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 - MISCELLANEOUS :

CONSENT ENERGY PROJECTS - CERTIFICATES :

DISCUSSION ITEMS :

STRUCK ITEMS :

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909TH COMMISSION MEETING

OPEN MEETING

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

Thursday, October 19, 2006
10:05 a.m.

APPEARANCES:

COMMISSIONERS PRESENT:

CHAIRMAN JOSEPH T. KELLIHER

COMMISSIONER SUEDEEN G. KELLY

COMMISSIONER MARC SPITZER

COMMISSIONER PHILIP MOELLER

COMMISSIONER JON WELLINGHOFF

SECRETARY MAGALIE R. SALAS

ALSO PRESENT:

DAVID L. HOFFMAN, Reporter

P R O C E E D I N G S

(10:05 a.m.)

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

Please join us in the Pledge of Allegiance.

(Pledge of Allegiance recited.)

CHAIRMAN KELLIHER: Before we begin, Commissioner Wellinghoff has an introduction that he wants to make.

COMMISSIONER WELLINGHOFF: I do, Mr. Chairman, thank you. At this time, I'd like to introduce an old, dear friend of mine who I found wandering in the halls this morning.

(Laughter.)

COMMISSIONER WELLINGHOFF: George Kahn is the Executive Director of the Colorado River Commission. I've known George for over ten years. He was a Washington native originally and he headed out for sunnier climes in Las Vegas and worked there for many years, and I just wanted to introduce him.

CHAIRMAN KELLIHER: Anyone else have an introduction they'd like to make?

(No response.)

CHAIRMAN KELLIHER: I want to point out that this is a pretty important meeting. I was reviewing our agenda this morning, and was struck at how substantive it is. We're covering a lot of ground today, and we're going to exercise nearly a full range of the Commission's jurisdiction.

We've got a number of significant natural gas Orders, electricity Orders, and hydro Orders. One thing that's missing is oil pipelines, and I guess I regret we didn't pull out an SFPP case.

(Laughter.)

CHAIRMAN KELLIHER: There's always an SFPP case somewhere at the Commission. If we had done that, we would have been exercising the complete range of our jurisdiction. Still, it's pretty good.

Let me highlight, in particular, some of what we're doing today. We're taking actions to strengthen reliability of the interstate power grid by acting on the proposed reliability standards as well as the ERO budget, and we're implementing important provisions of the Energy Policy Act.

We're maintaining necessary investments in the gas pipeline network; we're improving the coordination of electricity and gas scheduling, as part of assured reliability in the organized markets.

We're approving two utility mergers; we're taking action to strengthen the gas infrastructure by adopting changes to the blanket certificate program, as well as by implementing improved gas coordination and consolidated provisions of the Energy Policy Act.

We're approving a significant hydro settlement that made certain modifications consistent with Commission precedent. Altogether today, we're issuing five Final Rules, today, alone, so that's a pretty substantial amount of work.

Some of the matters we're addressing today have been pending at the Commission for some months. At last count, I saw no strikes since the Sunshine Act Notice was issued last week, so we're still at zero. Great.

I think that speaks very highly of the new Commission. I think it shows the new Commission has an excellent ability to grapple with complicated matters, and to reach resolution quickly, and I think it shows that the transition from the old Commission to the new Commission, has been seamless, and that really speaks very highly of our new colleagues.

That also speaks to our ability to work together, and I think the paucity of dissents shows our recognition of the importance of regulatory certainty, that it's best when the Commission speaks with one voice, and that we speak loudest when we speak with one voice.

It shows how we've created collegiality among the members. We won't always agree; that's one thing that comes with diversity of views. A greater diversity of views will sometimes get differences of views, but I think the performance of the Commission, to date, shows that while we have differences of views, it's for genuine policy reasons and because we're grappling with an issue that doesn't lend itself to compromise in some cases.

So, I just want to again use that Texas expression, brag on our new colleagues, a bit.

Now, altogether, since our last open meeting, we've issued 88 Notational Orders, which, by my math, works out to be more than four a day, every day, since the last meeting.

That's a very high level of work, and I'd praise the Commission Staff, as well as the advisors, for working through the list over the past month.

I want to take a moment to commend the Secretary's Office, the Office of the Secretary. Every month I talk about how many Notational Orders have been issued, and they're not issued effortlessly. It really takes a great deal of work by the Secretary's Office.

The Secretary's Office is very hard-working, very diligent. I think they really showed a lot of character in

July when we were facing a transition of the Commission.

Commissioner Brownell was leaving the Commission, she was no longer casting votes, and we had the arrival of new Commissioners, and it was very important for the Commission to issue the Orders from the July meeting in a timely manner.

The Secretary's Office worked until late that night.

SECRETARY SALAS: 11:30.

CHAIRMAN KELLIHER: Almost until dawn the next day, making sure the Orders that the Commission had approved at the July open meeting, were issued in a timely manner.

Again, that was important, to make sure the Commission's work was seamless. I just want to commend the Secretary's Office.

I understand that there are a number of employees in the Secretary's Office who are present. If they could just stand and be recognized?

(Applause.)

CHAIRMAN KELLIHER: Thank you for keeping us in business in July.

SECRETARY SALAS: Mr. Chairman, on behalf of them, I really appreciate your recognition. Thank you very much.

CHAIRMAN KELLIHER: My colleagues would like to discuss some of the Notational Orders, two of the Notational Orders issued recently; one, we issued yesterday, the Entergy ICT Order; another one, the Chandeleur Order, that Commissioner Moeller would like to discuss. Why don't we start with the ICT? Commissioner Wellinghoff?

COMMISSIONER WELLINGHOFF: I'd be happy to, Mr. Chairman. Actually, I just have a very short comment on that Order.

The Entergy ICT Order is, of course, an Order that provides for an independent corridor transmission for Entergy, but it also contains an issue relating to the legal point that this Commission has been struggling with for a long time, the Mobile-Sierra Doctrine and the application of the public interest standard.

I would just like to indicate that my concurrence in the ICT-Entergy Order lays out in detail my views on the Mobile-Sierra public interest standard, when I believe it should be appropriately applied at the Commission, and under what circumstances.

I would recommend that anybody interested in finding out those views please read my concurrence in that Order. Thanks.

CHAIRMAN KELLIHER: Thanks. Commissioner Kelly?

COMMISSIONER KELLY: I was going to actually take this opportunity to make a lengthy statement about the

Mobile-Sierra Doctrine. It has been a topic of concern, and Entergy ICT Order presents that to us with a new Commission and three new Commissioners.

There has been a lot of discussion over the last several months among the three of us about the Mobile-Sierra standard. I'd like to just talk for five minutes.

So I'd just like to take it from the top. What are we talking about here?

What we're talking about with the Mobile-Sierra standard, is the degree of risk that, after a contract has been accepted by the Commission, the Commission will take action, either on its own, or at the request of a contractual party, or on complaint by a third party to change it.

There's a very narrow point of disagreement among the five of us as to what the law should be regarding that risk. Let me illustrate:

In the unregulated world, the risk that a contract will be changed by a tribunal, I would say, is certainly less than one percent.

In the FERC-regulated world, the risk that a contract will be changed by FERC under the just and reasonable standard, is very small, certainly significantly less than one percent.

In the FERC-regulated world, under the public interest standard, what's the risk that a contract would be changed? Very small, probably a little smaller, certainly, significantly less than one percent.

But in all these situations, there will be -- there is some risk that a contract will be changed, whether you're talking about the unregulated world or the regulated world.

That's nothing new. Historically, what happens, is that the parties recognize that risk and contract around it, and that's worked very well for 70 years in the regulated industries that are subject to FERC's jurisdiction, with no seeming problems, until 2001.

In 2000 and 2001, we had the Enron scandal, we had the California market implosion, and suddenly contract stability became a very big issue, and, not surprisingly. Nor surprisingly, because or reliance on the markets, our reliance on Enron's integrity, our reliance on Enron's ability to help the market, had been so strong, so taken for granted, that we were shocked to the point, frankly, that we still have not yet recovered from that shock.

FERC has, I believe, at all times, behaved responsibly regarding contracts, even under the pressure brought to bear by the Enron scandal, by the market failure, and by the victimized public, and they were rightfully very, very upset about being victims.

FERC upheld the market-based rates contracts that were at issue. FERC upheld it under the public interest standard, which I think was the correct standard, because it was a market-based contract, very much like the contracts first at issue in Mobile and Sierra.

FERC also said that even if it applied the J&R standard, it would have upheld those contracts, so I think that another point that needs to be made strongly, is the history of FERC's deference to contracts, even under the J&R standard, has not changed and has been very great.

I believe, therefore, it's time that the perception of risk allies itself with the reality that the risk is very, very small under the J&R standard.

Nevertheless, I would say that there continues to be a lot of concern, in fact, probably close to hysteria, which I believe to be unwarranted, about this public interest standard debate.

For example, it's almost become sloganeering, that if you pledge your allegiance to the public interest standard, that means, it seems to me, that you're tough on contracts, that you really support contracts and the reliance that occurs with contracts.

However, if you pledge your allegiance to the just and reasonable standards, that means you're soft on contracts, you don't care about contracts.

I'd like to end that dichotomy, because I don't believe that it leads to reasoned decisionmaking.

What we need to talk about, is what's really at issue here. At issue here, is the Commission's responsibility under the Federal Power Act and the Natural Gas Act, to take action under the just and reasonable standard.

In taking that action, the Commission needs to determine what is just and reasonable, and if contractual reliance is part of that, the Commission should take it into account.

The standard of review NOPR, which I dissented from, proposes to change everything.

Instead of going from the Mobile-Sierra Doctrine, which says there are certain kinds of stated rate contracts that require a higher degree of certainty, a slightly higher degree of certainty than the J&R standard. We went with the NOPR to state that all contracts require a higher degree of certainty, and it doesn't matter what kind of contract it is -- almost all contracts.

To me, that presents a problem, because some contracts that parties bargain around deal with things that are very likely to change, deal with things that frankly are subject to our tariff responsibilities. Our tariff responsibilities under the law are to be undertaken under the J&R standard. Changes to the tariff are to be undertaken pursuant to the J&R standard.

We've received contracts at the Commission that have a public interest standard in them and deal with issues that are more appropriately dealt with in the tariff, so there is a conflict that comes to us.

I think our appropriate response to this conflict, is, rather than painting with a broad brush all contracts will be subject to the public interest standard, or they won't be -- which clearly the Supreme Court in Mobile and Sierra did not want all contracts to be subject to the J&R standard, although it wasn't very clear as to what ones, other than stated rate contracts, would be -- I think what's important for the Commission to do, is, to the extent parties want, in advance, more certainty, an increment more of certainty than they get under the J&R standard, that our job should be to ask the parties why and to develop criteria that set out meaningful guidelines as to what kind of contract might get more certainty.

The law around Mobile and Sierra is confused, but the most recent decision issued by the D.C. Circuit, in the Maine Public Utilities case, Maine PUC vs. FERC, issued a few months ago, in that case, the Court said -- the Court upheld the Commission's decision to not agree to a public interest standard, where the transmission owners and the ISO

New England had provided a provision in the contract, governing their exit from ISO New England, and the Court said that FERC was correct in not agreeing to a public interest standard in that contract.

The Court said that the transmission owners agreement that was filed to form ISO New England, is, quote, "a complex agreement establishing a new regional structure impacting all market participants."

The Court said that that kind of contract does not fall into the situation that Mobile and Sierra were designed to guard against, namely, the Court said, where one party to a contract on file with FERC, attempts to effect a unilateral rate change by asking FERC to relieve its obligations under a contract whose terms are no longer favorable to that party, the D.C. Circuit is saying what I say, or perhaps I'm saying what the D.C. Circuit said; that not all contracts should be entitled to extra certainty and it's our responsibility to determine which ones should and which ones shouldn't.

In the Entergy ICT case that we're discussing right now, John concurred and I also concurred, and I concurred in that case, provided that there would be a public interest standard applied to it.

I concurred in that case for a number of reasons, the first being that the Commission undertook a very active review of the contract at issue in that case, and looked at the various provisions that the contracting parties had agreed to.

And FERC said in advance, you know what? Some of these provisions shouldn't be in your contract; they should be in the tariff, or they should be outside of the contract.

But, in effect, FERC said these kinds of provisions need to be able to be modified under the tariff, under the J&R standard, and not ruled by private contract.

So I approve of what we did in this case, in the Entergy ICT case. We undertook an active review. We let the parties know in advance, what would and would not be acceptable to us.

The other reason that I agreed to approving the contract with the public interest standard, is that there was broad participation in this proceeding.

There were many parties involved, including non-signatories to the ICT agreement. None of them objected to the public interest standard, and we undertook to address their concerns about the contract, while we were reviewing the contract.

Then, finally, the contract provided that to the extent it dealt with issues that were governed by the tariff provisions, should the Commission need to change the tariff provisions, the underlying contract would be renegotiated.

So, we didn't set up -- this contract did not set up a battle of who's going to win, if there's a conflict, the Commission, under its tariff responsibilities, or the private parties, under the contract?

For all those reasons, I was very happy to concur in that case, to approve a contract with the public interest standard.

I want to publicly thank the new members of the Commission, who have brought new blood and enabled new debate and new reasoning, and I think that although the five of us still don't agree on what the law should be about the added incremental risk, the added incremental certainty that should be given to contracts, I think we might get there.

Thank you, Mr. Chairman.

CHAIRMAN KELLIHER: Thank you. Colleagues? Commissioner Spitzer?

COMMISSIONER SPITZER: Thank you, Mr. Chairman.

A few preparatory comments, and then I do have a brief statement. I, too, would thank the Commission and Staff for all their hard work in the past few months.

I've very much enjoyed working with my colleagues, and I want to make particular mention of my team of policy advisors, Martin, Louise, Phil, Chris, and Tiffany, for making me appear much brighter than I am.

On this matter, Mobile-Sierra, we have a fascinating, very narrow point of law, and I've enjoyed working with my colleagues and considered their views.

I would say that the point of disagreement, is, indeed, fairly narrow, if you consider the universe of all contracts and the history of the Federal Power Act and the Natural Gas Act.

I guess, in summary, I feel that cases are decided on facts, not on law. That doesn't mean that the legal discussion is not important. I think it is important to signal to the industry and to the consumers of this country, what are our views, so I think this is a worthwhile discussion.

With regard to the specific context of the Western energy crisis, my take on that is a little bit different, I suppose, than Commissioner Kelly's.

I didn't see that as a failure of markets. I saw the Western crisis as a failure of market participants, and, to the extent those failures were criminal, they've been adjudicated by the criminal justice system.

To the extent that the remedy is appropriately civil, there's been the civil system and Congress which responded, in part, by providing this Agency, as well as others, greater authority under the civil law.

But I would point out that in some cases, very severe criminal sanctions were applied to address and remedy the misconduct of the participants in the market, but that doesn't gainsay my general view that markets are appropriate in this sector of the economy.

This statement, then, carefully considered my colleagues' views and my own view of the appropriate law and policy. Again, I thank Commissioners Wellinghoff and Kelly for their thoughtful statements regarding the Mobile-Sierra Doctrine.

This is an opportunity for me to express my own views.

The competing interests to be balanced, are certainty and sanctity of contracts, versus a governmental obligation to assure just and reasonable rates.

I am sensitive to the interpretation of the Federal Power Act and the Natural Gas Act by the appellate courts, as well as the specific facts in each case.

In general terms, however, the reasonable expectations of the parties to a contract, should be respected.

In circumstances of stipulated settlements and bilateral executory contracts, a public interest standard is appropriate between the contracting parties, and appellate precedent informs us that the Commission should also be bound to that standard.

However, that precedent also indicates that the public interest standard, although clearly more rigorous than just and reasonable, is not practically insurmountable.

In the alternative, in instances where there are generic concerns, such as when the agreement broadly implicates interests of non-parties, a just and reasonable standard for this Commission, is appropriate.

I view the Mobile-Sierra Doctrine as an important tool to induce lower and les volatile energy prices. For example, federal and state regulators often advocate that market participants enter into long-term contracts as a means to reduce exposure to price fluctuations.

However, we cannot expect parties to enter into such contracts, if they believe the Commission will easily disrupt their arrangements.

Parties entering into voluntary contracts and those who finance such undertakings, have a reasonable expectation that such agreements will not be lightly disturbed by post hoc buyer's remorse or otherwise.

The fact that we apply the public interest standard, even to the Commission, does not mean that consumers are left unprotected. In fact, the Mobile-Sierra cases themselves, involved attempts by utilities to raise their rates in a manner inconsistent with these contracts.

The application of the public interest standard in those cases, precluded those rate increases. Further, my own experience is evidence that the public standard may advance consumer interests.

The Arizona Commission asserted the public interest standard in a FERC proceeding on a proposed modification to the so-called east-of-California contracts between shippers and El Paso Natural Gas.

Although the FERC ultimately surmounted the public interest standard in that case, the point is that the public interest standard is not simply a tool for sellers to use to protect their contractual expectations.

In sum, I believe that, in appropriate cases, contract certainty and sanctity brought about by application of the public interest standard, works to the benefits of consumers.

For these reasons, I support the standard of review enunciated in the Entergy ICT ruling, and I will vote accordingly.  Thank you.

CHAIRMAN KELLIHER:  Commissioner Moeller?

COMMISSIONER MOELLER:  Mr. Chairman, my views are largely reflected by Commissioner Spitzer.  I better learn to get the mike on first.

I do not believe the public interest standard is practically insurmountable.  We need to encourage long-term contracts and I believe we do that through this ruling.

CHAIRMAN KELLIHER:  Thank you.  I may as well make some comments, as well.

First of all, I do want to indicate that it probably won't surprise people on the outside, that we, over the past two months, have probably spent more time talking about Mobile-Sierra than any other single matter. I don't know if that embarrasses people on the outside.

(Laughter.)

CHAIRMAN KELLIHER: I have really enjoyed the discussion. I know that probably doesn't sound like a very pleasant prospect to people. It's a little abstract at one level, a little arcane at one level, but it's very important and comes up at the Commission in a lot of contexts.

We've had a two-month discussion. It's been very interesting, and really has helped me refine my views on this subject.

Mobile-Sierra comes before the Commission in a number of different ways, but the way it comes in for us in the Entergy ICT Order, is basically the question of to what extent and when does the Commission agree to be bound by the public interest standard, and when parties to a contract or settlement ask us to bound, it's up to the Commission to decide whether or not to be bound.

In the discussion, I have weighed different factors, as my colleagues have indicated some of the factors they have weighed in this discussion, but some of the factors I weighed, were, first of all, what are our statutory duties? That's clearly a paramount consideration.

Secondly, there is the importance of the Supreme Court's decision. The Mobile-Sierra Doctrine was not invented by the Commission; it was invented by the Supreme Court. I think we have to credit them with some deference, particularly what they do in the Mobile-Sierra cases about interpreting the Federal Power Act itself. We have to give them some deference when it comes to statutory interpretation.

We also weighed contract certainty. I think that's something everyone has mentioned. The Commission places great emphasis on contract certainty.

Other factors are: The changes in the public interest standard over time, that has occurred. I think it has changed over time, and, as Commissioner Moeller referenced, it is not nearly insurmountable.

I won't say I disagree with the Supreme Court, but I could disagree with Justice Scalia, at least when he was on the D.C. Circuit. I think that he was wrong.

If it were impossible or insurmountable, we wouldn't have been able to surmount it like we did in El Paso, Northeast Utilities, and other cases.

It can't be impossible, or the Commission has done the impossible, so the other must be true.

Also, in the changes in the nature of agreements and settlements that are presented to the Commission, we're not dealing only with the traditional notion of a bilateral power sales agreement that comes before us, when the buyer and seller ask us to be bound by the public interest standards.

We're actually getting very complicated settlements presented to the Commission, so the fact that the nature of the settlements and the nature of the agreements we're ruling on, has changed, has to be given some weight.

But also the backdrop for our discussions, was the Summer of 2006. We, this past Summer, saw eight records of electricity demand set in eight different regions of the country, in some cases, three records being set in the space of a week.

I think that this Summer was a wakeup call. It shows we have a crying need to increase investment in both generation and transmission.

That's also brought home by the long-term assessment that was just released this past week, looking at a very significant need for investment in generation and transmission the next decade.

Contract certainty, I think, is essential to secure that investment. I think that's something we all recognize.

I think, actually, this would be absolutely the wrong time for the Commission to undermine confidence in contract certainty, and that's not what we're doing today. I think that's something that we all agree on.

The Commission will continue to assure contract certainty.

Now, as Commissioner Kelly indicated, we don't all have the same line on Mobile-Sierra, but I think it's also true and I agree with you, that I think the differences are narrower than they used to be. I think we are talking about, actually, a fairly narrow difference of opinion.

Those differences, when applied to Entergy ICT, resulted in a five to zero decision, so the differences are narrower than they have been in the past.

I don't think we should forget the vehicle that led to this interesting discussion -- the Entergy ICT agreement. That was an innovative agreement. It promises a higher level and improved level of transmission service, and I think that's important.

That agreement raised difficult jurisdictional issues. There were, I think, concerns, legitimate concerns raised by state regulators, that if the Commission had the unfettered discretion to change that agreement over time, we might shift control of the Entergy transmission system somehow, under the ICT.

That's why the public interest standard is part of the ICT agreement.

The ICT agreement is not the only kind of innovative program we're likely to see in coming years. We might see interesting proposals coming out of the RTOs. We want to deal with legitimate jurisdictional issues by state regulators in the RTOs, where they are concerned that an RTO demand response program might trespass on state jurisdiction.

I'm trying to stick with hypotheticals, rather than other pending matters, but if were to see a hypothetical demand response along those lines, I would expect it would come perhaps with a public interest standard of review, in order to protect the jurisdictional concerns of the states, and I think we should give that some credit.

I think we all agree on this Order. We probably won't agree on other Mobile-Sierra cases. It's been a good two months of discussion. We've had somewhat of a backlog develop on pending cases where this arises, and I think we can work through the backlog.

I just want to say that I have been very impressed with the quality of the discussion we've had in the past two months. If we had a CSPAN camera in our meetings, I think people -- we probably could have gotten very high subscription rates for that discussion. I think you would have been impressed with the quality of the debates and deliberations we've had in the past two months on this matter.

I guess we don't need a voted, since we voted yesterday, and we can proceed to the second recent Notational Order, the Chandeleur Order.

COMMISSIONER MOELLER: Thank you, Mr. Chairman. This is a case where an entity came in very late with a tariff waiver.

In the end, it wasn't -- it did not cause harm to customers or to the public, but, in speaking with Staff, it sounds like this is happening on an increasing basis, that entities are coming in very late.

It's one thing, if it's an emergency, but if it's a planned outage or a planned computer upgrade or something of that nature, we'll need a little bit more notice, so that the customers are protected and the Staff can do their jobs.

Especially as we focus more on reliability, as we will later today, I think this is something that needs a little more attention.

Finally, it kind of goes with my philosophy toward policymaking and regulation, that if we have a regulation or a policy with tariff items that are outdated, I'd like to hear about them, so we can change them when we update things.

A lot of what we're doing, bringing up OATT reform ten years later, let's look back and see what's working.

In this case, we had an entity that was not timely, but I still concur.

CHAIRMAN KELLIHER: I want to thank Commissioner Moeller for bringing this issue up, because I think it's a legitimate matter, and it's true that the Commission, in the past, has been very lenient on tariff waiver requests.

We have generally granted late requests. Sometimes we grant requests after the fact.

One reason that the Commission has been lenient on tariff waiver requests, is that we lacked civil penalty authority. We have no ability to impose civil penalties in the event of a tariff violation that resulted from a late waiver request.

That, of course, has been corrected by the Energy Policy Act, and I want to be clear about what I'm not saying: I'm not saying we won't grant tariff waiver requests, such as those presented in the Chandeleur.

I think we are saying -- Commissioner Moeller is saying, and I'm agreeing with him that natural gas companies should make timely requests for tariff waivers that allow for notice and comment.

If they make late requests, the burden is on the company to demonstrate why they could not have made a timely request.

A lot of tariff waiver requests deal with minor matters. Sometimes, though, they follow in the wake of an emergency such as last year.

We saw a lot of tariff waiver requests after the hurricanes, and sometimes in that context, a late waiver request is understandable and quick Commission action is necessary.

But a tariff waiver request about significant matters and the waiver request is late, but then the company does run the risk, if we don't grant the waiver, they will have violated their tariff and there would be the possibility of civil penalties that attach to those violations.

So I think the message is, make timely requests, and if you make a late requests, fully explain why you could not have made a timely request and don't assume that a late tariff waiver request is going to be reviewed and granted by the Commission, going forward. We may not be so lenient in the future.

I just want to thank Commission Moeller for bringing this up. Any other comments on Chandeleur?

(No response.)

CHAIRMAN KELLIHER: Madam Secretary, let's turn to the consent agenda.

SECRETARY SALAS: Mr. Chairman and Commissioners, your consent agenda for this morning, is as follows: Electric Items - E-3, 4, 5, 6, 7, 8, 10, 11, 12, 13, 14, 15, 16, 17, 18, 20, 21, 22, 23, 24, 25, 26, 27, and 28.

Miscellaneous Items: M-1, 2, and 3.

Certificates: H-2, 3, 4, 5, and 6.

As required by law, Commissioner Moeller is not participating in the following consent items: E-3, E-23, and E-27. As to E-28, Commissioner Wellinghoff is dissenting, in part, with a separate statement.

Now we will proceed to vote. Commissioner Wellinghoff?

COMMISSIONER WELLINGHOFF: I vote aye, with the notation of my partial dissent in E-28.

SECRETARY SALAS: Commissioner Moeller?

COMMISSIONER MOELLER: Aye.

SECRETARY SALAS: Commissioner Spitzer?

COMMISSIONER SPITZER: Aye.

SECRETARY SALAS: Commissioner Kelly?

COMMISSIONER KELLY: Aye.

SECRETARY SALAS: Mr. Chairman?

CHAIRMAN KELLIHER: Aye.

SECRETARY SALAS: The first item for discussion this morning is A-3, the Energy Market Update. It is a presentation by Steve Harvey and Jeff Wright.

MR. HARVEY: Good morning, Mr. Chairman and Commissioners. Today I'm pleased to present the Office of Enforcement's Winter 2006-2007 Energy Market Assessment.

After I'm finished, I'll turn over the presentation to Jeff Wright of the Office of Energy Projects, to discuss natural gas infrastructure issues.

The Winter Assessment is designed to share our opinions about those markets that the Staff of the Division of Energy Market Oversight will be watching most carefully through the Winter.

Even so, the issues I present today, are certainly not the only ones that we'll be watching.

The prospects for this Winter, look as good as they have for some time. Current spot prices are relatively low, certainly at their lowest levels since last year's hurricanes.

These lower spot prices reflect strong storage inventories across a whole set of fuels, particularly natural gas. In addition, as of now, most predictions for Winter weather are mild.

These conditions exist, despite increased natural gas use last Summer due to heat and fuel switching away from oil.

While Staff does not predict prices, the current conditions for natural gas, indicate that the system has significant flexibility to deal with most challenges that might arise throughout the Winter.

(Slide.)

MR. HARVEY: Current natural gas prices are low, compared to the last couple of years. The graph shows a longer-term view of next-day spot natural gas prices, as traded at Henry Hub, Louisiana, on the Intercontinental Exchange.

We've labeled the two price peaks, and the narrow one on the left, in February 2003, was due to a late cold front when storage was low; and the more extended peaks to the right, occurred during the period after last year's Hurricanes Katrina and Rita.

Since then, spot prices have generally fallen. A short peak of over $8.50 per million British Thermal Units or MmBtu, labeled with a red arrowhead, occurred in early August, during one of last Summer's widespread heat waves.

That was characterized by significant increases in natural gas use in electric generation.

The most recent low price was for natural gas delivered the first weekend this month, when prices at Henry Hub fell to $3.66 per MmBtu.

That brief drop brought prices to their lowest level in four years.

As of the middle of this week, prices have risen back to above $6 per MmBtu, this morning, around $6.70. This week's rise is due to several factors, including stronger than normal demand due to early cool weather in the Midwest; continued incentives for storage injections, and fuel-switching that I will discuss later.

In addition, given tight storage conditions, day-to-day prices have become volatile with drops across weekends, associated with lower demand and increases during he week.

Most likely over the next few weeks, prices will remain volatile, but still relatively low.

(Slide.)

MR. HARVEY: The most significant single factor in the recent low prices of natural gas, is extremely high storage levels. This morning's report of working gas inventories in storage of 3,442 billion cubic feet or Bcf, is a recent record, well above storage levels over the past decade.

The red line on this graph, compares this year with the previous five storage injection and withdrawal cycles and shows how much higher last week's U.S. storage level is. We don't have this morning's, which came out about 25 minutes ago.

With three or four weeks of injections remaining this year, we will likely see inventories surpass their all-time high of 3,472 Bcf, recorded at the end of November, 1990, and, in fact, today's report brings us within one percent of that all-time high.

This high level of storage began with the very low withdrawals last Winter, due to record mild weather. This early 2006 surplus was sustained, despite a Summer when natural gas was used in unprecedented amounts to generate electricity during several geographically disbursed heatwaves.

In fact, the Energy Information Administration's report of 786.5 billion cubic feet of gas burned to generate electricity in the United States in July 2006, was the highest monthly delivery for that use over the past five years.

As a result of these heatwaves, the National Oceanic and Atmospheric Administration indicated that July was the second warmest since 1895, while August was the 11th warmest.

The resulting use of natural gas to generate electricity, is reflected on the graph in the dip in injections in July and August, including two weeks of rare Summer withdrawals to meet electric generation demands.

(Slide.)

MR. HARVEY: One factor in the increased use of natural gas in electric generation, has been its relative attractiveness, versus competing fuels.

Gas has not generally become competitive with coal, but certainly has with oil. This graph of competing fuel prices in New York since 2003, shows the historical relationship of gas and various oil prices.

In general, natural gas prices, in red on this graph, remain between heating oil, in green, and low-sulfur residual fuel oil, in teal.

The exceptions in the past few years, have occurred during short periods of extreme cold in the Northeast in January of 2003, 2004, and 2005.

The peak in February 2003, was due to high national prices. This historical relationship broke down in early March and New York natural gas prices have remained below low-sulfur resid since, with a brief exception in the Summer peak price I discussed earlier.

This is the longest sustained period of lower gas at resid prices, that we've seen in many years. Consistent with that relationship, we've seen switching from oil, particularly noticeable in New York and in Florida.

Currently, swap markets do not indicate that market participants believe this relationship will last into the Winter, and indicate higher gas prices relative to oil.

(Slide.)

MR. HARVEY: Whether it is likely to be the most important determinant in this price relationship, any sustained increase in spot gas prices that this point, would likely be due to weather.

The most current NOAA forecast for the Winter, is almost a month old, but I show it to observe that forecasts still tend to indicate mild expectations for the Winter.

This forecast for December 2006 through February 2007, shows widespread above-normal temperatures from across the West and East into New England and New York.

Outside that area, forecasts are closer to normal. Nowhere on the continental United States, is the weather indicated to be below normal.

More recent forecasts seem to indicate closer to seasonal weather. One forecaster even recently released an assessment of colder-than-normal Winter, though others did not follow.

No one currently expects the Winter to be as warm as last year.

(Slide.)

MR. HARVEY: If we attempt to assess market expectations for the Winter of 2006-2007, using futures prices, we see the recent moderation in prices extended into the Winter, as well.

The blue line on this graph is the average futures price of November 2006 through March 2007 contracts.

Through early 2005 and into the hurricanes, prices increased from a little over $6 per MmBtu, to over $10 per MmBtu. Only more recently have prices fallen significantly, briefly dropping to under $7 per MmBtu a few weeks ago, and rising even more recently to around $8.

This drop appears to reflect a reassessment for the prospects for Winter prices. I would note that this is the drop in futures prices that finished off hedge fund Amaranth advisors.

We've also graphed the open interest in the futures market for the same period, using gray columns. I would note that despite Amaranth's loss and subsequent sale of its natural gas positions, activity in the futures market related to this time period, has remained fairly stable at record levels, not decreased.

To some degree, that level of interest may be seasonal. Still, despite a spectacular failure by an active participant in financial natural gas markets, Winter positions remain significant.

I should note that the wholesale price decreases I've discussed here today, will not be fully reflected in retail prices this Winter. Distribution companies will use gas in storage that was injected at higher average prices than we see today, and will receive gas purchased under longer-term contracts.

These activities protect reliability and moderate retail price volatility.  In a falling market, however, they do moderate price decreases.

Distributors should not be discouraged from using these important purchasing tools, simply because of higher retail prices over the short term.

Altogether, conditions faced by U.S. natural gas markets at the end onset of the Winter, appear to be stronger than in recent years, reflecting continued strong storage levels and forecast mild weather.

Weather might force prices up through the Winter, but weather is still expected to be relatively mild.

Oversight Staff will continue to watch these areas throughout the Winter on every trading day, and report back to you, as needed.  Jeff?

MR. WRIGHT:  Thank you, Steve.

(Slide.)

MR. WRIGHT:  Good morning, Mr. Chairman and Commissioners.  This morning I would like to take a brief look at the natural gas infrastructure -- pipelines, storage, and LNG terminals -- that the Commission has approved in recent years, and also what projects are before the Commission and what projects may be expected in the not-too-distant future.

(Slide.)

MR. WRIGHT: This slides gives a summary of the pipeline facilities the Commission has approved from the beginning of 2000 until the present.

These approvals total 58 billion cubic feet per day of pipeline capacity, over 9200 miles of pipeline, and about 2.3 million horsepower of compression at an estimated cost of approximately $17 billion.

(Slide.)

MR. WRIGHT: Here I've taken the information on capacity and mileage from the last slide, to show how, over the last few years, there's been a dramatic change in the amount of capacity approved vis a vis the amount of mileage approved.

This may be attributed to the different purposes of the facilities. Approvals in the first few years of this decade, can be characterized as typical; that is, new, long-line pipelines or additions to existing pipelines.

But in recent years, we've seen a rise in high-capacity, short-mileage pipelines, associated with proposed LNG terminals.

(Slide.)

MR. WRIGHT: There are currently numerous projects before the Commission, totalling 18 billion cubic feet per day of capacity and nearly 2,000 miles of pipeline.

The trend appears that while there are pipeline projects delegated to LNG projects, approximately 50 percent of capacity, there are more projects popping up to transport North American production.

I note the Rockies Express, west from the Rockies to Missouri, and the Empire Connector and Millennium Pipeline bringing gas to the Northeast.

In our prefiling category, those cases that are beginning their environmental review, trying prior to making a formal filing with the Commission, the tide is truly changing.

(Slide.)

MR. WRIGHT: Out of 12.2 billion cubic feet per day of capacity and nearly 2400 miles of pipeline, only one Bcf of capacity and 223 miles of pipe is associated with LNG.

One major project in prefiling, is an extension of the Rockies Express West, what is called the Rockies Express East that will extend from Missouri through Ohio.

There are also projects seeking to transport more of the Barnett Shale gas out of Texas, to interconnections with interstate pipelines in the Southeast.

(Slide.)

MR. WRIGHT: Taking a quick look at potential projects that may be filed within the next couple of years, we see the possibility for over 15 billion cubic feet per day of capacity and nearly 7,000 miles of pipeline.

None of these potential projects are directly related to LNG terminals. I do note these totals contain an amount for the transportation of Alaskan North Slope gas due to the Lower 48, being currently in a state of flux due to the lack of approved contracts between the State of Alaska and potential transporter or transporters.

Otherwise, it appears we can expect much pipeline activity in the Southeast in the future.

(Slide.)

MR. WRIGHT: Changing the focus to storage, I would note that since 2000, the Commission has approved 275 billion cubic feet of storage capacity and daily delivery from storage of 14.6 billion cubic feet.

Storage proposals, especially in recent years, have centered around the Southeast's Gulf Coast area, where high-delivery salt formations can be utilized to store regasified LNG, in addition to traditional gas production from this region.

(Slide.)

MR. WRIGHT: The Commission has two storage projects pending, one in Michigan and one in Alabama, totalling 79.2 billion cubic feet of capacity and 1.8

billion cubic feet per day of deliverability.

Down the road, we see the potential for projects totalling about 125 billion cubic feet per day of capacity and over four billion cubic feet per day of deliverability.

The majority of these projects appear to be located in the Southeast and the Northeast. What is notable, is the lack of prospective storage development in the Western United States.

(Slide.)

MR. WRIGHT: Looking now at LNG development, we see that since the advent of the Hackberry Policy in December 2002, the Commission has approved 11 new terminal sites. All, except for one, are located on the Gulf Coast.

The total sendout of the approved terminals, is 20.6 billion cubic feet per day. In addition, the Commission has approved an expansion at Dominion's existing Cove Point, Maryland, terminal, as well as expansions in the approved, but yet to be built Freeport and Sabine Pass terminals, which total 4.7 billion cubic feet per day in sendout capacity.

The total approved sendout capacity is in excess of 25 billion cubic feet per day.

(Slide.)

MR. WRIGHT: The Commission is currently processing applications for ten new LNG terminal sites, with a combined redelivery capacity of 9.5 billion cubic feet per day. Additionally, there are expansions proposed at Southern LNG's existing Elba Island terminal and at the approved Cameron LNG terminal, totalling another 2.1 billion cubic feet per day of deliverability.

All told, there's a combine 11.6 billion cubic feet per day under analysis at the Commission.

On the horizon, we see the potential for nine more onshore and offshore sites in the preliminary planning stages, with a combined sendout of about 6.5 Bcf per day.

(Slide.)

MR. WRIGHT: In conclusion, I would note that so far in 2006, we've seen pipeline projects actually go into service with a combined capacity of 3.3 billion cubic feet per day; three storage projects that commenced service this year, with a combined capacity of over 32 billion cubic feet; and about a half Bcf per day of deliverability.

Expansions at two LNG terminals, Elba Island and Trunkline LNG's Lake Charles facility, went into service this year, offering a combined additional sendout of 1.1 billion cubic feet per day.

There's also a new pipeline put into service, dedicated to transporting up to 1.5 billion cubic feet per day from the Lake Charles facility.

This concludes my portion of the presentation.

Steve and I will be happy to answer any questions that you may have.

CHAIRMAN KELLIHER: Colleagues, any questions? Phil?

COMMISSIONER MOELLER: Steve, you talked about the Southern Henry Hub. How about the rest?

MR. HARVEY: It's been an interesting year for the relationship of prices at Henry Hub. We tend to go to Henry Hub. That's cited as a national price.

Coming out of the hurricanes about a year ago, Henry Hub and the East Coast prices came up relative to Western prices. There was a fairly significant differential and that made some sense, because most of the disrupted productive capability was pointing to the East Coast from those hurricanes.

That differential came back again and sort of disappeared, particularly as we got into the Summer, and it really hasn't -- it has not disappeared and come back to the historical relationships.

In effect, what we've seen, really, through the Summer, has been into the West Coast, sort of traditional relationships with the Rockies, with prices actually dropping lower relative to Henry Hub.

Then we've necessarily seen recently, and as we've gone into the Fall or the late Summer, certain times, particularly on weekends, when there's just no work with that Rockies gas to go. There have been really quite substantial drops relative to Henry Hub.

In mid-September, due to some pipeline outages, we actually saw Rockies prices below $2, which is something we hadn't seen in many, many years.

So those relationships are important ones for us. We want to track them very carefully, and those of the pipelines around that, but we have kind of come back to a more normal set of relationships than a year ago, I would have been able to tell you.

COMMISSIONER MOELLER: One followup question: What do the futures markets show?

MR. HARVEY: It's interesting. Winter futures right now, average futures like I showed in the one graph, are, on average, about the same as next Summer on the futures market.

Then what we actually see, is a high Winter, and a term used in futures markets called "backwardation," prices actually dropping through time year-after-year. It sort of underscores how not normal current conditions are, these relationships to oil prices and very, very high storage prices, and probably shows some assumption that when those things get worked out of the system, prices will tend to be a little bit higher, but with an interesting dropoff over time.

COMMISSIONER MOELLER: Thank you.

CHAIRMAN KELLIHER: I have a few questions. Anyone who wants to ask questions, can ask them.

One question for Steve: I'm not asking you to quantify this, but there was some analysis earlier in the Summer, that because of a gas storage inventory, that some domestic production might be shut in. Is there any evidence that there's been shut-in of some magnitude?

MR. HARVEY: It's very hard to track. We do have some visibility into that, looking at flows on pipeline systems. We've been looking at that a little bit this morning, to kind of see, even the recent price movements.

There is no large-scale evidence of that, and, in fact, in many ways, production has come back to some degree in the Gulf, production has increased, based on some of the more recent drilling.

Interestingly enough, even in the last week, we've seen a little bit lower production levels. We don't know, but that might be related to shut-ins, but certainly not much in the way of large organized production shut-in response to the price levels.

CHAIRMAN KELLIHER: I had a couple of questions for Jeff, on your storage slides. You refer to potential for projects built at 125 Bcf. There's been some expressed business interest on those projects that total that amount? It's not a physical assessment that there's 125 Bcf of physical storage capacity? It's tracking some express business interest?

MR. WRIGHT: You are correct.

(Laughter.)

MR. WRIGHT: We do track what's happening in trade journals and the meetings we have, but it's not a physical estimate of capacity; it's actually a business estimate in developing that amount.

CHAIRMAN KELLIHER: Tracking announcements of interest in certain pipelines. And when you say that these potentials are located in Southeast and Northeast gas tracking expressions, they're not expressing physical capacity?

MR. WRIGHT: Exactly. I would like to note one thing on my slide. The Commission has approved the siting of 11 terminals; nine are in the Southeast Gulf Coast area; two are in the Northeast.

CHAIRMAN KELLIHER: Colleagues, any questions?

COMMISSIONER KELLY: I was going to mention that the Energy Information Agency also put out a report on storage this week. I would assume that we helped them with the data that they needed for that storage report, or did they gather it independently?

MR. WRIGHT: They gather it somewhat independently. They do call us for information, but they subscribe to several other databases and do digging on their own to accumulate that information, so it's not a joint product, necessarily, but we contribute somewhat to it.

COMMISSIONER KELLY: I had read the report in the trade press on the report. Do we basically -- is there any significant findings there that we disagree with?

MR. WRIGHT: I just got hold of it last night. I looked at some of the numbers, and I don't see anything too far out of line in terms of their totals.

COMMISSIONER KELLY: Their conclusions seem to be very positive, just as ours seem to be.

MR. WRIGHT: Yes.

COMMISSIONER KELLY: One thing they noted, that I thought was interesting and I was wondering if you agree, that daily gas deliverability, they predict will rise by 11 percent or 9.5 Bcf per day by the end of 2008, despite only a five-percent increase in capacity.

MR. WRIGHT: That's possible, because of the development of salt formations, which are high deliverability, traditionally. I'm digging into the recesses of my mind and about 70 percent of our capacity is traditional depleted production fields, which are notably high-capacity, low-deliverability.

However, as you go into a salt dome formation, which a lot of people prefer, because they can turn that capacity over maybe up to ten times per heating season, that's where you could come out with actual greater increase in your deliverability vis a vis you increase in capacity.

COMMISSIONER KELLY: They also mentioned that the biggest roadblock to the development of new storage projects, are environmental considerations, public opposition, and customer creditworthiness.

I was wondering if our creditworthiness rules apply to gas storage.

MR. WRIGHT: In terms of signing contracts -- and if OMER wants to jump in at all, that's fine -- customers have to qualify under creditworthiness standards, to sign those contracts, so, yes, creditworthiness standards would apply.

COMMISSIONER KELLY: Have we seen any creditworthiness problems?

MR. WRIGHT: Personally, I don't deal with it on a day-to-day basis. I don't know if anyone else has anything to say.

MR. CANNON: I'm not aware of any, Commissioner, but we can certainly check.

COMMISSIONER KELLY: Probably if there are big ones they would have come to our attention. Jeff, do we approve all gas storage projects?

MR. WRIGHT: No. There are non-jurisdictional projects. I think that if you look in that report, the raw numbers all say, just offhand, about 75 percent is FERC-jurisdictional; 25 percent is non-jurisdictional.

COMMISSIONER KELLY: They're approved by the states?

MR. WRIGHT: Generally, it would be approved by the states.

COMMISSIONER KELLY: Thanks.

CHAIRMAN KELLIHER: Any other comments?

(No response.)

CHAIRMAN KELLIHER: I want to thank Staff for the presentation. It was very helpful. There's good information there. Why don't we proceed with the discussion?

SECRETARY SALAS: The next item for discussion is E-1, Mandatory Reliability Standards for the Bulk Power System, a presentation by Bob Snow, Jonathan First, Kumar Agarwal, and Todd Mullins.

MR. SNOW: Good morning, Mr. Chairman and Commissioners. My name is Bob Snow and I'm with the Division of Reliability of the Office of Energy Markets and Reliability.

Joining me at the table this morning, are

Jonathan First of the Office of General Counsel, and Co-leader of the Reliability Standards Team; Kumar Agarwal of the Office of Energy Markets and Reliability, and at the other end, Todd Mullins, of the Office of Enforcement.

Other members of the Team include: Carol Johnson, Paul Silverman, Yaisa Strickland, Christy Walsh, Syed Ahmad, Jan Bargen, Romulo Barreno, Emily Bartholomew, Sedina Eric, William Longenecker, Richard Mabry, Frank Macedo, Chris Mak, Partha Malvadkar, David Miller, Keith O'Neal, Michael Peters, Cynthia Pointer, and Jerry Taylor of the Office of Energy Markets and Reliability; Mark Higgins, Kristin McKeown, and Roger Morie, of the Office of Enforcement; Mike Miller of the Office of the Executive Director.

E-1 is a Draft Notice of Proposed Rulemaking or NOPR that addresses 107 reliability standards, a glossary of terms used in the standards, and eight regional differences from the standards, as proposed by the North American Electric Reliability Council, NERC, in its role as the electric reliability organization or ERO.

In accordance with the Energy Policy Act of 2005, the Commission must review and approve reliability standards proposed by the ERO, before they can become mandatory and enforceable under Section 215 of the Federal Power Act.

Given the complexities associated with the utility industry's transition from voluntary reliability standards to a new federal regime of mandatory standards, the large industry support for most of the standards and the Commission's desire to have the standards mandatory and enforceable for the next peak-load season, the NOPR proposes to approve 83 of the 107 reliability standards and the glossary of terms and not remand any standards.

The Commission recognizes the complexities associated with moving from voluntary to mandatory reliability standards and the importance of making the standards enforceable in an expedited timeframe.

These unprecedented factors, combined with the Commission's granting due weight to the technical expertise of the ERO, which attested to the adequacy of the standards, contributed to the proposed approval of the reliability standards.

In taking this approach, we believe that the responsibility for the technical adequacy of the proposed reliability standards, falls squarely on the ERO.

As a separate action, using our authority under Section 215(d)(5), the NOPR calls for some modifications to 62 of the 83 standards to implement remaining recommendations in the U.S./Canada Power System Blackout Report, or to address various concerns about ambiguities and inconsistent interpretations, technical adequacy, and measures of levels of noncompliance.

Finally, the draft NOPR proposes to leave pending at the Commission, the 24 remaining standards. Many of these are so-called fill-in-the-blanks standards, which require the addition of important regional reliability criteria, before the Commission can assess their effectiveness.

Others are the vestiges of the voluntary reliability standard regime, and, as such, do not limit their applicability to users, owners, or operators of the bulk power system, as required by Section 215 of the Federal Power Act.

Instead of remanding these standards, however, the NOPR would recognize their present level of enforceability as good utility practice for utilities with open access transmission tariffs, or as mandatory standards in certain states.

Notably, the NOPR proposes to resolve three significant issues identified in industry comments and in the Staff preliminary assessment: First, the industry and the standards generally define the nation's transmission system as a bulk electric system consisting of network facilities of 100,000 volts or higher.

However, since the EPAct more broadly defines the nation's transmission system as the bulk power system to exclude only local distribution facilities, the NOPR proposes that during the time of transition, the Commission approve these reliability standards that apply to the subset bulk electric system.

The intent is for the ERO to begin the process of developing standards that apply to the broader bulk power system.

Second, the NOPR proposes to interpret the user of the bulk power system on a standard-specific basis that depends upon the reliability objective of the relevant standard.  For instance, cybersecurity standards are likely to apply to both the small and large entities, as they are needed to protect the integrity of the bulk power system.

Third, the NOPR proposes that the Commission, the ERO, and the regional entities, could, as a transition mechanism, use their discretion in imposing penalties on violators that have not historically participated in the voluntary system of standards.  Thank you.

CHAIRMAN KELLIHER: Thank you very much. Today the Commission takes an important step towards assuring reliability of the bulk power system by proposing to adopt 83 of the reliability standards proposed by the North American Electric Reliability Counsel or the ERO. We propose to make these standards enforceable because we find they meet the statutory tests and we think our action today is consistent with our stated desire to have suite of reliability standards in place before the Summer of 2007.

As staff has indicated, our approach really has been very careful and deliberate. We gave due weight to the technical expertise of the ERO in our review of the standards. We developed an extensive record on the standards. We directed the staff to do a constructive review of the standards, which resulted in the May preliminary assessment. We also held a technical conference on the proposed standards this summer. So we've been very careful and deliberate in our approach. We've also resisted the temptation to let the perfect be the enemy of the good. We found the proposed reliability standards meet the statutory test. We also found that they can be stronger, but we propose to improve them over time. And in the proposed rule, we served notice of our intent to invoke our authority under Section 215(d)(5) of the Federal Power Act to direct the ERO to improve 62 of the reliability standards that we propose to approve in the NOPR.

We would act on that intent once their standards are finalized. The way Section 215(d)(5) works. we can direct the ERO to improve standards, but we can only direct them to improve approved standards. We're, in fact, announcing our intent to invoke 215(d)(5) later on once the reliability standards are approved. I think that whole approach is exactly the right policy. We're committed to getting a good number of reliability standards in place before the Summer of 2007. We're not letting the perfect be the enemy of the good. We're going to improve reliability standards over time. I think that's exactly what we should do at this point when we're transitioning from a regime of voluntary standards to enforcement standards. So we're commitment to continuous improvement of the standards over time and we will work the ERO to make sure that improvements are made in a timely manner.

Now there are there essential elements to a strong reliability regime. We took one step this summer when we approved the ERO. That's the first step. We've already taken it this past July. We're taking the second step today by proposing to improve a large number of reliability standards. The third step will be the regional enforcement of reliability standards once approved and I think developing a strong and consistent regime of enforcement of good reliability standards may be the greatest challenge of the three steps we have take. That one is still before us. Hopefully, we'll take it in due course, but we're taking the second big step today towards establishing a strong reliability regime. And we, of course, will consult with our Canadian and Mexican colleagues on the proposed rule and make sure that we work together with them on both the establishment and enforcement of reliability standards.

With that, I'd like to turn to any of my colleagues.

Jon?

COMMISSIONER WELLINGHOFF: Thank you, Mr. Chairman.

First of all, I'd like to commend your team and all the staff that worked on your team on these reliability standards. They're so important. They've done a wonderful job. I would also like to note that this proposed rulemaking, the Commission, I believe, has recognizing the importance of fully integrated demand response and maintaining reliability in our bulk power system, specifically, we're proposing to include demand response as first a resource for complying with reliability standards for continuous reserve power. Secondly, to eliminate a balancing authority to bring it into compliance in emergencies and the third factor is to define critical system conditions planning to rely on the bulk power system. I think these proposals are consistent with the recommendations of the Blackout Report and our responsibilities under the 2005 EPAct.

Further, I think these proposals, together with the others we've made today, will improve the reliability standards once the standards are finalized. I look forward to comments on this subject.

CHAIRMAN KELLIHER: Thank you.

Marc?

COMMISSIONER SPITZER: Thank you, Mr. Chairman.

The Congress and the American people recognize the critical necessity of a reliable power system. I applaud and thank the Chairman for his leadership of the Commission staff of these reliability standards. I look forward to further efforts to enforce the reliability mandate of uniform standards while accommodating regional variances within the bulk power system and will call for attention to the record and careful balancing of competing interests in this report. Thank you.

CHAIRMAN KELLIHER: Commissioner Moeller?

COMMISSIONER MOELLER: Thank you, Mr. Chairman.

I, too, commend the team. A large number of people in the industry who have worked on this -- some of us have been working on this in one capacity or another since probably '98 when the first legislation was drafted, so we have a personal story involved in this. But it is of most importance a lot of work has been done, I hope there's still a sense of urgency to make sure that we can deliver all three parts of this by next summer.

CHAIRMAN KELLIHER: Thanks.

Commissioner Kelly?

COMMISSIONER KELLY: I would agree with you, Joe, that one of the most aspects of the decision today is to encourage or order NERC to come back to us with improved standards in a variety of areas. I'm also very pleased that we didn't have to remand anything. One of the concerns, as we moved from voluntary to mandatory, was that we would, in attempting to deal with the difficult task of setting a mandatory standard, that it would devolve to the lowest common denominator and I think this rule sends the message that that's now what we intended to happen and in deed, that won't happen. Of course, we have to deal with the status quo. So we have to start with the status quo and think we've done a good job of doing that here. But we don't want the status quo to rule in the future.

Then finally, I'd like to add my thanks and praise to the team for their painstaking review that they undertook of those standards and I'm very pleased with the product.

CHAIRMAN KELLIHER: I just want to add my compliments to the staff. It's an excellent order, very well done and the quality of the review is evident in the order itself.

With that, any other comments?

(No response.)

CHAIRMAN KELLIHER: Let's vote.

SECRETARY SALAS: It's a procedural vote. Commissioner Wellinghoff?

COMMISSIONER WELLINGHOFF: I vote aye.

COMMISSIONER MOELLER: Aye.

COMMISSIONER SPITZER: Aye.

COMMISSIONER KELLY: Aye.

CHAIRMAN KELLIHER: Aye.

SECRETARY SALAS: The next item for discussion is G1. This is Kern River Gas Transmission Company. It is a presentation by Carl Urquhart, Richard Howe, Russell Mamone, and Robert Petrocelli.

MR. URQUHART: Good morning, Mr. Chairman and Commissioners. My name is Carl Urquhart. I would like to recognize the rest of the team working on the Kern River -- Andrew Lyon, Mickey Kim, Robert McLaine, Lynn Liechtenstein, John Robertson, John Carlton, Elizabeth Zerby, Candance Dunn, Kenneth Lise and David Lingifelder.

The draft order in G1 addresses a March 2006 initial decision in the Section 4 rate case of Kern River Gas Transmission Company. The gas order generally affirms the judge's initial decision, but reverses of findings on three issues including return on equity.

In the return on equity issue, the draft order finds that Kern River's return on equity should be 11.2 percent rather than the 9.34 percent adopted by the judge. The judge adopted a six-company proxy group based on the Value Line investment survey list of diversified natural gas companies with Commission-regulated pipelines. The draft order agrees that those companies provide the best starting point for determining the proxy group in this case. However, the draft order finds that the judge should have excluded two companies -- El Paso and Williams -- because of their financial circumstances made them inappropriate for inclusion in the proxy group.

The draft order also finds that on this record Kern River has not met its burden to support inclusion of Master Limited Partnership in the proxy group, but makes clears that the Commission is not making a generic finding. MLPs cannot be considered for future proxy groups if a proper showing is made. Since the revised proxy group adopted in the draft order is small and includes companies with a relatively low proportion of pipeline business and substantial distribution operations, the draft order approves a 50 bases point adjustment above the median to reach the 11.2 percent return on equity for Kern River. This approach accounts for the differences in risk between Kern River and the proxy group companies.

The draft order generally affirms the judge on all other issues. However, the draft order does reverse the judge's denial of a corporate income tax allowance and the judge's rejection of Kern River's proposal to use a weighed average cost of debt in designing rates for all groups of shippers on its system. Thank you.

The staff is prepared to answer any questions you might have.

CHAIRMAN KELLIHER: Thanks very much.

I want to thank the staff for this order. This order is very long, but it's actually as much of a pleasure to read as you can expect.

(Laughter.)

CHAIRMAN KELLIHER: I didn't want to go over the top.

(Laughter.)

CHAIRMAN KELLIHER: Perhaps the Commission's most important responsibility with respect to the regulation of interstate natural gas pipelines is protecting shipper routes by setting rates that are just and reasonable. A just and reasonable rate is a rate that reflects the risks that face interstate pipelines and gives them an opportunity to earn a reasonable profit. If we do our job well, shippers are protected against exploitation. Also, if we do our job well, pipelines will continue to invest in expansion of the interstate pipeline network.

In recent years, as we heard from the discussion this morning, the Commission has authorized over 9300 miles of interstate natural gas pipelines. Our actions have gone far towards developing a robust natural gas pipeline network, a network that serves both shippers and the nation well. This is important order. The initial decision attracted substantial attention when it was issued a few months ago. Many took it as a sign that the Commission may be considering a fundamental change in policy. One that offers fewer incentives to investing expansions of the natural gas pipeline network. Our order generally affirms the decision that reversal ALJ's findings on three issues, namely, return on equity, corporate income allowance and weighed average cost debt in designating rates.

With respect to the return on equity, our order sets the average at 11.2 percent rather than the 9.34 percent adopted by the ALJ. The calculation of pipeline rates has certainly been made more difficult by some of the changes that have occurred and are occurring within the pipeline industry, including the consolidation of pipelines, the integration of pipelines into other businesses and the adoption of the Master Limited Partnership structure by a growing number of pipelines.

As a result of these changes, there are relatively few pipelines that meet our historical test and for purposes of the discounted cashflow methodology, we are required to include companies in the proxy group that are not pure pipelines making the necessary and appropriate adjustments.

In short, the Commission has been adjusting its rate-making polices to reflect dynamic changes that have occurred and are still occurring in the pipeline sector. Our order shows that the Commission remains dedicated to protecting shippers, but recognizes the need to develop a strong interstate natural gas pipeline network.

With that, I'd like to recognize any of my colleagues.

Commissioner Spitzer?

COMMISSIONER SPITZER: Thank you, Mr. Chairman.

I did deal with the Master Limited Partner the need to be addressed the other day. I'm not going to read it, the subsection code of the Internal Revenue Code has never been associated with pleasure, so I think we need to dispense with that and I'll just briefly summarize.

I support the results achieved in the order in balancing competing interests of investors and customers. I think, certainly, we consider the benefits of expanded pipeline capacity and the record does reflect the competitiveness of this pipeline, not just the shippers in California but to the entire West. The record also does reflect very dramatic changes within the industry, specifically, in the context of Master Limited Partnerships. It is not just the tax efficiency of the partnership forum as opposed to the C Corporation that is very dramatic and recognized by investors. But the accounting, the compliance, corporate law, corporate governance issues are dramatically different and there is a long history in partnership law in the fiduciary relationships. So it's not as if we're imagining the concept of fiduciary relationships between directors and shareholders, but it's just a very different forum. And in the current environment, I think -- it's my view that MLPs will, in the future, be very involved in the entrepreneurial energy sector. The computation of the DCF formulate is case specific. We'll leave to another day and particularly the degree to which partnership distributions need to be backed out or account for current capital.

I won't use pleasurable. It's an interesting discussion and the concerns of the staff were recognized, and I would hope for a more fulsome discussion of this issue in future cases. Thank you, Mr. Chairman.

CHAIRMAN KELLIHER: Thank you.

Commissioner Moeller?

COMMISSIONER MOELLER: Mr. Chairman, this follows up on what you alluded to and what Commissioner Spitzer just said, the question of the staff. We do seem to have, for a variety of reasons, a truth in proxy group and your thoughts on that going forward.

MR. HOWE: This order we are still faced with the situation where we have the four companies we used in the last litigating case. So still having those companies and then expanding to other companies, it seemed best here to stick with them. In the future, if we lack to do the DCF, it has to be companies we can use that have publicly-traded stock. If the Commission would be forced to go beyond what it currently does, the proxy group continues to shrink, thereby, it may need to be expanded to other companies or going through a different method altogether.

CHAIRMAN KELLIHER: Commissioner Kelly.

COMMISSIONER KELLY: This case has raised some very interesting and very challenging issues. It certainly got it a lot of attention in the industry.

I would agree with you, Commissioner Spitzer, it was not pleasurable attention from the industry. In fact, it was more of this is the end of the civilized world as we now know it type of attention.

(Laughter.)

COMMISSIONER KELLY: I guess not surprisingly primary because of the unusually low 9.34 percent return on equity that was recommended by the presiding judge. But I think it is appropriately seen that this decision stands for the proposition that the Commission's method of determining an appropriate return on equity is based on reasoned analysis and it is fully capable of adjusting to changed circumstances. As a result of the record developed by the presiding judge, the Commission was able to appropriately reflect these changed circumstances, as Joe as mentioned, in our method of determining return on equity in order to arrive at a just and reasonable result of 11.2 percent.

I personally support that result as just and reasonable. And while it's quite different from the presiding judge's recommendation, I would just like to emphasize that what the presiding judge did was not wrong. She followed the precedent laid down by the Commission over the last 10 to 15 years, which has not changed significantly in that period. However, as Joe mentioned, further consolidation in the pipeline industry and other issues, as we've described more fully in order, have changed the playing field sufficiently to warrant adjustment to that precedent. This order recognizes that fact. This is a step that the Commission had to take before any presiding judge could.

Having taken that step, I'd also like to emphasize that if further adjustments are needed in future rate cases, so long as they are well supported, we stand ready to make those adjustments. In this case, Kern River proposed to include Master Limited Partnerships or MLPs in its proxy group and our rejects that proposal as unsupported because there are significant differences between MLPs and corporations. Commissioner Spitzer, in his concurrence, sets that out very nicely on non-MLP partnerships like Kern River that must be addressed before an appropriate comparison between the two can be made.

Kern River's proposal did not adequately address those differences. However, our order today provides extensive guidance on these issues so that future applicants proposing to include MLPs in their proxy groups will know what issues they must address in order to gain acceptance.

The order is long because its detailed, but that is also what I believe makes it so valuable for the industry and I would encourage industry practitioners to read it cover to cover. Perhaps, it will be good late night reading, Joe. Thanks to the staff hard work, it's the road map for pipeline rate cases in the foreseeable future.

CHAIRMAN KELLIHER: Than you.

Commissioner Wellinghoff.

COMMISSIONER WELLINGHOFF: I think they say you don't want to see legislation or sausage being made. I don't think you want to see commission selecting it our way either. It's a very difficult process at the 10,000 foot level. The Commission is trying to determine what's just and reasonable based upon the equities, based upon the interests of the shareholders and the interests of the consumers. But at the end of the day you have to have a return that's high enough to attract capital.

I support the 11.2 percent return on equity here, but I don't think, given what's happening to the shrinking size of the proxy group and other issues in the industry, we necessarily need to be wedded to any particular methodology. DCF is one methodology. There are a number of other methodologies to determine. The key is getting a range that's reasonable and that we can pick from. I think that range is provided to us and we have substantial evidence on the record to make a reasonable decision I think that would be upheld and I hope the Blue Bill cases will support that from the Commission's level of discretion.

The Commission has participated in many, many cases where ROE is an issue and it's been all over the board, but it is important for parties to have some direction. I think this order does provide that direction for parties going forward. Thank you.

CHAIRMAN KELLIHER: Thank you.

Any other comments?

(No response.)

CHAIRMAN KELLIHER: Let's vote.

SECRETARY SALAS: Commissioner Wellinghoff?

COMMISSIONER WELLINGHOFF: Aye.

COMMISSIONER MOELLER: Aye.

COMMISSIONER SPITZER: Aye.

COMMISSIONER KELLY: Aye.

CHAIRMAN KELLIHER: Aye.

SECRETARY SALAS: The next item for discussion is C1, revisions to the blanket certificate regulations and clarification regarding rates. It is a presentation by Gordon Wagner and Michael McGehee.

MR. WAGNER: Good morning, Chairman and Commissioners. I'm Gordon Wagner from the Office of General Counsel and with me is Mike McGehee from the Office of Energy Projects.

C1 is a draft final rule that addresses the Commission's blanket certificate program. C1 also discusses the Commission's policy regarding a pipeline negotiating different rates for essentially the same services based on when potential customers commit to take service. In

November 2005, the Interstate Natural Gas Association of America and the Natural Gas Supply Association jointly submitted a petition that requested the Commission revise its existing blanket certificate program to allow the construction of additional facilities under blanket authorization.

The joint petition also requested clarification on an unrelated matter, namely, whether a pipeline can offer more favorable rates to foundation shippers, that is those shippers whose early support of a project provides the necessary financial bases to enable a project go forward than to shippers that commit to service at a later point in time.

In response to the INGAA/NGSA petition, in June 2006, the Commission issued a note of proposed rulemaking. This draft final rule incorporates comments received in response the NOPR's proposal to expand the scope of the Commission's blanket certificate program to include certain presently excluded main line facilities, storage facilities, facilities transporting the mix of synthetic and natural gas and facilities transporting exclusively revaporized, liquified natural gas.

In addition to expanding the types of projects that can be undertaken pursuant to blanket certificate authority, a draft file rule proposes to raise the per-project cost limits from 8.2 million to 9.6 million for projects that do not require prior notice.  And from 22 million to 27.4 million for projects that do require prior notice.  This boost in the project cost limits is intended to account for increases in construction cost in excess of the overall inflation index the Commission has used for purposes of adjusting project cost limits annually since the blanket program's inception in 1982.

Further, recognition of the enlarged scope and scale of potential blanket projects, the draft final rule adds 15 days to the current notice period for landowners and the public and tightens the environment compliance conditions applicable to blanket projects.

The draft final rules also addresses INGAA/NGSA's request to clarify Commission policy regarding differential rates.  The final draft rule clarifies that a natural gas company may charge different customers different rates for the same service based on when the customer signs up for service as long as all potential customers have an equal opportunity to qualify for the more favorable rates.

In addition, the rules renders moot the joint petition by Kinder Morgan Interstate Gas Transmission and Northern Natural Gas Company requesting that main line facilities serving ethanol plants be eligible for inclusion in the blanket program.  The relief sought by the petitioners is effectively granted by today's action, revising the blanket certificate program to include main line facilities regardless of their intended purpose.

This concludes my presentation. We'll be pleased to answer questions.

CHAIRMAN KELLIHER: Colleagues any comments.

(No response.)

CHAIRMAN KELLIHER: I'll be very brief. I'm not going to focus on what we're doing in the order. Staff covered that very adequately. But clearly why we're acting as regulators, we have a general duty to constantly look at our rules and consider reforming our rules to reflect the changes that are occurring in the regulated industries. That's what we're doing here today. We're making some changes in the blanket certificate program in the form of some policies that trace back to 1982.

It's not 1982 anymore. The natural gas pipeline industry has changed dramatically since then and we're making some changes to our rules to reflect the changes that have occurred in the industry since that time. I really think that's a duty that we have on a general basis so they can operate better. I also think that's what we're doing to be consistent with the whole policy direction of the Energy Policy Act. One of the major goals of the Energy Policy Act was to energy infrastructure in both electricity and gas, and the actions taken here today will strengthen the natural gas pipeline effort. So I think it's a good order. I want to commend the staff for their fast work on it.

The petition came in, in February. Here we are just a few months later issuing a final rule. It's one of the five final rules we're acting on today.

Colleague?

COMMISSIONER KELLY: Thank you.

Some commenters wanted us to increase blanket cost caps. Others wanted us to lower them. Similarly, some wanted to add more eligible projects while others wanted to eliminate some. I think in the rule we issued today we took a balanced approach in raising the blanket cost caps and adding projects now eligible under the blanket program. They reflect the realities of slightly increased gas and utility construction materials costs while ensuring that the nature of the blanket certificate program remains unchanged. That is, to allow a generic class of projects to go forward without case-specific review based on the expectation that the projects will have minimal adverse impacts.

I'd like to mention one thing that I brought up in the NOPR part of this proceeding. That while I agree with the clarification in our final rule, that in certain circumstances the company may offer rate incentives to obtain early project commitments, and that the Commission's existing policies allow project sponsors to offer rate incentives under these circumstances. The risk of non-discrimination would be reduced to the extent that the rate incentives offered are clearly defined in the announcement of the open season, publicly verifiable and equally available to all potential shippers.

That said, I just wanted to add my thanks to the staff for the fine job they've done and allowing us to vote this order out.

CHAIRMAN KELLIHER: Colleague?

Yes, Commissioner Moeller.

COMMISSIONER MOELLER: Just briefly. Hopefully, this rule will allow more infrastructure to be built. Something we need in the country. I also want to point out there are a couple of items in there that really -- the fact that we are a growing economy and society and there's an increased notification as well as some issues on noise abatement. Maybe that will make for an infrastructure being developed in a more peaceful manner.

CHAIRMAN KELLIHER: Or at least a quieter manner.

(Laughter.)

CHAIRMAN KELLIHER: I'll make one comment on the dollar limits issue. The staff indicated that we propose to retain the dollar limits that were in the proposed rules a few months ago. We were urged to adopt higher dollar limits and we declined to do so largely because there was a lack of support for the higher dollar limits that were advanced. Just that little clarification.

Any other comments, colleagues?

(No response.)

CHAIRMAN KELLIHER: Let's vote.

SECRETARY SALAS: Commissioner Wellinghoff?

COMMISSIONER WELLINGHOFF: Aye.

COMMISSIONER MOELLER: Aye.

COMMISSIONER SPITZER: Aye.

COMMISSIONER KELLY: Aye.

CHAIRMAN KELLIHER: Aye.

SECRETARY SALAS: The next item for discussion, C2. This is regulations implementing the Energy Policy Act of 2005 coordinating responses for federal authorizations for applications under Sections 3 and 7 of the Natural Gas Act. We're bring back Gordon for the presentation accompanied by Lonnie Lister and Laurie McConnel and William Blume.

MR. WAGNER: Good morning one more time.

C2 is a draft final rule which continues the Commission's efforts to implement the provisions in the Energy Policy Act of 2005. A notice of proposed rulemaking was issued in this proceeding in May 2006 and this draft final rule responds to comments received in that NOPR. The draft final rule addresses two areas of the expanded Commission authority with respect to applications to construct new natural gas infrastructure.

First, Section 313 of the Energy Policy Act of 2005 directs the Commission to set a schedule for actions by other federal and state agencies on requests for federal authorizations that are necessary for a proposed NGA Section 3 or 7 gas project. The draft final rule states that for each proposed gas project the Commission will issue a notice of the projected schedule for the completion of its environmental review. In setting that schedule, the Commission will take into account statutory timeframes for other agencies actions. The agencies will be required to reach a decision on requests for federal authorizations within 90 days of the Commission's issuance of the final environmental document, unless an agency has a deadline established by federal law, to provide the Commission with the information needed to determine a reasonable schedule. The draft final rule directs applicants to submit all required requests for federal authorizations no later than when it files a Section 3 or Section 7 application with the Commission. The rules also requires other agencies to notify the Commission upon request when a federal authorization is received, whether the request is complete and if not, what further data is needed and when the agency anticipates ruling on a request.

Second, EPAct Section 313 directs the Commission to maintain a complete, consolidated record of the decisions of the other agencies responsible for issuing federal authorizations necessary for a gas project. The draft final rule proposes to compile this record by requiring agencies to electronically file their decisions and a document index with the Commission. The collected decision and indices will constitute the consolidate record, which will be the record for any review or appeal of an agency or a Commission decision.

This concludes my presentation. I'll be pleased to answer questions.

CHAIRMAN KELLIHER: Great. This is one of the five final rules we're adopting today. It is another staff action to implement the Energy Policy Act of 2005. It was somehow viewed that this would hamper review by federal agencies or state agencies acting under federal authority. I think it's clear, based on the record before us, that the Energy Policy Act provisions in no way undermine review by other federal agencies or state agencies acting under delegated authority to administer federal laws. They'll continue to review applications by project developers in the same manner, applying the same standards. That review, though, may be subject to a schedule set by the Commission.

That's the net effect of the statutory provisions.

I think the Energy Policy Act provisions are entirely reasonable and we're implementing them in a manner consistent with clearly manifested congressional intent, even though our approval of our rule, once we publish our rule, will become final this afternoon it's actually a subject that's been tested in the courts. There was a test of the constitutionality of this provision in the Islander East proceeding. It is probably worth noting that that challenge was soundly rejected. So authority actually has been attested. There's been a test of the statutory provision not our rule. It was found to be constitutional by the Courts. That doesn't mean we can't expect a challenge to our final rule, however.

Colleagues, any comments?

Jon?

COMMISSIONER WELLINGHOFF: Mr. Chairman, thank you.

In our decision today, we reconfirmed our willingness to coordinate with state agencies and environmental impacts on those projects. Explicitly in our decision today, I think it's very important. We need to continue that with the states and the states have to be partners in the projects.

CHAIRMAN KELLIHER: Colleagues?

Commissioner Kelly?

COMMISSIONER KELLY: This rule recognizes the fundamental principle for making timely, thorough decisions involving multiple agency authorizations. I agree with that principle, which everything done in parallel, not in sequence. Thanks to the thoughtful comments we've received on the NOPR, the revisions will, I believe, lead to better and more timely decisions without unduly burdening the states or the agencies.

In our final rule, we commit to coordinating with states where possible on the NOPR review. We are ready, willing and able to work with the states to coordinate. It's my hope that the states take the opportunity to do this. I believe it will lead to a better process and will facilitate this new process and that we will end up with better and more timely decisions if we do coordinate with the states. For all of these reasons I am pleased to vote out this rule.

Again, thanks to staff for all your hard work.

CHAIRMAN KELLIHER: Commissioner Moeller?

COMMISSIONER MOELLER: To me, it's about the regulatory certainty of getting more infrastructure built. I understand the staff were very good in accommodating some concerns that were brought about timing issues. Those seem to make sense and again, I want to commend staff.

CHAIRMAN KELLIHER: Commissioner Spitzer, you don't have to say anything.

(Laughter.)

COMMISSIONER SPITZER: You know that one after a floor debate in the House. Everything has been said, but not by everyone.

(Laughter.)

CHAIRMAN KELLIHER: Why don't we vote then?

SECRETARY SALAS: Commissioner Wellinghoff?

COMMISSIONER WELLINGHOFF: Aye.

COMMISSIONER MOELLER: Aye.

COMMISSIONER SPITZER: Aye.

COMMISSIONER KELLY: Aye.

CHAIRMAN KELLIHER: Aye.

SECRETARY SALAS: The last item for discussion this morning is ET. This is new PURPA Section 210(m) regulations applicable to small power production and co-generation facilities. It is a presentation by Martha Shaw, Samuel Higginbottom and Ed Murrill.

MS. SHAW: Good morning. Joining me today are Samuel Higginbottom and Ed Murrill.

The Energy Policy Act of 2005, which eliminated the Public Utility Regulatory Policy Act of 1978 known as PURPA 210 and among other things requires the Commission to enter into new contracts or obligations, to purchase electric energy from a qualifying facility. If the Commission finds that a QF has non-discriminatory access to one of the three types of wholesale markets described in the new law.

The final rule before you today considers industry comments filed in response to the notice of proposed rulemaking issued earlier this year and amends the Commission regulations to implement the requirements of PURPA Section 210. The draft final rule requires that the dependent system operator, PJM, ISO New England and the New York Independent System Operator provide wholesale markets that are the statutory criteria for a number of utilities to qualify for relief from the mandatory purchase requirements. It also establishes a rebuttal presumption that offline facilities above 20-megawatt net capacity have non-discriminatory access to these full markets and that the electric utility members should be relieved of their mandatory purchase requirements.

Under the QF, the regional entities make the statutory criteria by operating transmission facilities and other utilities in providing open access transmission services. They auction. They stay ahead in real time markets known as Day Two markets and within regions bilateral long-term contracts are available to market participants and QFs.

The draft rules also finds that the Electric Reliability Council of Texas, ERCOT offers comparable competitive wholesale market power access and meets the statutory criteria, making electric utilities. ERCOT also is eligible from relief from PURPA's mandatory purchase requirements.

The draft rules finds that the California Independent System Operator and Southwest Power Pool Markets do not currently have auction-based day ahead and wholesale markets similar to the previously mentioned four RTOs. A portion of the statutory criteria, as they related to transmission and interconnection services in Day One market. Version Two rely on these partial findings as they try to terminate the mandatory purchase requirement. That is SPP and California ISO, a Commission-approved regional transmission entities that provide transmission interconnection services pursuant to non-discriminatory open access transmission task.

The draft rule is clear that the purchase requirements of any utility is not being terminated with today's draft final rule. Electric utilities must file applications for relief in QFs at the above market, but the presumption of access to markets because of operational characteristics or transmission constraints. With respect to all markets, the rule establishes a rebuttal presumption that net capacity of no greater than 20 megawatts QFs have non-discriminatory access to markets if they're eligible for service and Commission-approved open access transmission tariffs or reciprocity tariffs filed by a non-jurisdictional transmission owner.

Recognizing the special circumstances faced by smaller QFs, the draft final rule also establishes a rebuttal presumption that the purchase requirement remain in effect in all markets for those that are 20 megawatts and smaller to rebut the presumption that the utility must demonstrate for each small QF that the QF has non-discriminatory access to the markets.

The draft rule establishes filing requirements for electric utilities to seek relief from the purchase requirement and also provides for the statement of the mandatory purchase upon showing that the conditions for terminating the requirement are no longer met.

This concludes the presentation.

CHAIRMAN KELLIHER: Thank you.

I want to thank the staff for this order. I think it is a very well-written order as are the others.

Let me turn to colleagues who are particularly interested in this. Commissioner Spitzer.

COMMISSIONER SPITZER: Thank you, Mr. Chairman.

Commissioner Wellinghoff referred to the sausage discussions on ROE. I believe the quote originally came from Chancellor Bismarck of Germany who was referring to the German parliament, actually, the legislative process as opposed to the regulator process about sausage.

Here we have a very interesting process on this matter. I'm not sure sausage is the right analogy. You have these competing interests. You have the statutory language, of course, as the starting point. You had the QF interest, utility interest and most importantly, the interest of the consumers. Maybe it's a stew. I support this order. I recognize that we're treading on some uncertain territory and I think we balanced competing interest in a fair way.

Two further observations. First, as has been pointed out, the utilities and the QFs will have their day in court based on a set of facts in each case and I think that's very important. Then secondly, this is really more aspirational. I very much look to forward to the day when this rule is not needed, when all generators, particularly those of renewable resources, which is a very important policy consideration, have unfettered and non-discriminatory access to their markets.

Mr. Chairman, I support the order. I recognize the difficulty of the task the staff worked on.

CHAIRMAN KELLIHER: Commissioner Wellinghoff?

COMMISSIONER WELLINGHOFF: Thank you, Mr. Chairman.

I do support the order. Paraphrasing from Mark Twain, the reports of my demise are much exaggerated. PURPA is alive and well. I think we are essentially fulfilling the intent of Congress here. The intent, interestingly enough, when this was first pass out of Congress, I had many people call me up and say PUPRA's been repealed. PURPA's been repealed. And I think what Congress really intended here and we're effectuating in the order is to allow electric utilities, in certain circumstances, to be exempted from mandatory purchase obligations. I think we've set forth the circumstances in this order where there are non-discriminatory access by the QFs to markets that provide both short-term and long-term opportunities for them. That will be done on a case-by-case basis. There are certain rebuttal presumptions here for administrative convenience that I think are necessary for the Commission to process these, but they are rebuttable presumptions. I look forward to the cases coming in and us deciding on those cases based upon that.

CHAIRMAN KELLIHER: Thank you.

Commissioner Moeller?

COMMISSIONER MOELLER: Mr. Chairman, I guess I want to be on record as supporting sausage.

(Laughter.)

COMMISSIONER MOELLER: Because it's delicious.

(Laughter.)

COMMISSIONER MOELLER: I think similarly we struck a good balance in this order. We have different market characteristics to deal with. We have different sizes of entities and I think overall, in striking that balance, we did a good job.

CHAIRMAN KELLIHER: Commissioner Kelly?

COMMISSIONER KELLY: I think it's important not to lose sight of the fact that QFs are a desirable source of electricity in our country. They've provided, over the years, many benefits to our country. They are a source of efficient, clean, green, environmentally-friendly power. They also lower the cost of the manufacturing sector of our economy through allowing them to sell electric energy into markets. Cogen facilities can use significantly less fuel to produce electric energy and steam or other forms of energy than would be needed to produce the two separately.

Small power production facilities use biomass waste or renewable resources to produce electric energy and can reduce the need to consume fossil fuels to generate electric power. This rule acknowledges that. It also acknowledges the existence of the fact that the existence of an open access transmission tariff or reciprocity tariff is not enough to ensure that QFs have actual access to competitive wholesale markets.

It's my belief that, while Congress wanted to reform the market responsibilities of QF, it did not want to strain QF capacity. That is why, to the extent that there are physical or financial barriers to the ability for QF to sell their energy into a competitive market based on operational characteristics or a transmission limitations, this rule establishes a process whereby the utility would continue to purchase energy through QF.

Also, if electric utility in any market, breaches relief from the mandatory purchase requirement, with respect to the small QF, the utility will have the burden to demonstrate as a small QF and I have review of the final rules decision to put that burden of proof on the utility which is better able.

Mr. Chairman, I'm very happy to vote for this rule. I'd like to thank the staff for all the work you've done on this. It's rule, I think, that has changed, frankly, than most of our rules from the NOPR stage to the final stage. In large part, that was due to the significant amount of generated in the industry on both sides of the contract as well as to the participation by our colleagues. I'm pleased that has occurred in this case and I believe the final rule is better for it.

CHAIRMAN KELLIHER: Thank you.

I want to say I agree with my colleagues as a starting point. It's a good place to start. This is one of the five final rules that we're issuing today. It's a technical implementation issue and I want to agree with Jon. The starting point is the statute. What does the statutory provision mean? Right off the bat it gets a little difficult, frankly, because the Energy Policy Act, by and large, is a very well-written statute. This is one of the less well-written parts of that statute. I think it's fair to say. I hope the author is not watching through our website.

(Laughter.)

CHAIRMAN KELLIHER: But it's not really a model of clarity, so there's a little bit of difficulty in the beginning to faithfully implement this provision. What exactly does it mean? Just speaking for myself, I think you can define some meaning. I think we've done that in the final rule.

First of all, the Commission's analysis is suppose to vary with the nature of the wholesale power market. I think the statutory provision envisions that our analysis vary -- would base on the three different kinds of wholesale power markets -- the Day Two, the RTO, Day One RTO and the bilateral markets. The statutory findings that we're supposed to make in each of these markets themselves vary. You can argue how high the hurdles are in each of these markets, but probably it's inarguable that the statutory hurdle in the Day Two markets is much lower than in the other markets.

That is explained wholly in the final rule. We do make certain preliminary findings that the Day Two RTOs in New England, New York and PJM and Midwest meet the statutory tests, but those are preliminary findings. The order itself is not granting relief to any utility for mandatory purchase obligations. There will be subsequent filings. We will make decisions in those subsequent proceedings.

I want to pick up on Commissioner Kelly's comment at the end. That the rule does mark a very significant change from the NOPR, particularly, in our treatment of the Day Two RTOs. In the NOPR, we would have granted relief from utilities in the Day Two RTOs. The subsequent filing would have been a compliance filing. So the decision would have been made in a proposed rule to grant relief to these utilities. The subsequent proceeding would have been purely ministerial. That's not what we're doing here at all. So it is a very significant change from the proposed rule. What we're undertaking here is more consistent with the statute than we did in the proposed rule and I expect in the end we will probably seek additional review. The nature of the statutory language and the fact its not that clear works to our advantage.

I think our reading is certainly a permissible reading and in the complete absence of any legislative history, it probably works hard and manages well. We may well see additional review of this provision, but I think the proceeding for taking the final rule is the correct one and consistent with the Energy Policy Act provisions. So I support it.

Again, it's one of those issues that's been here before the Commission for a number of months and new colleagues have helped us resolve it some. Why don't we vote, unless anyone else has additional comments?

(No response.)

CHAIRMAN KELLIHER: Let's vote.

SECRETARY SALAS: Commissioner Wellinghoff?

COMMISSIONER WELLINGHOFF: Aye.

COMMISSIONER MOELLER: Aye.

COMMISSIONER SPITZER: Aye.

COMMISSIONER KELLY: Aye.

CHAIRMAN KELLIHER: Aye.

Any other business?

(No response.)

CHAIRMAN KELLIHER: This meeting is adjourned.

(Whereupon, at 12:00, the above-entitled matter was concluded.)