I guess it's not surprising.  
12 But I have been told that liquidity at Henry Hub has  
13 decreased.

14 Are you aware of the nature of the liquidity at  
15 Henry Hub?

16 MR. HARVEY: Henry Hub--to some degree their  
17 operations, the actual physical operations at Henry Hub were  
18 hit by both hurricanes. It was briefly out of service after  
19 Katrina. I think a day. It sort of disappeared.

20 And then, after Rita, it had some pretty  
21 significant operating changes. I believe their control room  
22 was under water at one point. Those kinds of things.

23 But then there were also some continued issues  
24 with regard to pipeline access in and out of Henry Hub. So  
25 I think we did see something of a reduction in liquidity in

1 terms of activity there. But there were some physical  
2 reasons why that made a certain amount of sense.

3 Over time we watched that closely and have seen  
4 those facilities coming back on line over time, and that  
5 situation improving. But it is disruptive to have sort of  
6 the benchmark location hit as badly as I think it was hit by  
7 those hurricanes.

8 COMMISSIONER KELLY: How about the liquidity of  
9 Henry Hub apart from the short term impacts of Katrina and  
10 Rita?

11 MR. HARVEY: I haven't noticed anything that  
12 looks like a sort of long term shift away from that. But I  
13 haven't really focused on that. I can look and see, but  
14 it's nothing that has sort of popped out as being  
15 noticeable.

16 COMMISSIONER KELLY: In the LNG arena, with  
17 imports below expectations, do you all know how much of that  
18 is below expectations on the spot market, and how much, if  
19 any, is below expectations in the long term contract market?

20 Because, as I understand it, part of our supply  
21 is under long term contract. And I am assuming and hoping  
22 that that's been delivered as expected. And that the  
23 decreases in deliveries versus what has been expected is in  
24 the spot.

25 MR. WRIGHT: That would be correct. You see

1       Everett, which is probably the closest to a baseline LNG  
2       facility in this country, running at very high levels.

3               On the flip side is Lake Charles. The capacity  
4       is contracted for. And, for instance, BG--British Gas--  
5       holds contracts in various LNG terminals in the Atlantic  
6       Basin. They are willing to swing their deliveries to  
7       wherever they can get the highest price. They don't mind  
8       eating the costs of the reservation fees at the terminal,  
9       given the high price they are receiving for the LNG.

10              COMMISSIONER KELLY: Do you know what percentage  
11       of our LNG imports come in under long term contracts versus  
12       spot?

13              MR. WRIGHT: I can find that out for you. I know  
14       possible energy tracks, that form of energy--

15              COMMISSIONER KELLY: I just wonder how much we  
16       are getting into the country in the spot market. Is it very  
17       little?

18              MR. WRIGHT: I think it's the majority.

19              MR. HARVEY: I'm not sure about that. I think  
20       about Lake Charles. I think the majority of Lake Charles  
21       probably is spot. And again, at Everett, it's not.

22              So we'll come up with a good number for you.

23              COMMISSIONER KELLY: Thank you.

24              COMMISSIONER BROWNELL: Just a couple of quick  
25       questions. If Canada experiences significant cold over

1 time, can we expect their imports to be reduced?

2 MR. HARVEY: Our experience in the past under  
3 sort of extreme cold in the East, is that when it's  
4 extremely cold in the Northeast here, it's extremely cold in  
5 eastern Canada as well. And we do actually see a reduction  
6 of physical deliveries during those periods.

7 I would say again, if you have that kind of cold  
8 located on the eastern North American continent, that yes,  
9 you would see a reduction in deliveries from Canada.

10 COMMISSIONER BROWNELL: I think we can expect to  
11 see continued volatility in the markets for a variety of  
12 reasons, which a lot of people tend to interpret as  
13 manipulation. But when you look in the increase in the  
14 number of drilling rigs, there is clearly an expectation  
15 that prices are going to remain pretty high, as you  
16 indicated earlier, for some significant period of time.

17 MR. HARVEY: Yes.

18 COMMISSIONER BROWNELL: High, but with increased  
19 volatility.

20 MR. HARVEY: Yes. The volatility, particularly  
21 right now, is probably what we want to talk about in the  
22 facilities. The damage to the facilities, not just the  
23 production that can come from the offshore, but the ability  
24 to move it around the country, I think, increases that  
25 volatility over the short term a great deal.

1                   We have seen that. Big movements, up and down,  
2                   day to day, depending on, really, weather, sort of in the  
3                   Midwest to the eastern part of the country.

4                   COMMISSIONER BROWNELL: I would like to add to  
5                   Suedeen's inquiry in terms of liquidity. Not only at Henry  
6                   Hub but elsewhere. Because I think we might have been in  
7                   the same meeting where we'd heard of declines in liquidity.  
8                   And I think we both walked away kind of wondering what that  
9                   might be about.

10                  We've got one explanation, but we would like a  
11                  focus group of more than one. So that would be helpful.

12                  MR. HARVEY: There are certain markets at this  
13                  time of the year, and I don't know if this is related or  
14                  not, but in particular, the futures and some of the  
15                  financial trading toward the end of the year, many of those  
16                  financial traders basically sat down. They are getting  
17                  close to close-out of their books and that sort of thing.

18                  So there is an effect, I think, on the futures  
19                  market in terms of that activity. That can actually lead in  
20                  the futures market to more volatility if there are willing  
21                  buyers and sellers--people who want to be active in that, a  
22                  little room becomes much larger. That's sort of regular  
23                  during the course of late November into early December.

24                  The physical markets tend to be a little  
25                  different. Let me look at the physical markets and see.

1 COMMISSIONER BROWNELL: Thanks.

2 CHAIRMAN KELLIHER: Thank you very much. Very  
3 helpful.

4 SECRETARY SALAS: Next on the agenda for  
5 discussion is E-1. This is Accounting And Financial  
6 Reporting For Public Utilities Including Regional  
7 Transmission Organizations. It's a presentation by Julie  
8 Kuhns, accompanied by John Okrak, Lodie White, Jim Guest, Ed  
9 Chris Thomas.

10 I also see Larry Greenfield at the table!

11 (Laughter.)

12 MS. KUHNS: Good morning, Mr. Chairman, and  
13 Commissioners. E-1 is a draft final rule that amends part  
14 101 of the Commission's regulations to revise the Uniform  
15 System of Accounts and the annual financial reporting forms  
16 for public utilities and licensees, including regional  
17 transmission organizations, RTOs.

18 The draft final rule updates the Uniform System  
19 of Accounts to accommodate the restructuring changes  
20 occurring in the electric industry due to the availability  
21 of open access transmission service, and increasing  
22 competition in the wholesale bulk power markets.

23 These revisions are in response to comments  
24 received from the Commission's Notice of Inquiry issued on  
25 September 15, 2004. And the Notice of Proposed Rulemaking

1 issued on June 3, 2005.

2 While the Notice of Inquiry requested comments on  
3 a broad range of RTO-related matters, including cost  
4 oversight and management issues, the Notice of Proposed  
5 Rulemaking and this Draft Final Rule address only accounting  
6 and financial reporting for public utilities, including  
7 RTOs.

8 The cost oversight and management issues raised  
9 in the Notice of Inquiry are beyond the scope of this Draft  
10 Final Rule and will be addressed in a separate proceeding.

11 The new accounts and changes to the Commission's  
12 quarterly and annual financial reports will provide for  
13 better comparability between public utilities, along with  
14 providing for uniformity and transparency in accounting for  
15 and reporting of transactions affecting public utilities  
16 including RTOs.

17 Further, these revisions allow the Commission to  
18 better understand transactions and events that affect RTOs  
19 and their members and non-RTO utilities, as well as  
20 activities related to administering regional markets.

21 In addition, the Final Rule expands the  
22 transition function expense accounts to provide more  
23 granularity regarding the cost of operating the transmission  
24 system.

25 Finally, the changes in the financial reporting

1 in the Draft Final Rule will lead to improvements in cost  
2 recovery practices. These revisions provide more details  
3 concerning the costs of certain functions and increased  
4 assurance that the costs are legitimate and reasonable costs  
5 of providing service and are assigned to the correct period  
6 for recovery and rates.

7 This Draft Final Rule has an effective date of  
8 January 1, 2006, which is the date proposed in the Notice of  
9 Proposed Rulemaking.

10 This concludes our presentation. Thank you.

11 CHAIRMAN KELLIHER: Thank you very much for your  
12 presentation and for delivering this Final Rule to us. I  
13 just want to make a few comments.

14 The Final Rule, as Staff indicated, would modify  
15 this Commission's accounting and financial reporting  
16 requirements to provide uniformity and transparency in  
17 accounting for and reporting of transactions and events  
18 affecting public utilities, including RTOs.

19 These modifications reflect the fact that RTOs  
20 perform many of the same activities previously performed by  
21 public utilities whose transmission systems they now  
22 operate, but also that RTOs perform some unique functions  
23 not undertaken by traditional public utilities.

24 Our Final Rule responds to some significant  
25 concerns about RTO costs. There has been some growing

1 criticism expressed by transmission customers about RTO  
2 costs, both the level of the costs and the rate of increase.

3 The Final Rule will make RTO costs more  
4 transparent and enable a cost comparison of RTOs as well as  
5 between RTOs and traditional public utilities to the extent  
6 that they perform the same activities. I think RTOs have  
7 great potential benefits. I voted since I joined the  
8 Commission to establish RTOs in New England, in SPP, and I  
9 voted for PJM expansion.

10 But while I believe RTOs have great potential  
11 benefits, I don't think they are predestined to achieve  
12 those benefits. In my view, the key to continued expansion  
13 of RTOs is the performance of the existing RTOs. If they  
14 deliver the potential benefits and prove to be effective in  
15 managing costs, they will succeed.

16 I believe the Final Rule is a necessary, but not  
17 sufficient, step. Greater transparency may encourage  
18 greater cost accountability by RTOs, but there is probably a  
19 limit to what can be accomplished through transparency  
20 alone. The Commission does have the legal duty to ensure  
21 that RTO costs are just and reasonable.

22 But I support the order, and I am glad we are  
23 finalizing it, colleagues.

24 COMMISSIONER KELLY: I agree with Joe that this  
25 is an excellent step to making the expenses and revenues on

1 RTOs more transparent. We need to have that before we can  
2 undertake the next step of looking at the accountability of  
3 RTOs on a systematic basis. I anticipate the Commission  
4 will look after that in the upcoming months, in 2006.

5 I also wanted to point out that this Final Rule,  
6 although it was perhaps developed out of an interest in RTO  
7 accountability, also will provide more transparency  
8 generally for transmission investment revenues and expenses,  
9 and in fact this rule will require public utilities other  
10 than RTOs to account for their costs according to this  
11 system.

12 So, it should make it clear how much money has  
13 been spent for transmission system planning and development  
14 activities for generation interconnect and transmission  
15 services and for revenues received for transmission of  
16 electricity over its transmission facilities.

17 I anticipate that this rule will not only help  
18 with RTO oversight and accountability, but also will help  
19 the Commission as it embarks on implementing the  
20 transmission incentives policy initiative.

21 Thank you very much for all your hard work. I  
22 think that you have done an excellent job, and it's so good  
23 that even in reading parts of this rule dealing with  
24 accounts and esoterica, I did not fall asleep!

25 (Laughter.)

1                   COMMISSIONER BROWNELL: You have done a terrific  
2 job. My only regret is we didn't do this four years ago  
3 because we might able to answer some of the tough questions  
4 we have been challenged on.

5                   But I think this is a good step, and I think it  
6 has broad implications. First and foremost, I hope that the  
7 transparency will allow us to actually answer the question  
8 of whether RTO costs are excessive, and have a better  
9 understanding of why.

10                  I think we also ask the flip side of that  
11 question, which is why, if the RTOs are taking over more  
12 responsibilities and more functions, that we haven't seen  
13 cost reductions on the utility side. I think if we don't  
14 see that, both we and the states should be asking why.  
15 Because I think that is a critical piece that has been  
16 missing.

17                  I also agree with both Suedeem and Joe that this  
18 has broader implications. I think it will allow us to have  
19 a better understanding of what is and is not being spent.  
20 As we implement real reliability rules, I think it will help  
21 us measure the effects of various transmission incentives.  
22 And I suspect we won't stop with just what we are doing now.  
23 But we will be looking at different ways to do that in the  
24 future.

25                  And I think we will actually be able to have this

1 as a tool in dealing with cross-subsidization issues.

2 So I think, implemented appropriately and audited  
3 appropriately, we can learn a lot more than the very narrow  
4 question, I think, that started this rule.

5 I know there were some issues raised about  
6 implementing it in January 2006. That may be a short  
7 timeline. But I think this is long overdue, and I think  
8 people are just going to have to make that. For all those  
9 rehearing orders that are going to come in, asking us to  
10 postpone this, I think we have to look at the cost and the  
11 benefit.

12 Thanks.

13 CHAIRMAN KELLIHER: I need a vote.

14 COMMISSIONER KELLY: Aye.

15 COMMISSIONER BROWNELL: Aye.

16 CHAIRMAN KELLIHER: Aye. Thank you very much.

17 SECRETARY SALAS: Next for discussion is C-1.

18 This is Regulation Of Certain Underground Storage  
19 Facilities. It is a presentation by Ed Murrell, Sandra  
20 Delude, Susie Holmes, Mike Henry, Mike Goldenberg, and Berne  
21 Mosley.

22 MR. MURRELL: Good morning, Mr. Chairman and  
23 Commissioners. I am Ed Murrell with the Office of Markets,  
24 Tariffs and Rates. I will be presenting C-1 this morning.  
25 Joining me today are representatives of a much larger staff

1 team responsible for this effort.

2 To my left, Sandra Delude, Mike Henry and Mike  
3 Goldenberg of OGC. To my right, Berne Mosley of the Office  
4 of Energy Projects, and Susie Holmes, also with OGC.

5 Significant contributions also were made by a  
6 large group of staff, which included members of the Office  
7 of Market Oversight and Investigation.

8 Item C-1 is a Draft Notice of Proposed Rulemaking  
9 on Storage Pricing Policy. The draft NOPR has two main  
10 parts

11 First, the NOPR proposes to reevaluate how the  
12 Commission examines potential market power in the context of  
13 natural gas storage. Second, the NOPR proposes to implement  
14 the new Natural Gas Act, Section 4(f). In addition, the  
15 NOPR will codify filing requirements for market-based rate  
16 applications for storage and storage-related services.

17 Prospective storage developers will have the  
18 option of either supporting their request for market-based  
19 rates by filing a market power analysis or seeking  
20 consideration of their requests under the provisions of the  
21 new section 4(f).

22 The Commission's purpose, as stated in the NOPR,  
23 is to adopt policy reforms that would encourage the  
24 development of new natural gas storage facilities while  
25 continuing to protect consumers from the exercise of market

1 power. To that end, the draft proposes to reform the  
2 Commission's market power test for natural gas storage  
3 operators to more accurately the competitive conditions in  
4 the market for gas storage services.

5 In individual applications, the Commission would  
6 give consideration to potential substitutes for storage,  
7 such as available pipeline capacity, local gas production,  
8 LNG, and released transportation capacity.

9 However, the burden is still on the applicant to  
10 show in its individual case that adequate substitutes for  
11 its own products are available in the market so that it  
12 cannot exercise significant market power.

13 The Commission's basic standards for making these  
14 findings would not be modified. The initial screen of 1800  
15 on the Herfindahl-Hirschman Index--I'm glad I got that out  
16 right the first time--

17 (Laughter.)

18 COMMISSIONER KELLY: You can use HHI now.

19 (Laughter.)

20 MR. MURRELL: Thank you. It remains the  
21 Commission's standard for determining whether to look more  
22 deeply into market power issues in a particular case.

23 In codifying regulations the draft proposed  
24 specific filing requirements for market-based rate  
25 applications. This process follows the Commission's

1 practices developed since the 1996 Policy Statement first  
2 articulated in the Commission's views on evaluating market  
3 power. In addition, the draft would impose a periodic  
4 review requirement once every five years to newly authorized  
5 storage providers.

6 On August 8, 2005, the Energy Policy Act of 2005  
7 was enacted. Section 312 of that Act amends the Natural Gas  
8 Act to include a new section 4(f). This new provision  
9 permits the Commission to authorize market-based rates for  
10 storage and storage-related services related to a specific  
11 facility placed in service after August 8 if the Commission  
12 determines that market-based rates are in the public  
13 interest and necessary to encourage the construction  
14 capacity in the area needing storage services and if the  
15 Commission determines that customers are adequately  
16 protected.

17 Section 4(f) also requires the Commission to  
18 ensure that reasonable terms and conditions are in place to  
19 protect consumers and to review periodically whether the  
20 market-based rate is just, reasonable and not unduly  
21 discriminatory or preferential.

22 Accordingly, this NOPR takes a fresh look at the  
23 Commission's policies governing market-based storage rates.  
24 And proposes to codify filing requirements and describes how  
25 the Commission would implement the new provisions created by

1 Section 312.

2 In the new Natural Gas Act, Section 4(f), the  
3 draft NOPR would clarify that the Commission interprets the  
4 new Section 4(f) provisions to apply only to a new facility  
5 and not to an expansion of an existing facility. It  
6 requires the applicant to show that market-based rates are  
7 necessary to encourage the construction of storage capacity,  
8 and invites comments on how this might be done. And it  
9 requires the applicant to demonstrate that customers will be  
10 adequately protected.

11 The draft discusses at some length how customer  
12 protection might be accomplished, noting that there are two  
13 general approaches that might be deployed.

14 The first approach is to prevent withholding of  
15 capacity from the market. The second approach involves  
16 different rate protections, including price caps, recourse  
17 rates, and other pricing and rate design alternatives.

18 At this time, the draft NOPR does not propose to  
19 adopt any single approach, but asks for comments on what  
20 might work and whether the Commission should establish  
21 generic safeguards.

22 The draft order proposes to rely on existing  
23 reporting requirements and publicly available data, and  
24 staff monitoring of storage markets to meet the periodic  
25 review requirement of the new NGA Section 4(f). Comments

1 will be requested within 60 days of publication of the NOPR  
2 in the Federal Register.

3 We look forward to hearing the industry's views.  
4 We did make some last minute changes to the draft order this  
5 morning. I believe the offices are in agreement on the  
6 language. If Staff runs into any conforming issues, we will  
7 make those changes as well before the order is issued.

8 That concludes my presentation. Thank you.

9 CHAIRMAN KELLIHER: Thank you. That was an  
10 excellent summary of this proposed rule, I have to say.  
11 Very good job. I'll make a few comments, just to describe  
12 my reasons for supporting the proposed rule, and then turn  
13 to my colleagues.

14 The proposed rule, as the Staff indicated, would  
15 reform the Commission's pricing policies for natural gas  
16 storage facilities in order to encourage greater investment  
17 in storage facilities.

18 The Commission believes that expansion of storage  
19 capacity may help reduce the volatility of natural gas  
20 prices. The goal is clear. Reduce volatility in gas prices  
21 by encouraging expansion in gas storage capacity. Gas  
22 storage capacity has remained relatively static for many  
23 years, while demand has increased sharply. Since 1988, gas  
24 storage capacity has expanded only 1.4 percent, while demand  
25 for gas has risen 24 percent.

1                   Significantly, the volatility of gas prices has  
2 risen sharply during this same period. One possible cause  
3 of this greater volatility in gas prices is inadequate gas  
4 storage capacity.

5                   This order is one of the Commission's responses  
6 to a winter of record high gas prices. We have improved our  
7 ability to detect market manipulation by entering into a  
8 memorandum of understanding with the CFTC. We have issued  
9 anti-manipulation proposed rules. We have authorized more  
10 efficient use of our existing energy infrastructure by  
11 acting quickly in emergency filings, and we have acted to  
12 speed recovery from the hurricanes by expediting gas  
13 infrastructure construction.

14                   And today we act to reduce gas price volatility  
15 by encouraging expansions in storage capacity. I think our  
16 action could not come at a better time.

17                   The proposed rules would reform gas storage  
18 pricing in two ways. First, it would reform Commission's  
19 market power analysis to better reflect competitive  
20 alternatives to storage. In particular, the NOPR would  
21 expand the product market to include close substitutes for  
22 gas storage services, such as available pipeline capacity,  
23 local gas production and LNG imports. In short, instead of  
24 treating gas and storage as a discrete product, the  
25 Commission will recognize that gas and storage compete with

1 other gas that can be delivered in the same geographic  
2 market.

3 In my view, these changes reflect the economic  
4 realities of gas storage providers currently. Gas and  
5 storage providers effectively compete with other gas  
6 supplies, whether from pipeline sales, local production or  
7 LNG imports. I think it is only appropriate that that  
8 reality be reflected in Commission analysis.

9 The order also implements the new Section 4(f) of  
10 the Natural Gas Act, headed by the Energy Policy Act, which  
11 authorizes the Commission to permit market-based rates for  
12 new natural gas storage facilities if the provider is unable  
13 to show it lacks market power, or if the Commission  
14 determines that market-based rates are in the public  
15 interest and necessary to encourage needed storage  
16 infrastructure and that customers are adequately protected.

17 It is important to recognize that this EPACT  
18 authority is effective immediately. There is no requirement  
19 that the Commission issues rules to implement this  
20 provision, but we do so to clarify our approach on any  
21 future filings for market-based rates under the new EPACT  
22 provision.

23 I want to emphasize that EPACT authorizes the  
24 Commission to allow market-based rates for gas storage  
25 providers, even if it has market power, only if certain

1 findings are made. Market-based rates have to be in the  
2 public interest and they have to be necessary to encourage  
3 needed infrastructure. Further, customers must be  
4 adequately protected.

5 The proposed rule proposes a number of ways to  
6 protect customers. For example, an applicant could propose  
7 measures to prevent withholding by requiring the storage  
8 operator to sell or make available to the market all of its  
9 capacity.

10 Let me be clear that the burden rests with the  
11 applicant to prove to the Commission that customers are  
12 protected.

13 All in all, I think the order clearly benefits  
14 consumers by reducing price volatility. I want to note that  
15 this proposed rule provides an alternative approach. A  
16 prospective developer of unused storage facilities need not  
17 go through the modified analysis and may make an EPACT  
18 filing directly with the Commission.

19 Gas storage pricing reform is something the  
20 Commission has been considering for some time. It is one of  
21 my top priorities as Chairman, something that I announced on  
22 my first day in office. The State of the Gas Industry  
23 conference in October of 2004 examined this very issue.  
24 But, the fact that Congress gave us this new authority adds  
25 momentum to our efforts. EPACT showed that Congress

1 recognizes the relationship between gas storage capacity and  
2 price volatility. Congress arrived at the same approach as  
3 the Commission, reform gas storage pricing. I respect the  
4 judgment of Congress and agree with the policy goal, and we  
5 are moving swiftly to implement our new EPACT authority.

6 I support the order.

7 I turn to my colleagues for comments.

8 COMMISSIONER KELLY: I also support this order.

9 As I noted in connection with the discussion we had earlier  
10 on the Liberty gas order, I believe that our existing policy  
11 for authorizing market-based rates for gas storage  
12 facilities has worked very well.

13 Indeed, of the 40 applications that we have  
14 received since we implemented that policy, we granted all  
15 but three. Two of the three we denied. Those storage  
16 developers did develop their storage under a cost-based  
17 system, because they were found to have market power.

18 The third one was not built. We don't know why  
19 it wasn't built. We have not heard from local distribution  
20 companies, who are the primary customers of storage  
21 facilities, that there is imminent need for additional  
22 storage, except perhaps in the New England area, where there  
23 is not a capability geologically to build underground gas  
24 storage, and we need to rely on above ground gas storage.

25 That's not what this NOPR deals with. It deals

1 with underground gas storage. As far as the record goes, it  
2 is not clear to me that the Commission needs to make any  
3 radical changes in our existing policy. I support this  
4 NOPR, because one thing that it does do is, it will codify  
5 our regulations.

6 What has to date been our existing market-based  
7 rate authority for gas storage, it does make it clear that  
8 we will expand the definition that we have heretofore used  
9 for good alternatives to gas storage facilities when we  
10 consider whether or not the storage provider will exercise  
11 market power.

12 Specifically, we will look at other possibilities  
13 besides just other storage facilities. We will look at  
14 other possibilities that could be close substitutes for  
15 storage, and I think that is a very good decision. And that  
16 indeed we should look to close substitutes in making our  
17 market determinations.

18 However, I am a bit uneasy about the  
19 authorization of market-based rates for gas storage  
20 providers that can exercise market power. This is an  
21 extraordinary incentive. The Commission does not authorize  
22 any other monopoly that we regulate to charge market-based  
23 rates if they have market power. We don't do that for  
24 wholesale sales of electricity. We don't do that for  
25 transmission providers. We don't do that for gas

1 transportation providers.

2 So this is a very serious endeavor.

3 Nevertheless, Congress has indeed us to approve market-based  
4 rates for companies, even if they have market power. But  
5 Congress has been very clear that doing that would be  
6 extraordinary.

7 And Congress has limited us to do that only in  
8 certain circumstances, as Joe explained. When it's in the  
9 public interest. When it is necessary to encourage storage  
10 capacity be built. And when that storage capacity is  
11 actually needed. And in addition, when there are adequate  
12 consumer protections in place.

13 So I think that given those protections, that  
14 this market-based rate authority could be implemented in a  
15 way that does not harm local distribution companies or other  
16 consumers. And in our NOPR, we ask for comment about  
17 whether or not we should look at specific types of consumer  
18 protections that we could decide in advance would be  
19 sufficient to protect consumers and allow storage providers  
20 with market power to nevertheless have market-based rates.

21 I will be very interested in hearing from the  
22 industry and the public about what those protections could  
23 be.

24 So, I am pleased with the NOPR that we have put  
25 out and look forward to the comments. I want to thank the

1 team for all the hard work that they did on developing this  
2 NOPR. And for Joe's leadership in getting this NOPR issued.

3 COMMISSIONER BROWNELL: Hard to add to those  
4 comments. Let me simply say this. I think, Suedeen, I  
5 actually agree that our policies have worked to date, but I  
6 think that as markets develop, and as we see strong economic  
7 signals, as we are certainly seeing in today's market, with  
8 or without Katrina, that it is incumbent upon us to develop  
9 new tools and new responses, clearly with the understanding  
10 that our first goal is customer protection and enhancing  
11 infrastructures, whether they be storage or anything else,  
12 ultimately protects customers because it creates more  
13 opportunity and more stability in the market.

14 I think it's clear that Congress through EPACT  
15 not only recognized the importance of continuous improvement  
16 in how we approach markets, and develop market solutions,  
17 but I think they also recognize that with the development of  
18 a number of tools, the market monitoring group, which Susan  
19 is leading, that they have some belief that they are able to  
20 monitor those pretty carefully.

21 And I think we will get lots of ideas, in terms  
22 of customer protection. I think we need to step back and  
23 look at what we are trying to do here. When I see tools  
24 like price caps and things like that, I kind of am hesitant  
25 that that's ultimately the best protection for customers,

1 because I have seen it have the opposite effect in some of  
2 our markets.

3 Is this a stretch? Sure. Is it going to be  
4 widely used? Doubtful. But could it be one more critical  
5 tool that gets needed storage built? I think it will be.

6 So, I look forward to hearing comments, but I  
7 think this is a good demonstration of how regulatory bodies  
8 can respond to market conditions.

9 I am happy to support it.

10 COMMISSIONER KELLY: May I respond to Nora? I  
11 think that you raise a very good point. And it will be  
12 interesting to see, on a case-by-case basis, what comes to  
13 us, because clearly if we need something, then we should  
14 find a way to get it built.

15 That whole idea of need, we haven't really  
16 fleshed out in our NOPR. But I can imagine a proposed  
17 storage facility, and the hole in the ground is what the  
18 hole in the ground is. And it may come to us with  
19 85 percent of the capacity contracted for, but this other 15  
20 percent not contracted for. In a situation like that, I  
21 think one could clearly say there is need.

22 On the other hand, if it is a facility that comes  
23 in with 20 percent of the capacity contracted for, is it  
24 needed? And if so, it will be interesting to see how this  
25 develops on a case-by-case basis.

1                   COMMISSIONER BROWNELL: I don't want to continue.  
2 We have been debating this for quite awhile. But I am not  
3 sure the benchmarks by which we judge need are the same  
4 today as they were five years ago. And so, it would be nice  
5 to have that really black and white, how much is contracted.  
6 But the markets are different. We have had endless  
7 discussions over more reliance on shorter term contracts as  
8 opposed to longer term contracts.

9                   So I think the issues you raise are important,  
10 but I am not sure that the litmus test remains the same.

11                  CHAIRMAN KELLIHER: Shall we vote? Or do you  
12 want to respond?

13                  COMMISSIONER KELLY: I think I will wait until we  
14 get the comments.

15                  (Laughter.)

16                  COMMISSIONER KELLY: It will be interesting to  
17 see how need is defined in the new markets. Aye.

18                  COMMISSIONER BROWNELL: Aye.

19                  CHAIRMAN KELLIHER: Aye. Thank you very much.

20                  SECRETARY SALAS: Next for discussion, E-4. Duke  
21 Energy Corporation. And it is a presentation by Rich  
22 Benjamin, David Hunger, Jan MacPherson, Jim Akers, and  
23 Valerie Kait.

24                  MR. BENJAMIN: Good morning, Mr. Chairman and  
25 Commissioners. E-4 is a draft order authorizing the merger

1 of Duke Energy Corporation and Cinergy Corp. The merger was  
2 analyzed under Section 203 as it existed before the Energy  
3 Policy Act, as provided for in the Energy Policy Act,  
4 Section 1289(c).

5 The draft order finds that the merger would not  
6 adversely affect competition, rates or regulation, and is  
7 therefore consistent with the public interest. Applicants  
8 analyzed the effect of the acquisition on the relevant  
9 products and geographic markets in accordance with the  
10 Commission's competitive analysis screen.

11 The draft order finds that applicants have shown  
12 that the combination of their generation assets does not  
13 raise horizontal competitiveness issues in any relevant  
14 market. The applicants' generation overlaps in the MISO  
15 market only. And the extent of the overlap is minimal  
16 compared to the size of the MISO market.

17 Further, the MISO market is un-concentrated.  
18 While the Duke market is highly concentrated, it is not made  
19 more concentrated by the merger.

20 Competitive merger analysis focuses on the harm  
21 caused by a merger, not preexisting conditions. The draft  
22 order also finds that applicant's hold-harmless commitment  
23 provides adequate rate payer protection and ensures that the  
24 merger will not adversely affect rates.

25 The draft order also approves the transfer of

1 Duke's ownership of merchant generation facilities in the  
2 Midwest to Cincinnati Gas & Electric, finding that because  
3 Cincinnati Gas & Electric will not be able to pass on costs  
4 to captive cost-based customers, the transfer will not  
5 adversely affect wholesale rates or harm competition through  
6 affiliate preferences.

7 It also clarifies the Commission's policy on  
8 acquisition of affiliated generation under Section 203 of  
9 the Federal Power Act.

10 This concludes Staff's presentation, and we would  
11 be happy to answer any questions.

12 CHAIRMAN KELLIHER: Thank you for that  
13 presentation. Let me make a few comments about this merger.

14 This order, as Staff indicated, authorizes the  
15 purposed merger between Duke Energy and Cinergy, finding  
16 that the merger is consistent with the public interest.  
17 This merger was reviewed under the preexisting Section 203,  
18 the pre-EPACT Section 203. As provided for by EPACT,  
19 pending applications would not be considered under the  
20 revised Section 203.

21 This merger, although significant in size, the  
22 merger analysis was very straightforward. The merger  
23 analysis focuses on potential harm caused by the merger and  
24 not preexisting conditions.

25 As Staff indicated, there is very little overlap

1 between the Cinergy and Duke markets. MISO is a very  
2 unconcentrated market, and Duke, while highly concentrated,  
3 is a not made more so by the merger.

4 I think even though it is a large merger, the  
5 merger analysis is actually very straightforward, so I  
6 support the merger.

7 Any comments?

8 COMMISSIONER KELLY: No comments. I support it.

9 COMMISSIONER BROWNELL: I'm giving my generic  
10 merger speech on the next one.

11 CHAIRMAN KELLIHER: Let's vote then.

12 COMMISSIONER KELLY: Aye.

13 COMMISSIONER BROWNELL: Aye.

14 CHAIRMAN KELLIHER: Aye. Thank you very much.

15 SECRETARY SALAS: Next for discussion is E-6.

16 Mid-American Energy Holding was company. We have the same  
17 team presenting, but this time it's Valerie Kait doing the  
18 presentation. Again she's accompanied by Jim Akers, Rich  
19 Benjamin, Dave Hunger, Jim MacPherson.

20 MS. KAIT: Good morning, Chairman and  
21 Commissioners.

22 E-6 is a draft order authorizing Mid-American  
23 Energy Holdings Company's proposed acquisition of  
24 PacifiCorp. The merger analysis was conducted under Section  
25 203 of the Federal Power Act as it existed before the Energy

1 Policy Act of 2004 was enacted. As is provided for under  
2 Section 1289(c) of that Act, the draft order finds that the  
3 acquisition will not adversely affect competition rates or  
4 regulation and is therefore consistent with the public  
5 interest.

6 Applicants analyzed the effect of the acquisition  
7 on the product and the geographic markets in accordance with  
8 the Commission's competitive analysis screen. The analysis  
9 demonstrates that the Mid-American and PacifiCorp markets  
10 are remote from each other and that the two companies  
11 control very little capacity outside their respective  
12 control areas. Thus, the draft order finds that the  
13 applicants have shown that combining their generation assets  
14 does not raise horizontal competitiveness issues in any  
15 relevant market. The draft order finds that applicants have  
16 also shown that the application does not increase their  
17 incentive or abilities to exercise vertical market power in  
18 the wholesale electricity markets. Applicants have  
19 demonstrated that the combination of their generation and  
20 transmission facilities will not harm competition because  
21 the applicants do not compete in downstream markets that  
22 could be affected by their upstream transmission assets.

23 Applicants have also shown that the combination  
24 of their generation and natural gas transportation assets  
25 will not harm competition because the relevant upstream

1 market is not highly concentrated. Thus, the merged firm  
2 would not be able to use control of upstream natural gas  
3 resources to harm competition in relevant wholesale markets.

4 Applicants have also shown that the acquisition  
5 does not erect barriers to entry for gas fired generators,  
6 which have alternative of fuel supply sources. The draft  
7 order finds that applicants' commitment to hold harmless  
8 transmission and wholesale power customers from any  
9 acquisition-related costs will provide adequate rate payer  
10 protection.

11 Finally, the draft order finds that the  
12 acquisition will not adversely affect federal or state  
13 regulations.

14 This concludes Staff's presentation. We would be  
15 happy to answer any questions.

16 CHAIRMAN KELLIHER: Thank you. This merger, or  
17 this acquisition, like the Duke/Cinergy merger, was reviewed  
18 under the old merger test. The commission has issued merger  
19 proposed rules and will soon start working on final rules.

20 But under the previous test, again, this is a  
21 significant transaction but it's a very straightforward  
22 analytical exercise. As Staff indicated, the Mid-American  
23 and PacifiCorp markets are remote from each other. The two  
24 companies control very little capacity outside their  
25 respective control areas.

1                   So it's a very straightforward matter. I would  
2                   conclude there is no harm to competition. I am pleased that  
3                   the Commission was able to act expeditiously on this  
4                   acquisition, as well as the Duke/Cinergy merger.

5                   I support the order. Colleagues?

6                   COMMISSIONER KELLY: I also support the order.  
7                   As you mentioned, the test that the Commission uses is to  
8                   ensure that there's no adverse impact from the merger on  
9                   rates, regulation or competition.

10                  This merger clearly meets that test.

11                  I would also like to point out that in this  
12                  merger we are also looking at a significant benefit to the  
13                  Northwest. The PacifiCorp's region in the Northwest clearly  
14                  needs an infusion of capital into infrastructure  
15                  improvements and Mid-American has that capital, and has  
16                  significant access to that capital. That will be a benefit  
17                  to the customers in the Northwest.

18                  I believe this transaction will allow needed  
19                  infrastructure improvements to proceed so that both rate  
20                  payers and shareholders will ultimately benefit from this  
21                  merger.

22                  COMMISSIONER BROWNELL: Generic merger talk. I  
23                  am approving both of these mergers as we have previously for  
24                  a variety of reasons.

25                  Certainly the tests that we are obligated to look

1 at are important and I think we have addressed those, but on  
2 a larger issue getting beyond the scope of our purview--  
3 sorry, Mr. Chairman--I think we don't ask the right  
4 questions generally about mergers.

5 Customers and local policymakers are often left  
6 with the impression that there is really no value added. I  
7 encourage the companies to start talking about what value  
8 they have brought to customers, not where the headquarters  
9 are, which is important if you're governor, but not  
10 necessarily if you are a customer.

11 Not how many employees there are in each state,  
12 once again important to a governor, but look at larger  
13 issues. Do these mergers of now well capitalized companies  
14 bring increase investment in infrastructure? What  
15 difference does that make to the customer? Are there  
16 efficiency gains in generation and delivery?

17 Let's talk about those. Is there expertise that  
18 the combined companies have that brings value to the overall  
19 management of the companies? So, rather than simply approve  
20 mergers and walk away, I would really ask the companies,  
21 come back to us in a year. Come back to us in two years,  
22 and let's talk about what you brought to the customers.

23 So we begin looking at mergers in the larger  
24 context. Because what I see what happens at the state  
25 levels and the local approval level, I feel that they are

1 not necessarily looking at what's best for the customer, but  
2 what what's best for narrow parochial interests.

3 I think it behooves the companies to start  
4 talking about those issues. Thank you.

5 COMMISSIONER KELLY: Along those lines, Nora, I  
6 think that PacificCorp and Mid-American did exactly that in  
7 this case. They did talk about the synergies, not just the  
8 complementarity, but the synergies that will likely result  
9 from the merger.

10 So I support exactly what you said, and I'm glad  
11 that with this merger we see that kind of value added.

12 CHAIRMAN KELLIHER: Shall we vote?

13 COMMISSIONER KELLY: Aye.

14 COMMISSIONER BROWNELL: Aye.

15 CHAIRMAN KELLIHER: Aye.

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1                   SECRETARY SALAS: The final item for discussion  
2 this morning is a joint presentation. This is E-3, which is  
3 Duke Power, and E-5, MidAmerican Energy Company. It's a  
4 presentation by Edie Kinsley and Elizabeth Arnold,  
5 accompanied by Steve Rodgers, Brandon Johnson, and Steve  
6 Pointer.

7                   MS. KINSLEY: Good morning, Mr. Chairman and  
8 Commissioners. Agenda Items E-3 and E-5 are draft Orders  
9 that accept utility proposals for independent transmission  
10 coordinators on the Duke Power System and the MidAmerican  
11 Transmission System, respectively.

12                   I will present E-3, concerning Duke Power's  
13 filing. Elizabeth Arnold will present E-5 for MidAmerican's  
14 filing.

15                   Agenda Item E-3 is an Order accepting a voluntary  
16 filing by Duke Power to revise its open access transmission  
17 tariff to retain the Midwest ISO as an independent entity,  
18 and Potomac Economics as the independent monitor under the  
19 proposed transmission monitoring plan.

20                   Under Duke's proposal, the Midwest ISO will have  
21 the responsibility for performing certain OATT-related  
22 functions on Duke's transmission system, including the  
23 evaluation and approval of all transmission service  
24 requests, calculation of total transfer capacity, and  
25 available transfer capacity, operation and administration of

1 Duke's OASIS evaluation processing and approval of all  
2 generation interconnection requests and related  
3 interconnection studies, and coordination of transmission  
4 planning.

5 Duke notes that it will continue to have ultimate  
6 responsibility for the provision of transmission service,  
7 including the sole authority to amend its OATT, pursuant to  
8 Section 205 of the Federal Power Act.

9 Under Duke's transmission monitoring plan,  
10 Potomac Economics will monitor the operations on and examine  
11 the dispatch of Duke's transmission system. It will also  
12 have the authority to investigate any potential  
13 anticompetitive activity on Duke's transmission system, and  
14 will submit quarterly reports to this Commission and to  
15 Duke's state commissions, summarizing their analyses.

16 Duke has submitted Attachment K to its OATT, that  
17 codifies the independent entity's responsibilities and  
18 transmission monitoring plan that establishes the  
19 independent monitor's responsibilities.

20 Duke has also submitted the independent entity  
21 and independent monitor agreements. Duke states that the  
22 primary aim of its proposal is to increase confidence in the  
23 independence and transparency of the operation of its  
24 transmission system.

25 The draft Order finds that Duke's proposal is an

1 improvement over the existing transmission services and  
2 transmission decisionmaking offered under its OATT, and,  
3 therefore, meets or is consistent or superior to standard of  
4 review under Order Number 888 for departures from the pro  
5 forma OATT.

6 The Order accepts Duke's independent entity  
7 proposal, transmission monitoring plan, and the agreements  
8 between Duke and the independent entity and independent  
9 monitor, to be effective November 1, 2006.

10 Finally, the draft Order explains that Duke is  
11 not seeking a determination that the independent entity  
12 satisfies the Commission's independent entity variation  
13 standard under Order No. 2003 to implement a transmission  
14 pricing proposal or any special rate treatment, and that the  
15 Commission is not making any finding on that issue here.  
16 That concludes this presentation.

17 MS. ARNOLD: Agenda Item E-5 is a draft Order  
18 conditionally accepting for filing, MidAmerican Energy  
19 Company's proposal to establish an independent transmission  
20 service coordinator or TSC.

21 The filing consists of a proposed Attachment K to  
22 MidAmerican's open access transmission tariff, and a draft  
23 agreement between MidAmerican and the TSC, referred to as  
24 the TSC Agreement.

25 Under the proposal, the TSC will assume

1 responsibility for, among other things, evaluation and  
2 approval of all transmission service requests, calculation  
3 of total transfer capacity and available transfer capacity,  
4 operation and administration of MidAmerican's OASIS,  
5 approval of all generation interconnection requests and  
6 related interconnection studies, and coordination of  
7 transmission planning.

8 MidAmerican explains that it will select the TSC  
9 after conducting a request for proposals. The draft TSC  
10 agreement will be subject to negotiation between MidAmerican  
11 and the entity selected after the RFP process.

12 Today's draft Order finds that the proposal meets  
13 the consistent-with-or-superior-to standard of review for  
14 departures from the pro forma OATT, as well as helping to  
15 address concerns about MidAmerican's compliance with its  
16 standards of conduct, and accepts the proposed tariff  
17 revisions, subject to certain conditions, and subject to  
18 further Commission Orders.

19 The draft Order requires the elimination or  
20 revision of several provisions that would impair the  
21 independence of the TSC, and requires the modification of  
22 Section 6.4 of Attachment K, regarding the release of  
23 confidential information to the Commission and its Staff.

24 The draft Order also advises MidAmerican that  
25 before the TSC arrangement can become effective, MidAmerican

1 must file an executed TSC agreement for Commission approval  
2 under Federal Power Act Section 205, and that any change to  
3 the agreement, including a change in the identity or  
4 existence of the TSC, would also require filing under  
5 Section 205. That concludes our presentation. Thank you.

6 CHAIRMAN KELLIHER: Thank you for both  
7 presentations. Let me make a few comments on these Orders.

8 Today, the Commission approves two voluntary ITC  
9 proposals filed by Duke and MidAmerican. I refer to them as  
10 ITCs, for purposes of shorthand.

11 As Staff indicated, the actual acronyms used by  
12 Duke and MidAmerican are different, namely, IE, independent  
13 entity, and TSC, transmission service coordinator. I'm sure  
14 we'll see other acronyms developed over time.

15 I just want to clarify that these filings are  
16 unrelated to the merger Orders the Commission approved  
17 earlier today. They were filed separately from the merger  
18 filings, and the Commission did not approve the mergers,  
19 conditioned on the ITCs.

20 As I indicated earlier, the Commission's merger  
21 analysis concentrates on the potential competitive harm  
22 caused by a merger, not preexisting conditions.

23 The Commission is limited in conditioning mergers  
24 to mitigating harm caused by the mergers. In the case of  
25 Duke and MidAmerican's mergers, the Commission found that

1 the mergers actually pose no competitive harm.

2 I just want to be very clear that because we  
3 found no competitive harm, the ITC Orders are not  
4 mitigating, they are not conditional aspects of our merger  
5 approval.

6 The Duke and MidAmerican ITC proposals were  
7 considered by the Commission under the consistent-with-or-  
8 superior to test. They were both approved because the  
9 Commission determined that assigning certain OATT functions  
10 to an independent third party is an improvement over the  
11 transmission service offered under the Duke and MidAmerican  
12 OATTs.

13 Establishment of these ITCs should provide  
14 greater confidence in the independence and transparency of  
15 the operation of the Duke and MidAmerican transmission  
16 systems, and, for that reason, I support the Orders.  
17 Colleagues?

18 COMMISSIONER KELLY: I also support the Orders.  
19 I would just like to note that this is the first time that  
20 we've seen this innovation in the industry, that we've  
21 actually proposed it.

22 It is a new entity, an independent transmission  
23 coordinator that will enhance the manner in which  
24 transmission customers are being served by having the  
25 utility hire independent entities to oversee key aspects, to

1 ensure open access on their transmission.

2 I applaud both Duke and MidAmerican for their  
3 initiatives in proposing these, and I'm pleased to vote for  
4 them.

5 COMMISSIONER BROWNELL: I'm pleased to vote for  
6 them, but I'm absolutely opposed to any more acronyms.

7 (Laughter.)

8 COMMISSIONER BROWNELL: It's confusing to us,  
9 it's confusing to the public. I think it, over time, is not  
10 going to perhaps generate the kind of confidence that we  
11 want to generate, so, I, myself, would like people to start  
12 thinking about calling them what they are and agreeing on  
13 what they should all be called.

14 More importantly, though, I think it's time, if  
15 we are going to introduce yet more one variation on the  
16 independence theme, that we should develop, either in a  
17 collaborative process, vis a vis a technical conference,  
18 some measurements about what these bring to the table.

19 I wish we would have been clearer when we  
20 developed RTOs, so that two years from now or three years  
21 from now, we're not in a position of saying, well, I believe  
22 they added value, and then we can't articulate what that  
23 value was.

24 We've said very clearly that we do think that the  
25 addition of transparency will bring value, and I absolutely

1 agree with that, but how are we going to measure that?

2 Are the calculations of ATC going to improve and  
3 be more precise? Are we going to get more throughput? Are  
4 we going to get better economic dispatch?

5 There's a whole bunch of questions we could ask.  
6 I think we could keep it simple, but I think we need to  
7 start thinking about that.

8 I think the GAO report raised some issues  
9 recently about having a lack of standardization of market  
10 rules -- pretend I didn't say that -- and having different  
11 models, which is fine. We've agreed to do that, but let's  
12 start looking at who's bringing what values, so we know what  
13 models we should be approving and what models we should not.

14 I think that's something we ought to think about  
15 early in the lives of these two particulars, so that we're  
16 not, to some extent, caught up with the problem we have  
17 about measuring costs of RTOs. The costs of PJM were buried  
18 long ago, so we can't really compare them to MISO's startup  
19 costs, which are doing over five years, what we did over 20  
20 years.

21 Let's start early, so that we've got some  
22 datapoints for comparison. I'm pleased to support it, glad  
23 for the innovation, glad we emphasized the importance of  
24 independence in the MidAmerican, particularly, but think we  
25 have a little more work to be done.

1                   CHAIRMAN KELLIHER: One comment in response to  
2 your comment on acronyms. One possibility is joint  
3 operating entity, and then we could decide it by the JOE  
4 test.

5                   (Laughter.)

6                   CHAIRMAN KELLIHER: Good JOEs and bad JOEs,  
7 really.

8                   COMMISSIONER BROWNELL: Why do I think the die is  
9 cast on this?

10                  COMMISSIONER KELLY: I'm going to vote for it.

11                  COMMISSIONER BROWNELL: You've got to find the t-  
12 shirts, though.

13                  CHAIRMAN KELLIHER: With that?

14                  COMMISSIONER KELLY: Aye.

15                  COMMISSIONER BROWNELL: Aye.

16                  CHAIRMAN KELLIHER: Aye.

17                         Thank you very much. I think we're done here.  
18 I'll see some of you later today. Thank you.

19                         (Whereupon at 11:50 a.m., the open session was  
20 concluded.)

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