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BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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

911TH COMMISSION MEETING
OPEN MEETING

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

Thursday, December 21, 2006
10:10 a.m.

1 APPEARANCES :

2 COMMISSIONERS PRESENT :

3 CHAIRMAN JOSEPH T. KELLIHER

4 COMMISSIONER SUEDEEN G. KELLY

5 COMMISSIONER MARC SPITZER

6 COMMISSIONER PHILIP MOELLER

7 COMMISSIONER JON WELLINGHOFF

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9 SECRETARY MAGALIE R. SALAS

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21 ALSO PRESENT :

22 DAVID HOFFMAN, Reporter

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

2 (10:10 a.m.)

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

8 Please join us in the Pledge of Allegiance.

9 (Pledge of Allegiance recited.)

10 CHAIRMAN KELLIHER: Before we start, we have some
11 introductions to make. Commissioner Wellinghoff.

12 COMMISSIONER WELLINGHOFF: Thank you, Joe, I
13 appreciate it. I would like to introduce my family, who is
14 here today, my wife Karen and my two sons, Jay and Jules.

15 (Applause.)

16 (Discussion off the record.)

17 CHAIRMAN KELLIHER: I'll make some general
18 opening comments, really recapping the year, to some extent,
19 and then give some awards to Commission Staff. Then there
20 are a couple of notationals that we approved recently that
21 we want to have some discussion about.

22 Before we get to today's business, let me just
23 start with a recap of 2006, and make some general
24 observations.

25 I think this really was an important year. The

1 Commission accomplished a great deal. We smoothly
2 implemented the Energy Policy Act of 2005, which made the
3 most important changes to the laws we administer since the
4 New Deal.

5 We met every deadline, and we actually exceeded a
6 few, and, really significantly, most of our EPCRA Orders
7 were not challenged in the courts, so that our Orders are
8 the law of the land.

9 There's one notable exception. The PURPA Order
10 as expected, will be challenged. The courts will decide
11 that one, but in other cases, we really haven't had Orders -
12 - we haven't had parties seeking judicial review of very
13 significant Orders such as the Anti-Manipulation Rules and
14 other EPCRA Orders.

15 In 2006, we acted to empower the consumer by
16 implementing the Anti-Manipulation Rules and our expanded
17 merger authority. We assessed for sure the reliability of
18 the interstate grid by certifying electric reliability
19 organizations and approving proposed mandatory reliability
20 standards.

21 We moved to strengthen our energy infrastructure
22 by adopting transmission pricing reforms. We're taking
23 final action on them today by issuing transmission siting
24 rules and by making changes in the gas blanket certificate
25 program.

1 We acted to assure an adequate energy supply,
2 both electric and gas, through our actions to approve LNG
3 import terminals and reform capacity markets and organized
4 power markets.

5 We've also steadily pursued regulatory reform in
6 both electricity and gas policy. This is a reform agency.
7 We are not resistant to change. We take our duties
8 seriously.

9 That involves constantly looking at our policies
10 to see which ones are working well and which ones could be
11 improved.

12 That commitment to regulatory reform, is perhaps
13 best demonstrated by our initiatives to reform the open
14 access transmission tariff, reform the market-based rate
15 program, and provide the blanket certificate program.

16 But we've also acted to make power markets more
17 competitive. That's reflected in the Anti-Manipulation
18 Rules and the Merger Rules, as well as our initiatives to
19 reform the OATT and the market-based rate programs. It's
20 also reflected in the establishment of the FERC-State
21 Collaborative Demand Response Working Group, led by
22 Commissioner Wellinghoff.

23 We recognize we have more to do in this area.
24 Earlier this week, I announced that the Commission will hold
25 a series of conferences next year to explore the state of

1 competitive wholesale power markets. I'm pleased to
2 announce that the first conference will be held on February
3 27th.

4 Last year -- this year -- we had a very
5 productive year. Altogether, through today, the Commission
6 issued 1,380 Orders. I think that's a record to be proud
7 of.

8 The Commission -- I think if you sum it up, we
9 had one of the most productive years in Commission history.
10 I hope that listeners noticed that I'm using the first
11 person plural, not the singular, because this is a multi-
12 member Commission and these are accomplishments of the
13 Commission, both the old Commission, the ancien regime, as
14 well as the new Commission.

15 This will probably be the last meeting that I
16 refer to my colleagues as new Commissioners. I think, after
17 500 or so votes, they no longer deserve the appellation,
18 "new."

19 These accomplishments are the work of both the
20 former Commission, as well as the new Commission.

21 There have also been changes in the Commission.
22 Our friend and colleague, Nora Brownell, stepped down after
23 good service, and three new Commissioners -- that will be
24 the last time I call you that -- have joined us.

25 I really can't say enough about how well the new

1 Commissioners have performed in recent months. They're
2 excellent colleagues. They take clear points of view; they
3 take clear positions; they understand the dynamics of a
4 multi-member body, and they're willing to compromise, but
5 not desperate to do so, and that policy matters to them.
6 And I think the public is very well served by the current
7 Commission.

8 One reason the Commission has been so productive,
9 is the character of the Agency. We are a nonpartisan
10 agency, and, by contrast with some other agencies, party
11 line votes here are quite rare.

12 I think, in part, it's due to the nature of the
13 issues that we address. Energy issues, by their very
14 nature, are nonpartisan. There are certain politics, but
15 they tend to be regional politics, not party politics.

16 I think that helps us do the people's business
17 efficiently.

18 When I became Chairman, I did have certain policy
19 goals. I also had other goals, such as improving our
20 relationship with Congress and the states, and boosting our
21 standing in the courts.

22 We've made a lot of progress in all three of
23 these areas. Our relationship with Congress strong and is
24 best reflected by the Energy Policy Act, which gave us a lot
25 of discretionary authority.

1 The Energy Policy Act really was a clear sign of
2 trust by Congress in the Commission. I think we've proved
3 worth of that trust.

4 Our relationship with the states is also strong.
5 At one point, I referred to the recent comments by the NARUC
6 Electricity Chairman, Jimmy Ervin, where he has publicly
7 said a number of times that the relationship between the
8 FERC and the states is stronger now than it's been at any
9 point in the past ten years.

10 The states feel, the state regulators feel they
11 have a better relationship with FERC than they do with any
12 other federal regulatory body.

13 I take great satisfaction in that. It's
14 something that's important to me.

15 Now, our standing in the courts has also
16 improved. As Chairmen, we have all had a great year in the
17 courts, a good win/loss record.

18 Before last week, we really had an exceptional
19 win/loss record.

20 (Laughter.)

21 CHAIRMAN KELLIHER: The calendar year 06,
22 including Tuesday, our record in the Circuit Courts was 15,
23 3, and 6, with two of the losses coming this week.

24 Now, Mr. Moot is a baseball fan. I'm not really
25 a baseball fan. I try to work in historical analogies, but

1 Mr. Moot has pointed out that a relief pitcher doesn't
2 inherit runners on base, I think was your comment, but I
3 still take the losses very seriously. These are important
4 decisions.

5 It would have been nice to have had a 15, 0, and
6 record, but 15, 3, and 6 is still very good.

7 Another reason we've been so productive, of
8 course, is the excellent Commission Staff. They are
9 hardworking professionals and model public servants. This
10 is where I'm going to try to work in the historical analogy
11 and try to analogize the Commission Staff.

12 I think I'd have to say that the analogy would be
13 to Caesar's Tenth Legion, which helped conquer Gaul -- there
14 aren't too many Gauls running around, so they can't be
15 offended -- or the Third Corps of Napoleon's Grand Army, is
16 also another analogy, which is probably pretty obscure.

17 The Commission and Staff are excellent and
18 hardworking. There have also been some changes in the ranks
19 of the Commission Staff. Since our last open meeting,
20 McLaine Laden has stepped down, the director of external
21 affairs, who put in very good service here at the
22 Commission.

23 She's replaced by Andy Black. Andy, if you could
24 stand up, please, and I'll embarrass you for a moment.

25 Andy Black is a friend and colleague. We worked

1 together on legislation about ten years ago on the House
2 side. Andy is a real veteran, a Congressional veteran. He
3 has a strong policy background, and is a man of great
4 integrity and character. I'm glad you could join us.
5 Thanks.

6 At this point, I'd like to give some awards to
7 Commission Staff, and let's start with Gus Tjoumas. Where
8 is Gus? There he is. Thanks, Gus. Why don't you sit down
9 for a minute?

10 (Laughter.)

11 CHAIRMAN KELLIHER: I have long comments of
12 praise for you. I met Gus, actually, on my first trip as a
13 Commissioner, which was to the Saluda remediation project
14 outside Columbia, South Carolina.

15 Gus really -- his real name is Constantine G.
16 Tjoumas, but he's better known nationally as Gus, both
17 inside the building and outside, and he's given the people
18 of the United States, 37 years of service.

19 Really, Gus, at this point, I view him as the
20 face of Dam Safety Program at the Commission. He has helped
21 design and construct dams with the U.S. Army Corps of
22 Engineers.

23 He worked for the Bureau of Reclamation, the
24 Nuclear Regulatory Commission, and, most importantly, he's
25 given the Commission 25 years of good service, improving,

1 shaping, and leading the Federal Energy Regulatory
2 Commission's Dam Safety Program.

3 Dam safety engineering in the United States and
4 throughout the world, is better because of Gus Tjoumas. He
5 leaves a significant and lasting impact, not only on the
6 Commission's Dam Safety Program, but on the entire dam
7 safety community.

8 He's earned the respect of the dam safety
9 community and is considered a leader who understands what a
10 safe dam is and what an effective dam safety program
11 requires to ensure that dams are designed, constructed, and
12 operated safely.

13 Gus's leadership has been founded on the guiding
14 principle that effective dam safety programs have to change
15 and improve constantly in respect of the new challenges they
16 face.

17 A major factor in his success, is the way he did
18 his job. Once he recognized a way to improve dam safety, he
19 worked to achieve that goal through a cooperative and
20 collaborative effort that included all stakeholders, the
21 owners, consultants, FERC engineers, but led by one guiding
22 force, by Gus himself.

23 Gus knew the dam owners had to believe the
24 changes would be useful and efficient, and worth the effort.
25 While putting into place, important dam safety measures, Gus

1 achieved an unprecedented level of support among the
2 companies the Commission regulates.

3 Beyond regulatory compliance, they realized that
4 they, in fact, were improving the safety of their dams.

5 He is a tireless leader. Not satisfied with
6 concentrating on the Commission's 2500 dams, he made his
7 expertise and technical guidance available to other programs
8 throughout the world.

9 I think that the safe building of the Saluda Dam,
10 really is a hallmark of the Commission's Dam Safety Program,
11 and it showed -- that was a very major effort, and very
12 costly to the licensee, but the fact that we essentially
13 required the licensee to either remove the existing dam or
14 build a backup dam behind it at a cost of nearly \$400
15 million shows the Commission puts safety first when it
16 regulates hydropower projects like that.

17 With that, I'd like to present the Exemplar of
18 Public Service to Gus Tjoumas. Gus?

19 (Applause.)

20 CHAIRMAN KELLIHER: The second award is to Ed
21 Gingold. Ed, where is Ed? There he is. Ed Gingold has
22 served as the FERC's CFC Chairman for the past two years,
23 and, particularly, this year.

24 Really, as I described him at the beginning of
25 the CFC Campaign, he really is the spirit of the CFC

1 Campaign at the Commission.

2 Just for this year's campaign, he organized
3 weekly events, which included the Gonzaga Boys High School
4 Choir, the Virginia Raptor Conservancy, Fidos for Freedom,
5 FERC Child Development Center, Habitat for Humanity, which
6 is a cause selected by Commissioner Wellinghoff, and, of
7 course, the Civil War Preservation Trust, where he gave a
8 dramatic reading from Bruce Catton's Stillness at
9 Appomattox.

10 I think it was a very good program, and the
11 results are very significant. Contributions were collected
12 on a weekly basis, submitted to the Commission's payroll
13 office, and weekly updates were prepared for Commissioner
14 Wellinghoff, this year's Chair of the Combined Federal
15 Campaign.

16 Receipts for the 2006 Campaign exceeded \$385,000,
17 which represents 135 percent of the Campaign's goal.

18 The Commission earned a Summit Award for
19 surpassing the 2005 results by ten percent. All 13 Offices
20 at the Commission earned the highest office award, the
21 Presidential Citation, and five Offices achieved 100-percent
22 participation.

23 Really, what's particularly impressive, is the
24 number of Eagles here at the Commission, both the Eagles and
25 the Double-Eagles. An Eagle represents a contribution of

1 one percent of an employee's salary; a Double-Eagle
2 represents a contribution of two percent of an employee's
3 salary.

4 The number of Eagles and Double-Eagles here at
5 the Commission, was 141, or 17 percent of the total donors
6 were Eagles or Double-Eagles, which is two and a half times
7 the government average.

8 So, Ed has certainly earned this award. He's an
9 outstanding public servant. The CFC Campaign reflects very
10 well on the Commission, and I turn to Commissioner
11 Wellinghoff for whatever comments you have.

12 COMMISSIONER WELLINGHOFF: Thank you, Mr.
13 Chairman. I would just like to say that I appreciate all
14 your efforts this year.

15 It's remarkable, what Ed did, organizing this
16 campaign, putting it together. Ed was the heart and soul
17 behind the campaign.

18 CHAIRMAN KELLIHER: I want to thank Jon for
19 agreeing to chair this Campaign. It's something I've done
20 in the past. In the past, Pat has done it, and I want to
21 commend you for taking it on right off the bat.

22 With that, Ed, why don't you come up and we'll
23 present you with the award.

24 (Applause.)

25 CHAIRMAN KELLIHER: Now I think we'll turn to the

1 notational discussion, but before I talk about the
2 notationals, I want to follow regular order and reference
3 how many notationals we've approved since the last open
4 meeting.

5 Since the November 16th open meeting, the
6 Commission has approved 83 notational Orders, again, a very
7 good pace of production. I understand Commissioner Moeller
8 would like to discuss the Aquila Order that the Commission
9 approved recently.

10 COMMISSIONER MOELLER: Thank you, Mr. Chairman.
11 I bring to the Commission's attention, an Order we issued
12 back on December 7th. The Order in Docket Number EC06-46,
13 authorized the transfer of jurisdictional facilities between
14 Aquila and Mid-Kansas Electric Company.

15 At issue was the sale and transfer of certain
16 assets from Aquila to Mid-Kansas. Those included
17 transmission lines, interest in generating capacity, and
18 wholesale power sales agreements.

19 I supported the Order, as I believe the
20 transaction met the requirements of Section 203 of the
21 Federal Power Act, however, I mention this case today to
22 highlight the fact that in making our determination, one
23 element of the transfer that we reviewed, was that Mid-
24 Kansas would largely freeze retail rates for five years,
25 after acquiring the assets of Aquila.

1 While the Commission has generally viewed rate
2 freezes, particularly in merger cases, as a customer
3 protection device, I may not reach the same conclusion in
4 every instance. Recent events have shown us that retail
5 rate freezes do not always result in the initially-
6 advertised benefits, once the caps are removed.

7 Since the future is hard to predict, utilities
8 may be forced to book deferred balances when costs exceed
9 revenues from the frozen rates. In a rising or high fuel
10 cost environment, rate freezes could result in future
11 ratepayers subsidizing current consumption and sending the
12 wrong price signal, and, at the same time, thwarting any
13 potential for price competition.

14 I will, however, remain open to considering the
15 promised benefits of rate freezes in the future.

16 Speaking of Kansas utilities, I recently attended
17 the fourth annual Kansas Electric Transmission Summit held
18 in Lawrence. The Summit, sponsored by State Representative
19 Tom Sloan, and attended widely by stakeholders, focused on
20 initiatives that Kansas is using to encourage the
21 development of transmission projects.

22 I was particularly impressed with the leadership
23 that Representative Sloan and his colleagues have shown, and
24 I was impressed to see that Kansas is not waiting for a
25 solution, but is moving forward on its own and using

1 innovative methods to solve the all too common problem of
2 transmission constraints and lack of adequate transmission
3 infrastructure.

4 Without question, Kansas is setting the example
5 for other states to follow. As I believe the first step in
6 solving transmission constraints, is to recognize the
7 problem early and take ownership of the solution, that's
8 what Kansas is doing at the state level and I commend them
9 for it. Thank you for the time, Mr. Chairman.

10 CHAIRMAN KELLIHER: Any other comments? Jon?

11 COMMISSIONER WELLINGHOFF: Yes, Mr. Chairman,
12 just a brief comment on the issue of rate freezes.

13 I would agree with Commission Moeller, that this
14 issue can be very detrimental to consumers, to the extent
15 that you ultimately see very high, rapid fuel prices. Every
16 time you see rates frozen, at the end, there's a large spike
17 that consumers have to contend with.

18 It can actually work the other way, again, also
19 to consumers' detriment. When you have little increases in
20 expenses, such a fuel prices, but if you have rapidly
21 increasing customer base, you can have a situation where, in
22 essence, the utility is over-earning and an excessive amount
23 of consumers are left out, and there are these dangers to
24 rate freezes.

25 CHAIRMAN KELLIHER: Any other comments?

1 (No response.)

2 CHAIRMAN KELLIHER: Commissioner Kelly would like
3 to discuss the Federal Market Monitor Order.

4 COMMISSIONER KELLY: On December 5th, the
5 Commission issued an Order on Rehearing regarding PJM's
6 proposal to revise certain tariff provisions relating to the
7 function of its market monitoring unit.

8 In this proceeding, a number of parties,
9 including the Organization of PJM States and the
10 Pennsylvania Public Utility Commission, raised concerns
11 about various issues, including the structure of the PJM
12 market monitoring unit and the structure of its
13 independence.

14 Our Order recognized that the parties raised
15 concerns about a range of issues and policies regarding the
16 functions of MMUs that were generic in nature, and not
17 necessarily limited to the market monitoring unit in a
18 particular RTO or ISO.

19 Therefore, our Order announced that we will
20 initiate a review of our MMU policy and hold a technical
21 conference early next year to explore these issues.

22 I think it's particularly appropriate to talk
23 about this today, having just announced our upcoming series
24 of conferences to look at competition.

25 As the Commission recognized in its policy

1 statement of May 2005, on market monitoring units, the
2 market monitoring units perform an important role in
3 assisting the Commission to enhance the competitiveness of
4 ISO and RTO markets.

5 Given the importance of the market monitoring
6 unit's role, I think the technical conference will provide
7 the Commission with an opportunity to explore more deeply,
8 how market monitors within the ISOs and RTOs, are currently
9 structured, what best practices now exist among the market
10 monitors, and whether potential clarifications or
11 improvements can be made.

12 CHAIRMAN KELLIHER: Any comments?

13 (No response.)

14 CHAIRMAN KELLIHER: I have a brief comment. I
15 completely support a technical conference on this subject.

16 When the Commission actually developed a market
17 monitoring policy statement, frankly, I preferred that we
18 act by rulemaking. I thought a policy statement would
19 entertain a two-step process, unless the RTOs and ISOs
20 actually voluntarily made filings to conform the market
21 monitors with our policy statement.

22 To date, since May of 2005, only one RTO has
23 actually filed a policy statement, to my knowledge, and
24 that's PJM.

25 I thought we did the right thing with the PJM

1 Order, since they made a filing that was consistent with the
2 policy statement and we agreed, we approved it, because it
3 was consistent with the policy statement, but on other RTO
4 has made a filing.

5 So, really, it begs the question of whether the
6 policy statement is the right one. I would have preferred a
7 rulemaking, but I went with the will of the majority of the
8 Commission at the time.

9 I think it's a reasonable thing to consider at
10 the technical conference. I just I'd just have to make a
11 comment to the RTOs, that if they do come forward and
12 actually make filings in due course, that may affect the
13 decision on whether or not to act generically, and they
14 should at least consider making filings in conformance with
15 our policy statement.

16 COMMISSIONER KELLY: Well, I think you raise a
17 good point, Joe. What I'd like to point out, along those
18 lines, is that most of the ISOs and RTOs have outside market
19 monitors, and that relation is governed by a contract.

20 For those ISOs and RTOs, the full panoply of
21 provisions regarding their market monitoring units, might
22 not be in their tariff, and that's one of the issues that I
23 expect that we're going to address at the technical
24 conference, whether -- PJM has a market monitor inhouse, and
25 so it's particularly important that PJM file for tariff

1 provisions relating to their market monitor, since they
2 don't otherwise have a contract.

3 And I'd like to join you in applauding them for
4 doing that.

5 CHAIRMAN KELLIHER: The policy statement was
6 pretty careful on structure. I think we, deliberately, did
7 not include a phrase saying it should be internal, it should
8 be external, and we actually see a real variety of
9 approaches in the existing RTOs.

10 We see some with internal only, some with
11 external only, and some with both an internal and external
12 market monitor. But I don't start off thinking we should
13 choose which structure is right, but I agree that the roles
14 should be well defined.

15 Colleagues, any comments?

16 (No response.)

17 CHAIRMAN KELLIHER: No? Madam Secretary, let's
18 turn to the consent agenda.

19 SECRETARY SALAS: Good morning, Mr. Chairman and
20 Commissioners, and very happy holidays to all of you.

21 Since the issuance of the Sunshine Notice on
22 December 14th, E-17 was struck from the agenda.

23 Your consent agenda for this morning, is as
24 follows: Electric Items - E-2, 4, 5, 6, 7, 8, 9, 10, 11,
25 12, 13, 14, 15, 16, 18, 19, 21, 22, 23, 24, 27, 28, 29, 30,

1 and 31.

2 Gas Items: G-2.

3 Hydro Items: H-1, 2, 3, 4, 5, and 6.

4 Certificates: C-2.

5 As required by law, Commissioner Moeller is not
6 participating in Consent Items E-8 and E-9, and Commissioner
7 Kelly is not participating in E-24.

8 The specific votes for some of these Consent
9 Items are as follows: E-6, Commissioner Wellinghoff
10 concurring, with a separate statement; and E-21,
11 Commissioner Kelly concurring, with a separate statement,
12 and Commissioner Wellinghoff dissenting, in part, with a
13 separate statement.

14 And now we're ready to vote. Commissioner
15 Wellinghoff?

16 COMMISSIONER WELLINGHOFF: Yes, Madam Secretary,
17 noting my concurrence in E-6 and my dissent, in part, in E-
18 21, I vote aye.

19 SECRETARY SALAS: Commissioner Moeller?

20 COMMISSIONER MOELLER: I vote aye, with exception
21 of the two items that I'm recused from.

22 SECRETARY SALAS: Commissioner Spitzer?

23 COMMISSIONER SPITZER: I vote aye.

24 SECRETARY SALAS: Commissioner Kelly?

25 COMMISSIONER KELLY: Aye, noting my concurrence.

1 SECRETARY SALAS: Chairman Kelliher?

2 CHAIRMAN KELLIHER: Aye.

3 SECRETARY SALAS: The first item for discussion
4 this morning, is M-1. This is Process for Assessing Civil
5 Penalties. It is a presentation by Ted Gerarden from the
6 Office of Enforcement.

7 MR. GERARDEN: Good morning, Mr. Chairman and
8 Commissioners. I'm Ted Gerarden from the Office of
9 Enforcement.

10 Agenda Item M-1 is a Draft Statement of
11 Administrative Policy that explains the processes to be
12 followed when the Commission assesses a civil penalty under
13 the provisions of the Federal Power Act, the Natural Gas
14 Act, or the Natural Gas Policy Act of 1978.

15 The Energy Policy Act of 2005, expands the
16 Commission's enforcement authority by extending civil
17 penalties to all of Part II of the Federal Power Act, and by
18 giving the Commission civil penalty authority under the
19 Natural Gas Act, for the first time.

20 The Energy Policy Act also set the maximum
21 penalty at \$1 million per day, per violation, for violations
22 of rules, regulations, and Orders issued under Part II of
23 the Federal Power Act, and all the Natural Gas Act and
24 Natural Gas Policy Acts.

25 In October 2005, the Commission issued the Policy

1 Statement on Enforcement, which discussed the factors the
2 Commission will consider in deciding on the appropriate
3 remedies for a violation, including the level of civil
4 penalty to be assessed.

5 The Commission twice noted in the Policy
6 Statement, that it intends to provide firm, but fair
7 enforcement. As a practical matter, most important matters
8 are resolved as a result of negotiations between enforcement
9 staff and companies under investigation.

10 Settlements avoid litigation and significantly
11 speed the implementation of remedies, including payment of
12 civil penalties.

13 The Draft Statement encourages companies to
14 continue to negotiate resolution of violations, wherever
15 possible. There may be instances, however, when a
16 negotiated resolution is not possible.

17 In such cases, the Commission may assess a civil
18 penalty. The purpose of the Draft Statement is to explain
19 the steps involved in assessing penalties.

20 The three governing statutes each contain
21 somewhat different requirements for the assessment of civil
22 penalties. The Federal Power Act provides a choice of an
23 administrative hearing on the record before an
24 Administrative Law Judge or an immediate assessment by the
25 Commission, which is then reviewed, de novo, in the United

1 States District Court.

2 Under Part I of the Federal Power Act governing
3 hydroelectric projects, however, there are certain
4 circumstances in which the hearing can only be before an
5 Administrative Law Judge.

6 By contrast, the Natural Gas Policy Act provides
7 only for immediate assessment and review de novo in the
8 United States District Court, that is, there is no
9 administrative hearing procedure.

10 The Natural Gas Act, on the other hand, has no
11 specific provisions for penalty assessment, requiring only
12 that there be notice and opportunity for public hearing.

13 The Commission noted this in the Policy
14 Statement, and said that when assessing penalties under the
15 Natural Gas Act, the Commission would provide administrative
16 hearing procedures.

17 Today's Draft Statement underscores the
18 Commission's commitment to exercising its enhanced
19 enforcement powers in a fair manner. Although the
20 requirements differ among Part I and Part II of the Federal
21 Power Act, the Natural Gas Act, and the Natural Gas Policy
22 Act, in each case, the Commission first will give notice of
23 the proposed penalty and an opportunity to show why the
24 penalty should not be assessed or should be reduced or
25 modified.

1 If the penalty is contested, the Commission will
2 follow the procedures appropriate for the statute involved.
3 The Draft Statement explains each of these in detail,
4 including the process the Commission will use for the
5 Natural Gas Act, when hearings are necessary, and provides
6 flow charts to illustrate the processes under each statute.
7 These flow charts will be made available on the Commission's
8 website.

9 I would be happy to respond to any questions
10 about this item.

11 CHAIRMAN KELLIHER: Thank you. First of all, I
12 want to apologize for your name tag. Your name has been
13 changed to protect the innocent.

14 (Laughter.)

15 (Discussion off the record.)

16 CHAIRMAN KELLIHER: I'll start off, unless one of
17 my colleagues gestures wildly. But why don't I start off.

18 Really, one of the most important of the changes
19 that were made to the laws we administer in the Energy
20 Policy Act of 2005, is in the area of enforcement.

21 Really, for the first time, the Commission was
22 granted significant civil penalty authority, and that
23 ability to impose civil penalties is really at the heart of
24 the enforcement authority of a federal regulatory body.

25 Before the Energy Policy Act, the Commission's

1 authority to impose civil penalties was quite limited. We
2 had no legal authority to impose a civil penalty for
3 violation of the Natural Gas Act, and no legal authority to
4 impose a civil penalty for most violations of the Federal
5 Power Act.

6 Now, I encouraged Congress to strengthen the
7 Commission's enforcement authority by establishing express
8 prohibition of market manipulation, and also granting us
9 civil penalty authority comparable to that enjoyed by other
10 federal regulatory bodies.

11 I did that because I believed we needed new
12 regulatory tools to discharge our historic duty to protect
13 the consumer.

14 Now, Congress agreed and the Energy Policy Act
15 both established an express prohibition of market
16 manipulation, as well as strengthened our civil penalty
17 authority, both expanding the scope of our civil penalty
18 authority, as well as raising the dollar limits very
19 substantially.

20 I just want to thank Congress for granting us
21 this new enforcement authority.

22 Now, we did move very quickly to implement our
23 new enforcement authority. The first step we took was on
24 issuance of the Enforcement Policy Statement last year,
25 which explained our commitment to firm and fair enforcement.

1 The Enforcement Policy Statement also explained
2 our goals and fines. We intend to develop a strong
3 compliance culture in the companies we regulate and we will
4 use our enforcement and civil penalty authority to that end.

5 The second step was the issuance of the Anti-
6 Manipulation Rules earlier this year. Now, today, we take
7 the third step in issuing a civil penalty administrative
8 policy that explains how we will assess civil penalties when
9 we take enforcement actions under the various statutes we
10 administer, principally Part II of the Federal Power Act,
11 the Natural Gas Act, the Natural Gas Policy Act of 1978, and
12 Part I of the Federal Power Act.

13 Now, the process we will use to assess civil
14 penalties for violations of these various laws, will not be
15 uniform; it will vary from statute to statute, and that is
16 driven by differences in the laws themselves.

17 Now, with respect to Commission enforcement
18 actions, I would expect that, in many cases, they would
19 result in settlements. Settlements allow us to stretch our
20 enforcement resources and to develop investigations across a
21 wider field.

22 They also benefit consumers by delivering
23 benefits such as disgorgement of profits, soon than would be
24 the case under litigation.

25 However, not all enforcement actions will result

1 in settlements, and in those instances, we are prepared to
2 litigate.

3 This Order lays out the process that we will use
4 to assess civil penalties in enforcement actions that do not
5 result in settlement.

6 This administrative policy, again, demonstrates
7 our commitment to firm and fair enforcement, and I strongly
8 support it.

9 Colleagues? Jon?

10 COMMISSIONER WELLINGHOFF: Thank you, Mr.
11 Chairman. I, too, support the Order on civil penalty
12 procedures. I think they're very important from the
13 standpoint of the operation of an efficient energy market.
14 To provide consumers with lower-cost services, you need fair
15 robust competition to do that, and to do that, you have to
16 have vigorous oversight.

17 A part of vigorous oversight is the effective
18 enforcement, as well as a need for civil penalties. I think
19 this Order does provide us with procedures to do that and I
20 think that helps to ultimately move toward more efficient
21 markets.

22 CHAIRMAN KELLIHER: Colleagues?

23 COMMISSIONER SPITZER: Mr. Chairman, thank you.
24 There are two aspects, both important, of this Order:

25 The Chairman alluded to some history and the

1 disparate historical antecedents of the provisions that give
2 rise to different procedural mechanisms. It's complex, and
3 I think it's very valuable that in one document, we now
4 spell out some of those somewhat residual nuances among the
5 substantive laws.

6 It is important that this Commission is
7 undertaking these matters in a vigorous way. It's new
8 responsibility, and, as the Chairman has pointed out, it is
9 imperative that they be enforced in a firm and fair manner,
10 and that the regulated community understands the procedures
11 under which these cases will be taken up.

12 The fact that we're not certainly hostile the
13 concept of settlements, but there is, every now and then, a
14 time and place where cases need to be tried, and this Agency
15 will not be passive.

16 As important, if not more important, are the
17 impacts among the ratepayers of this country. As you all
18 know, there's been some turmoil in the energy markets, both
19 wholesale and retail, and it is critical that the regulated
20 community has faith and confidence in the system, and aware
21 that misconduct will not be tolerated.

22 And in terms of faith and confidence in both
23 wholesale markets and ultimately state retail regulation, I
24 think the fact that there is a cop on the beat now, should
25 give great comfort to market participants and, more

1 importantly, the ratepayers.

2 And that faith and confidence is critical to this
3 industry, and I look forward to promoting faith and
4 confidence of Americans in wholesale markets and retail
5 regulation. Thank you, Mr. Chairman.

6 CHAIRMAN KELLIHER: Thank you. Commissioner
7 Kelly?

8 COMMISSIONER KELLY: I think that where we start
9 on this, is recognizing that Congress gave us a significant
10 penalty authority in the Energy Policy Act, and with that
11 significant authority, comes quite a weighty responsibility
12 to implement that authority as we need to, in a fair and
13 reasoned way.

14 I think that the Commission has gone out of its
15 way to attempt to assure the industry that we really are
16 intent on taking this responsibility seriously.

17 In October of last year, we issued a Policy
18 Statement that discussed what factors the Commission would
19 take into account in determining the severity of penalties
20 to be imposed for violations, and we articulated there, how
21 the Commission intends to apply its new and expanded civil
22 penalty authority.

23 That policy statement addressed the substance of
24 how the Commission will act, and this Order explains the
25 process that the Commission will go through in assessing

1 civil penalties when enforcing the statutes, the Orders, the
2 rules, and the regulations we administer, if there is no
3 negotiated resolution.

4 I also want to mention that for those among us
5 who are visually oriented, I really commend this Order to
6 you, because it includes four great pictures, very handy
7 flow charts. Ted, I don't know if that was your visual and
8 technical expertise brought to bear on the Order, or your
9 team's, but it helped me understand the process immensely.
10 Thank you very much.

11 MR. GERARDEN: I definitely had help.

12 (Laughter.)

13 CHAIRMAN KELLIHER: Commissioner Moeller?

14 COMMISSIONER MOELLER: Mr. Chairman, I don't have
15 a lot of original thought to add to the comments of my
16 colleagues, but I want to make it clear that I strongly
17 endorse what we're doing here. I think it's a good process.

18 CHAIRMAN KELLIHER: Thank you. Shall we vote?

19 SECRETARY SALAS: Commissioner Wellinghoff?

20 COMMISSIONER WELLINGHOFF: I vote aye.

21 SECRETARY SALAS: Commissioner Moeller?

22 COMMISSIONER MOELLER: Aye.

23 SECRETARY SALAS: Commissioner Spitzer?

24 COMMISSIONER SPITZER: Aye.

25 SECRETARY SALAS: Commissioner Kelly?

1 COMMISSIONER KELLY: Aye.

2 SECRETARY SALAS: Chairman Kelliher?

3 CHAIRMAN KELLIHER: Aye. The second item for
4 discussion this morning, is G-1, Panhandle Complainants vs.
5 Southwest Gas Storage Company.

6 It's a presentation by Richard Howe, Mike
7 Strzelecki, and Bob Fulton.

8 MR. HOWE: Good morning, Mr. Chairman and
9 Commissioners. I am Richard Howe from the Office of General
10 Counsel, and joining me at the table are Mike Strzelecki and
11 Bob Fulton of the Office of Energy Markets and Reliability.

12 G-1 is a Draft Order on a Complaint requesting
13 that the Commission act under NGA Section 5, to reduce the
14 rates of Southwest Gas Storage Company.

15 The Complainants are producers, shippers, and
16 users of natural gas transported on Panhandle Eastern
17 Pipeline Company, which is an affiliate of Southwest Gas and
18 is Southwest Gas's only current customer.

19 The Complainants allege that Southwest Gas's most
20 recent Form 2-A filing shows that it is currently over-
21 recovering its costs by almost 60 percent.

22 The Draft Order sets the Complaint for hearing
23 before an Administrative Law Judge and institutes a Section
24 5 investigation.

25 The Draft Order also requires Southwest Gas to

1 file a cost and revenue study within 45 days.

2 The Draft Order denies both Southwest Gas's
3 request that the Commission dismiss the Complaint, and the
4 Complainants' request for an immediate interim rate
5 reduction.

6 However, the Draft Order states that if the cost
7 and revenue study to be filed by Southwest Gas, does not
8 support Southwest Gas's current rates, then the Commission
9 will order an immediate rate reduction down to the level
10 that Southwest Gas's cost and revenue study does support,
11 and the hearing would then continue to consider whether a
12 further rate reduction would be justified.

13 This concludes my presentation, and we would be
14 pleased to answer any questions.

15 CHAIRMAN KELLIHER: Thank you. First of all --
16 and this is at the risk of embarrassing you within the
17 Commission, not the way to start off, but I just want to say
18 that I really enjoy the Orders that you write and you help
19 write, because you are an excellent writer, so when I see
20 your name on an Order, I really perk up, because I --

21 (Laughter.)

22 CHAIRMAN KELLIHER: Now that I've completely
23 embarrassed you, let me make some general comments on the
24 Order.

25 I called this Order to discuss the general

1 approach to natural gas pipeline storage rates that are
2 reflected in the Order and the steps that we're taking to
3 support Complainants.

4 Now, in this case, the storage customers filed a
5 Complaint with Southwest Gas Storage, concerning unjust and
6 unreasonable rates for storage service, and we set the
7 Complaint for hearing.

8 As a general matter, I prefer to rely on
9 Complainants to address gas rates outside -- I prefer to
10 rely on Complaints to address gas rates outside of Section 4
11 rate proceedings. That's how we proceed with respect to
12 electric rates, on the electric side, and I really think
13 that is the correct course to follow with respect to gas
14 rates, as well.

15 However, if we're going to rely on Complaints to
16 review gas rates outside of Section 4 rate cases, it's
17 necessary that Complainants have access to public
18 information that proves to be a sufficient basis for a
19 complaint.

20 In a Section 5 proceeding, the Complainant has
21 the burden of proof, and it's necessary that they have
22 access to the information they need to meet that burden.

23 Now, Form 2 provides public information on gas
24 rates. In all likelihood, a Section 5 Complaint will be
25 based on Form 2 data.

1 In other cases, such as National Fuel, earlier
2 this year, pipelines have challenged Section 5 Complaints
3 based on Form 2 data, arguing that Form 2 data is an
4 insufficient basis for a Section 5 Complaint. We rejected
5 that argument in National Fuel.

6 Now, in my view, it's absolutely necessary that
7 Form 2 data prove to be a sufficient basis for a Section 5
8 Complaint. That was our holding in National Fuel, however,
9 the fact that this defense is even raised, is disturbing,
10 and I think the time has come to revisit the Form 2 and
11 assure that it provides the data that Complainants need.

12 If the Form 2 is inadequate in any respect, then
13 we should strengthen it. Now, the Commission has been
14 conducting a review of Form 2 data, and I want to commend
15 the Office of Enforcement for conducting that review.

16 They have been examining the breadth of the data
17 collected by both Form 1 and Form 2, but with respect to
18 Form 2, they have been examining the breadth of data
19 collected by the Form, assessing the need for
20 clarifications, corrections, deletions, or additional
21 information.

22 I expect that we will soon take some steps to
23 strengthen Form 2 in order to improve the ability of
24 Complainants to meet their burden under Section 5 of the Gas
25 Act.

1 So, I think this is an important Order, and,
2 really, I wanted to describe some of the actions we're
3 taking with respect to Form 2.

4 Colleagues?

5 (No response.)

6 CHAIRMAN KELLIHER: Okay, shall we vote?

7 SECRETARY SALAS: Commissioner Wellinghoff?

8 COMMISSIONER WELLINGHOFF: Aye.

9 SECRETARY SALAS: Commissioner Moeller?

10 COMMISSIONER MOELLER: Aye.

11 SECRETARY SALAS: Commissioner Spitzer?

12 COMMISSIONER SPITZER: Aye.

13 SECRETARY SALAS: Commissioner Kelly?

14 COMMISSIONER KELLY: Aye.

15 SECRETARY SALAS: Chairman Kelliher?

16 CHAIRMAN KELLIHER: Aye.

17 SECRETARY SALAS: The third item for discussion
18 this morning, is E-3, PJM Interconnection, and it's a
19 presentation by Jon McPherson, Susanna Ehrlich, and David
20 Mead.

21 MR. MCPHERSON: Good morning, Mr. Chairman and
22 Commissioners. I'm Jon McPherson with the Office of Energy
23 Markets and Reliability, and with me at the table are
24 Susanna Ehrlich from the Office of the General Counsel, and
25 David Mead, also of the Office of Energy Markets and

1 Reliability.

2 I'd like to recognize other members of the team
3 from the Office of Energy Markets and Reliability. They are
4 Deborah Ott, Dionne Thompson, Kathleen Williams, David
5 Kathan, Tatyana Kramskaya, Josef Gardner, and Daniel Nowak.

6 Team members from the Office of General Counsel
7 include Katherine Waldbauer, Michael Goldenberg, and Chris
8 Wilson, and also Alan Haymes of the Office of Enforcement.

9 In this Draft Order, the Commission approves,
10 with conditions, a Settlement filed by PJM and a broad
11 spectrum of PJM market participants, addressing PJM's
12 reliability pricing model or RPM.

13 RPM establishes new market rules that will enable
14 PJM to obtain sufficient energy to reliably meet the needs
15 of consumers, while at the same time it ensures just and
16 reasonable rates for PJM customers.

17 MS. EHRLICH: RPM is the product of extensive
18 discussions between PJM and its membership. PJM filed this
19 proposal on August 31st, 2005, to revise its markets to deal
20 with projected violations of its reliability requirements.

21 In response, the Commission issued an Order on
22 April 20, 2006, concluding that as a result of a combination
23 of factors, PJM's existing market rules are unjust and
24 unreasonable.

25 It also provided guidance as to a just and

1 reasonable replacement for the existing market structure.

2 This Order also established further proceedings
3 to resolve open issues.

4 The Commission encouraged the parties to
5 negotiate a Settlement. Parties commenced Settlement
6 discussions under the direction of Administrative Law Judge
7 Lawrence Brenner.

8 More than 65 parties participated for over 25
9 days in extensive Settlement discussions and reached a
10 Settlement that is widely supported.

11 Compared to 33 Protests of PJM's original filing,
12 the Settlement is formally opposed by only 11 parties. The
13 parties supporting or not opposing the Settlement, include a
14 broad spectrum of PJM stakeholders, including generators,
15 load-serving entities, and municipalities, as well as five
16 state commissions and two consumer groups.

17 The Draft Order finds that the Settlement, with a
18 few changes, is expected to result in the availability of
19 reliable energy supplies within PJM, at just and reasonable
20 rates.

21 Based on the evidence supplied by the parties,
22 the Settlement will provide greater incentives for new
23 generation, transmission, and demand response.

24 At the same time, it will provide sufficient
25 revenues to retain existing resources. Under the

1 Settlement, PJM is forecasted to meet its reliability
2 obligations 95 percent of the time, as compared with a
3 forecast of only 52.5 percent under its existing market
4 structure.

5 PJM also projects that the overall cost of the
6 Settlement provisions will be less than what would be
7 incurred under PJM's existing mechanisms.

8 MR. MEAD: The major provisions of the Settlement
9 are briefly described as follows:

10 First, the Settlement creates separate locational
11 deliverability areas within PJM, each with a reliability
12 target.

13 The Settlement requires that each company
14 providing electricity to customers, must obtain sufficient
15 supplies to meet the reliability targets for its service
16 territory.

17 Second, the Settlement provides that utilities
18 can supply energy needs through a combination of generation,
19 transmission, and demand response.

20 The Settlement also encourages greater
21 consideration of energy efficiency.

22 Third, prices will be set in each area, to
23 reflect the needs of each area. The Settlement provides for
24 prices to be determined through an auction market, with a
25 demand curve that reflects the reliability value of

1 increased supply.

2 The demand curve is expected to decrease the
3 volatility of the market and thereby create a better
4 environment for investment in new generation.

5 The demand curve is also expected to support
6 investment in existing plants and in demand-response
7 programs.

8 Utilities that prefer not to participate in the
9 auction market with the demand curve, and that meet certain
10 other requirements, may procure a predetermined amount of
11 supply outside of the auction.

12 Fourth, to increase the opportunities for
13 increased competition from new investments, the Settlement
14 provides that companies providing service to customers, must
15 contract with suppliers, three years in advance, to ensure
16 that reliability goals are met.

17 The Draft Order conditions approval of the
18 Settlement on the filing by PJM of, first, changes to the
19 provisions that discriminate between signatories and non-
20 signatories; second, changes to the provisions giving
21 inappropriate discretion to the PJM Market Monitor; and,
22 third, changes to enable a greater number of resources,
23 expeditiously, to recover the costs of complying with state-
24 mandated requirements.

25 The Draft Order also requires PJM to report to

1 the Commission on the status of additional process on demand
2 response and energy efficiency, and the results and
3 conclusions of its forum that it commits to hold on demand
4 response.

5 Finally, the Draft Order requires a number of
6 demand-response rules and procedures that presently are in
7 the manuals and in the reliability assurance agreements, to
8 be placed into the PJM tariff.

9 And, finally, before I close, I would just like
10 to mention that today is the last day at the Commission here
11 for Jon McPherson, the leader of our team. He has led our
12 efforts on this for over a year, with competence and with
13 persistent good nature. We on the team would like to wish
14 him well, with good cheer in his retirement.

15 With that, that concludes our presentation, and
16 we would be happy to answer any questions.

17 (Applause.)

18 MR. MCPHERSON: If I may just take a moment of
19 the Commission's time to say that it has been an honor and
20 privilege to have worked here. I have never enjoyed more,
21 my employment anywhere else but here. I have spent over 35
22 years working in energy. My first job was with Anchor
23 Refining Corporation, in a coal mining operation, so I have
24 literally worked from under the bottom, up.

25 (Laughter.)

1 MR. MCPHERSON: Thank you.

2 CHAIRMAN KELLIHER: I want to commend you for
3 your service. Colleagues, does anyone want to start? Jon?

4 COMMISSIONER WELLINGHOFF: Sure, I'd be happy to,
5 Mr. Chairman, thank you.

6 Today we are asked to approve conditions of
7 Settlement that I support, and it addresses issues that PJM
8 and its stakeholders have struggled with for years, and that
9 is how to ensure there are adequate resources to provide
10 reliable service within the PJM region, at just and
11 reasonable rates to consumers.

12 It's expected that this reliability pricing model
13 will create those incentives to invest in improving
14 inefficient and aging infrastructure in the region.
15 Safeguards are also included to protect consumers against
16 the exercise of market power or market manipulation.

17 In my view, the most significant of those
18 safeguards is demand response. The Settlement provides for
19 qualified demand-response resources to participate in the
20 RPM auctions on a comparable basis with generation.

21 A forward price curve will drive the investment
22 in demand response and a three-year contract can be used by
23 many demand response providers to obtain financing.

24 The parties have committed to continuing efforts
25 with regard to demand response and energy efficiency, and

1 we're looking forward to seeing the fruits of those filings
2 in the future.

3 I also wish to thank my colleagues for requiring
4 that the rules and procedures for qualifying demand response
5 as a resource in the RPM auctions, and for verifying
6 performance that will be filed in PJM's tariffs, thus
7 providing clear rules of the road for demand-response
8 providers to participate in the RPM auctions.

9 I also appreciate the support in calling for
10 additional analysis of the minimum six-hour direction
11 requirement. It may not be necessary to achieve the goals
12 of the market and may unnecessarily preclude demand
13 resources from participating in the market.

14 I also want to thank the Staff team for their
15 hard work in this Settlement and for their responsiveness to
16 our numerous questions regarding this filing.

17 I would like to also indicate that I understand,
18 John, that you -- one of the first things you started out
19 doing at TVA, was demand response.

20 MR. McPHERSON: Yes, sir, I spent ten years
21 working on demand programs.

22 COMMISSIONER WELLINGHOFF: I think it's fitting
23 that you're ending your service at FERC with an important
24 milestone for enabling demand-response resources to
25 participate in the wholesale markets. Thank you.

1 CHAIRMAN KELLIHER: Colleagues, any other
2 comments? Commissioner Kelly -- oh, Commissioner Spitzer.

3 COMMISSIONER SPITZER: Thank you, Mr. Chairman.
4 This is a proceeding that's been around for quite some time,
5 and perhaps because the underlying economic issues are very
6 complex, as well as the procedural difficulties of a matter
7 of general allocability in broad service territory.

8 I just wanted to make a brief comment regarding
9 the undertaking of Settlement discussions before Judge
10 Brenner. That was somewhat of a courageous undertaking,
11 because a settlement can go south very quickly.

12 But there are benefits in settlements in matters
13 such as those Commissioner Wellinghoff alluded to, as well
14 as others, and they are embraced and enhanced in the give-
15 and-take of a settlement discussion, whereas in a litigated
16 proceeding, a lot of times those matters fall off.

17 So it was, I think, a great benefit attendant to
18 the efforts of the Administrative Law Judge conducting the
19 settlement which was ultimately successfully achieved, and I
20 think that reflects credit upon the parties to the
21 proceeding, as well as the Administrative Law Judge. Thank
22 you.

23 CHAIRMAN KELLIHER: Commissioner Moeller?

24 COMMISSIONER MOELLER: Briefly, Mr. Chairman, I
25 will echo the comments of Commission Spitzer on the

1 Settlement. The fact that, although it wasn't unanimous, it
2 was by far -- by far most of the parties agreed to it, so, I
3 think it's important to keep that in mind.

4 And I support, certainly, the demand-response
5 initiatives and efforts that are in this, but I also want to
6 point out the fact that, as the Order will state, there is
7 aging generation infrastructure in this market, which is
8 quite old, and there have been a lot of retirements
9 recently, with more to come, and that needs to be a focus
10 going forward, as well.

11 CHAIRMAN KELLIHER: Commissioner Kelly?

12 COMMISSIONER KELLY: Well, PJM has operated a
13 regional organized electricity market since 1997, so almost
14 ten years now.

15 And the capacity market structure being approved
16 today, represents another step in the evolution of PJM's
17 market development.

18 And that's a theme that I wanted to point out
19 again, as I did earlier with the MMU Order. These markets
20 have sprung from total regulation, and as we move towards
21 more effective competition, it takes time and it takes
22 planning.

23 And this Settlement is a result of that process.
24 I'm pleased with the process, as well, that we used and the
25 parties used to arrive at the Settlement.

1 PJM ensures the reliability of the largest
2 centrally-dispatched electric grid in the country, indeed,
3 in the world, by coordinating the movement of electricity
4 across 14 states.

5 In light of the difficulty that PJM has had under
6 its current capacity market structure, in meeting
7 reliability requirements in localized areas, it has been
8 working with its stakeholders for several years now to
9 develop a structure that would improve its ability to
10 reliably meet the needs of its customers.

11 The Settlement approved in this Order,
12 establishes a new reliability pricing model capacity market
13 structure which will allow PJM to ensure that there are
14 sufficient resources within PJM at the right time and the
15 right place to meet demand.

16 As has been noted by several of the
17 Commissioners, the Settlement was supported by a broad range
18 of PJM stakeholders. The capacity market set into place by
19 this Settlement, with its locational component and its
20 downward-sloping demand curve, promises to send price
21 signals more effectively than the existing market structure,
22 and thereby encourage investment in additional
23 infrastructure in locations where it is needed.

24 The regional pricing model approved in this
25 Order, should allow PJM to procure sufficient capacity to

1 meet its capacity needs by helping to retain existing
2 generation and establishing prices that encourage the entry
3 of new resources to resolve reliability issues.

4 CHAIRMAN KELLIHER: Thank you. I'll say some
5 brief comments, as well.

6 In our action today, as my colleagues have said,
7 our action takes an important step towards assuring adequate
8 electricity supply at just and reasonable prices in the PJM
9 Interconnection.

10 And as the Order demonstrates and my colleagues
11 have said, there's a growing electricity supply problem in
12 PJM. This problem has grown to the point where reliability
13 has been degraded in New Jersey, and these reliability
14 problems are becoming more persistent.

15 Under the status quo, we can expect reliability
16 problems to expand to other parts of the Eastern PJM.

17 Now, in essence, this problem is caused by
18 steadily increasing demand, combined with a slowdown of new
19 entry and a surge in generator retirements, and it's
20 declining in areas where supply additions are the most
21 needed.

22 Now, part of the problem is caused by a surge in
23 retirements by generators who are unable to recover their
24 costs under the current capacity market rules.

25 While demand steadily increases in PJM, planned

1 retirements have also increased, and as is the case in the
2 slowdown in new entry, retirements are occurring exactly
3 where supply is most needed.

4 Roughly 40 percent of generator retirements since
5 2003, are located in New Jersey, the state that is presently
6 suffering the highest -- the greatest reliability problem.
7 Now, as a result of declining entry and rising retirements,
8 PJM anticipates degraded reliability will expand outside of
9 New Jersey to other parts of Eastern PJM, such as the
10 Delmarva Peninsula and the Baltimore-Washington area.

11 Now, just as we saw in New England, this problem
12 will not resolve itself. It requires Commission action.

13 The changes made by the Settlement should address
14 the problem and should assure an adequate electricity supply
15 at just and reasonable prices.

16 I think the Settlement takes a balanced approach.
17 It places great emphasis on demand response, as well as
18 generation additions and increased investment in
19 transmission.

20 As my colleagues have noted, the Settlement is
21 broadly supported. There were 89 parties in the original
22 proceeding, but, in the end, only 11 parties protested the
23 Settlement Agreement.

24 I want to congratulate the Deputy Chief Judge
25 Lawrence Brenner on his success in fostering the Settlement.

1 He seems to be the Henry Kissinger of capacity markets.

2 (Laughter.)

3 (Discussion off the record.)

4 CHAIRMAN KELLIHER: But Judge Brenner, in my
5 view, is one of the best that we have, and he's had
6 tremendous success in this and other settlement
7 negotiations, and I just want to commend him for his good
8 work here. With that, shall we vote?

9 SECRETARY SALAS: Commissioner Wellinghoff?

10 COMMISSIONER WELLINGHOFF: I vote aye.

11 SECRETARY SALAS: Commissioner Moeller?

12 COMMISSIONER MOELLER: Aye.

13 SECRETARY SALAS: Commissioner Spitzer?

14 COMMISSIONER SPITZER: Aye.

15 SECRETARY SALAS: Commissioner Kelly?

16 COMMISSIONER KELLY: Aye.

17 SECRETARY SALAS: Chairman Kelliher?

18 CHAIRMAN KELLIHER: Aye.

19 SECRETARY SALAS: Next on the discussion agenda,
20 is C-1, Millennium Pipeline Company. It is a presentation
21 by Sheila Hernandez, Elizabeth Aklam, Buu Nguyen, Jennifer
22 Kerrigan, Robert Sheldon, and Joel Arneson.

23 (Pause.)

24

25

1 MS. HERNANDEZ: Good morning, Chairman Kelliher
2 and Commissioners. My name is Sheila Hernandez. I work in
3 the Office of Energy Projects. I would like now to
4 introduce the staff team members for the Northeast-07
5 project. Unfortunately the team is too large for us all to
6 sit at the table.

7 The team members are: Elizabeth Anklam, Buu
8 Nguyen, Jennifer Kerrigan and Joseph Caramanica of the
9 Office of Energy Projects; Joel Arneson of the Office of
10 General Counsel; Audrey Wong of the Office of Enforcement;
11 Robert Sheldon and Frank Sparber of the Office of Energy
12 Markets and Reliability.

13 (Slide.)

14 Agenda Item C1 approves the Northeast-07 project,
15 a series of individual projects designed to access new gas
16 supplies from Canada to the New York City area. The
17 Northeast-07 project is a reconfiguration of the Millenium
18 Pipeline project approved in 2002, which authorized the
19 construction and operation of a pipeline from the United
20 States-Canada border at a point in Lake Erie across southern
21 New York and the Hudson River to a terminus in Mount Vernon,
22 New York.

23 The Northeast-07 project before us today is
24 comprised of five proposals by Millenium Pipeline Company,
25 Columbia Gas Transmission Corporation, Empire Pipeline,

1 Algonquin Gas Transmission, and Iroquois Gas Transmission
2 System.

3 (Slide.)

4 Specifically, Empire Pipeline, a new interstate
5 pipeline company, proposes to install 20,620 horsepower of
6 compression and construction and operate 78 miles of
7 pipeline from Empire State Pipeline's existing intrastate
8 facilities at Victor, New York south to an interconnection
9 with the proposed Millenium Pipeline at Corning, New York.
10 The design capacity of Empire's facilities will be 250,000
11 decatherms per day. The project cost is estimated to be
12 \$144.2 million.

13 On July 20, 2006 the Commission issued a
14 preliminary determination to Empire Pipeline finding that
15 conversion of its existing facilities to interstate service,
16 coupled with the construction of the new facilities to
17 interconnect with Millenium is in the public convenience and
18 necessity, subject to an evaluation of environmental issues.

19 The preliminary determination also required
20 Empire to make numerous revisions to its proposed rates and
21 tariff.

22 (Slide.)

23 Millenium proposes to acquire certain facilities,
24 install 15,002 horsepower of compression, and construct and
25 operate 181.7 miles of pipeline from the North Greenwood

1 Compressor Station in central New York east to Rockland
2 County, New York. The Millenium Pipeline will interconnect
3 with the facilities of Algonquin at the existing Ramapo
4 meter and regulation station also in Rockland County.

5 The design capacity of Millenium's facilities
6 will be 525,000 decatherms per day. The estimated cost of
7 the project is \$663.8 million.

8 Millenium no longer proposes to cross Lake Erie
9 or the Hudson River or terminate in Mount Vernon, New York.
10 Since Millenium's pipeline will follow the route of
11 Columbia's existing line A5 from the vicinity of the North
12 Greenwood compressor station to the Ramapo station in
13 Rockland County.

14 Columbia proposes to abandon its line A5 and to
15 lease capacity on the newly constructed Millenium system to
16 continue to provide service to its existing customers off of
17 line A5.

18 (Slide.)

19 Algonquin proposes to install 71,810 horsepower
20 of compression and construct and operate 4.8 miles of
21 replacement pipeline to facilitate the transportation of new
22 supply receipts from Millenium from the Ramapo station to an
23 interconnection with Iroquois' system in the town of
24 Brookfield, Connecticut, and to an interconnection with the
25 certificated facilities at Islander East and Cheshire,

1 Connecticut.

2 The design capacity of Algonquin's facilities
3 will be 325,000 decatherms per day. The estimated cost of
4 the project is \$191.7 million.

5 (Slide.)

6 Iroquois proposes to install 7700 horsepower of
7 compression to transport the gas from Brookfield,
8 Connecticut into New York City. The design capacity of
9 Iroquois' facilities will be 100,000 decatherms per day.
10 The estimated cost of the project is \$41.6 million.

11 (Slide.)

12 During the first year of service 250,000
13 decatherms per day will be delivered into the New York City
14 area, increasing to 300,000 decatherms per day in the second
15 year of service.

16 (Slide.)

17 In total, the Northeast-07 project will add
18 approximately 265 miles of pipeline and 115,132 horsepower
19 of compression to the energy infrastructure. The total
20 estimated cost of the Northeast-07 project is over one
21 billion dollars.

22 This draft order amends the certificates issued
23 to Millenium and Columbia in 2002, vacates the portions of
24 the 2002 order that are no longer needed, issues
25 certificates to Empire Pipeline to become a jurisdictional

1 pipeline and to construct and operate facilities, grants and
2 denies requests for rehearing and clarification of Empire
3 Pipeline's preliminary determination, issues a certificate
4 to Algonquin to construct and operate facilities, and amends
5 a certificate to Iroquois to construct and operate
6 facilities.

7 This concludes our presentation. We will be
8 happy to answer any questions.

9 COMMISSIONER KELLY: I have a question.

10 Is there also a relationship between Millenium
11 Pipeline and Islander East? As I understand it from your
12 presentation this order authorizes Algonquin to transport
13 150,000 decatherms per year, eventually increasing to
14 200,000 decatherms per year for Key Span, and that this
15 Millenium Project would deliver gas to the Bronx. However,
16 it's also proposed to have an interconnection with the
17 Islander East Pipeline, and that pipeline the Commission
18 certificated in 2002.

19 The actual construction of that pipeline has been
20 held up for a long time. And I understand that this past
21 October the Second Circuit Court of Appeals ruled that the
22 Connecticut Department of Environmental Protection had no
23 legal basis for denying a water quality certificate to the
24 Islander East Pipeline and told Connecticut it must conduct
25 a further review.

1 My question is:

2 Given today's order what would happen if the
3 Islander East Project does not go forward?

4 MS. HERNANDEZ: If Islander East is not
5 constructed Iroquois would have to come in to a certificate
6 proceeding to operate its system.

7 COMMISSIONER KELLY: Where would that upgrade
8 take place?

9 MS. HERNANDEZ: In Milford, Connecticut.

10 COMMISSIONER KELLY: Where would the delivery
11 point be? Would there be a delivery point to Long Island?

12 MR. NGUYEN: At this time Iroquois will deliver
13 to Hahn Point, New York.

14 MS. HERNANDEZ: There is a point that it could go
15 into Long Island. I don't know what it is. It's not named
16 on the map. There is a point that Iroquois could deliver
17 into Long Island.

18 COMMISSIONER KELLY: When is the Millenium
19 Pipeline Project proposed to be completed?

20 MS. HERNANDEZ: 2008.

21 COMMISSIONER KELLY: It would be helpful to have
22 Islander East on that.

23 MR. ROBINSON: Commission, it just isn't updated.
24 The State of Connecticut on Tuesday of this week, following
25 the court's remand of 401 back to the state of Connecticut,

1 I fully expect that this will continue. That denial may be
2 looked at by Islander East and they'll take appropriate
3 steps and continue to pursue this.

4 The gas is needed in Long Island. The Commission
5 found several years that additional pipelines leading to
6 Long Island had benefits beyond just delivery of gas but
7 also in terms of reliability with another pipe coming in
8 from the north. So it's not over yet.

9 CHAIRMAN KELLIHER: The additional acts, do you
10 suggest they're seek judicial review of the denial of the
11 permit?

12 MR. ROBINSON: I'm sure that's a decision they're
13 going to make.

14 COMMISSIONER KELLY: So it would go directly to
15 the second circuit again?

16 MR. ROBINSON: I believe it does.

17 CHAIRMAN KELLIHER: Any other comments on
18 Millenium?

19 COMMISSIONER WELLINGHOFF: Just a quick comment.

20 This is a massive project. And apparently it
21 brings needed gas supplies into the New York City area,
22 which I think is a good thing from a number of perspectives.
23 And I support this order.

24 One perspective in particular, I think it will
25 make available additional gas to reduce further generation.

1 From our perspective, the FERC perspective, it is a project
2 that's going into what is right now a constrained area of
3 the country. From this standpoint I hope that we can most
4 efficiently construct the project as soon as possible.

5 COMMISSIONER KELLY: I think by approving phase
6 one of the Millenium Pipeline project we've taken an
7 important step toward ensuring available orderly and
8 reliable supplies of natural gas to meet not only New York's
9 but the northeast's growing energy needs. The phase one
10 project will provide for the delivery ultimately of about
11 525,000-plus decatherms per day of natural gas
12 transportation service into the area.

13 Now this Millenium Pipeline project has been
14 delayed for some time. And I want to comment on that. The
15 reason for the delay underscores an extremely important
16 issue. That is the states and local communities do have a
17 voice in determining the state of natural gas
18 infrastructure.

19 In 2001 the Commission had the Millenium Pipeline
20 project before it. We issued an interim order there
21 authorizing it. The interim order recognized that there was
22 significant opposition to a portion of the proposed pipeline
23 that would cross the Hudson River into the city of Mount
24 Vernon and Westchester County. We required Millenium and
25 Mount Vernon to work together to come up with a solution.

1 COMMISSIONER MOELLER: Mr. Chairman and fellow
2 Commissioners, I just hope consumers realize that there is a
3 cost to delay. Some of those costs come out to \$40 million
4 a mile; it's about \$8,000 a foot by my math. I heard
5 recently that the cost of LNG facilities worldwide
6 construction of them has gone up 60 percent in the last
7 year. The longer we delay putting the structure in the
8 ground the more we're going to pay for it.

9 CHAIRMAN KELLIHER: I'll make some comments as
10 well. As a New York City native I think I have to make
11 those comments.

12 I grew up in New Jersey too. I'll refrain from
13 saying anything in the order about that.

14 Anyway, the Millenium Pipeline Project was
15 proposed to meet the rising need for natural gas in New York
16 City and the surrounding area. As the staff indicated, it
17 was originally proposed in 1997 and amended in 2000. The
18 Commission authorized the original project in 2002. It
19 wasn't built for reasons that have been discussed.
20 Nonetheless demand for natural gas supplies in the New York
21 City area has continued to rise. Since our 2002 order
22 natural gas demand in New York City has risen over seven
23 percent while supplies have remained flat. By 2008 -- the
24 expected in-service date of the new Millenium project -- the
25 demand in New York City is expected to increase by over 15

1 percent compared to the 2002 level, again the supplies being
2 flat.

3 The capacity of the new Millenium Project we
4 certificated today is much less than the original project we
5 approved in 2002, and that will have consequences for New
6 York City. Natural gas supplies will be less and prices
7 will likely be higher.

8 As Commissioner Moeller mentioned, it's very
9 important to understand -- for consumer-citizens to
10 understand the relationship between energy infrastructure
11 and price. Energy infrastructure sounds like a vague
12 concept. What is energy infrastructure? But energy
13 infrastructure is the ability to produce energy where it's
14 needed by consumers and our economy. To the extent our
15 energy infrastructure isn't adequate the natural and
16 predictable result would be reduced supplies at higher
17 prices. There is a direct relationship between the two.

18 Consumers and businesses bear the cost currently
19 of an inadequate energy infrastructure. The fact that these
20 costs are largely hidden does not mean that they're not real
21 and they're not being paid by consumers. So I'm pleased to
22 support this project and work to deliver needed gas supplies
23 to New York City, less than the projects we approved a
24 number of years ago.

25 Shall we vote?

1 SECRETARY SALAS: Commissioner Wellinghoff.

2 COMMISSIONER WELLINGHOFF: Aye.

3 SECRETARY SALAS: Commissioner Moeller.

4 COMMISSIONER MOELLER: Aye.

5 SECRETARY SALAS: Commissioner Spitzer.

6 COMMISSIONER SPITZER: Aye.

7 SECRETARY SALAS: Commissioner Kelly.

8 COMMISSIONER KELLY: Aye.

9 SECRETARY SALAS: Chairman Kelliher.

10 CHAIRMAN KELLIHER: Aye.

11 SECRETARY SALAS: Mr. Chairman and Commissioners,
12 the final item for discussion this morning is E-1. This is
13 promoting transmission investment. It is a presentation by
14 Tina Ham and Ray Goodson and Jeff Hitchings.

15 MS. HAM: Good morning, Mr. Chairman. Good
16 morning, Commissioners. My name is Tina Ham from the Office
17 of General Counsel. Sitting with me at the table are Andre
18 Goodson from the Office of General Counsel and Jeffrey
19 Hitchings from the Office of Energy Markets and Reliability.

20 E-1 is a draft order on rehearing, order number
21 679-A, that provides further guidance on promoting
22 transmission investment through pricing reforms and
23 addresses rehearing requests on order number 679.

24 The Energy Policy Act of 2005 directed the
25 Commission to develop incentive-based rate treatments for

1 transmission of electric energy in interstate commerce,
2 adding a new Section 219 to the Federal Power Act. The
3 final rule, order number 679, issued on July 20, 2006,
4 implemented that new statutory directive by providing
5 transmission pricing reforms and incentives designed to
6 promote needed investment in energy infrastructure.

7 Congress's intent in the Energy Policy Act of
8 2005 is clear. Congress directed the Commission in Section
9 219 to use its broad discretion under Section 205 of the
10 Federal Power Act to spur investment based on its
11 determination that the status quo was unacceptable. The
12 status quo resulted in, for example, a decline in
13 transmission investment while electric load has more than
14 doubled over the past thirty years so that today the
15 industry is spending 75 cents for every dollar spent in the
16 1970s, adjusted for inflation, on transmission investment.

17 The U.S. Department of Energy estimates that
18 congestion charges in 2008 will add approximately eight
19 billion dollars to electricity costs on the eastern grid.
20 The Energy Department report states that expensive plants
21 built just to meet peak demand as on hot summer days now run
22 40 percent of the year. It adds that congestion has become
23 so chronic that some century-old and very inefficient steam
24 turbines must also be operated to avoid blackouts.

25 Also, additional transmission investment will be

1 needed to connect remote renewable energy sources to the
2 electric grid. Edison Electric Institute estimates that
3 capital spending on transmission investment must increase by
4 25 percent from four billion to five billion annually to
5 assure system reliability and to accommodate wholesale
6 electric markets.

7 Further, according to Cambridge Energy Research,
8 its survey of electric company chief executives estimates
9 that 150 billion in transmission investment will be needed.

10 The final rule in this draft order 679-A
11 accomplishes the purpose set out by Congress in Section 219
12 by providing incentives that will encourage investment in
13 transmission in all regions of the country, reduce the cost
14 of delivered power by reducing transmission congestion, and
15 remove impediments to new investment or otherwise attract
16 needed investment. Order number 679 identifies specific
17 incentive rate treatments the Commission would allow when
18 justified in the context of specific applications.

19 A key component of Section 205, as recognized in
20 Section 219, is the requirement that the Commission protect
21 consumers according to the just and reasonable standard and
22 that rates are bounded by the zone of reasonableness.
23 Therefore, in addition to providing incentive-based rate
24 treatment the Commission is enhancing its consumer
25 protection provisions.

1 In draft order number 679-A specifically the
2 draft order clarifies that a nexus test will require
3 applicants to demonstrate that the total package of
4 incentives is tailored to the demonstrable risks or
5 challenges faced by the applicant in undertaking the
6 project. Also, the draft order clarifies that the
7 Commission does not intend to grant incentive returns
8 routinely at the top o the zone of reasonableness. Rather,
9 each applicant will first be required to justify a higher
10 ROE under the revised nexus test; and second, to justify
11 where in the zone of reasonableness that return should lie.

12 Other changes set forth in the draft order are
13 the Commission will rebuttably presume that a transmission
14 project will satisfy Section 219 if it results from a fair
15 and open regional planning process or has received state
16 siting approval. The Commission agrees with NARUC that the
17 planning and siting processes may not in all cases include a
18 determination that satisfies Section 219 requirements.
19 Thus, the regulatory text is amended to state that to the
20 extent these approval processes do not require that a
21 project ensures reliability or reduces the cost of delivered
22 power by reducing congestion, the applicant bears the burden
23 of demonstrating that its project satisfies these criteria.

24 Also, the draft order clarifies that applicants
25 can request a specific ROE in a petition for declaratory

1 order, thereby providing up-front certainty before
2 investments are made.

3 Finally, in regards to single issue ratemaking,
4 the draft order clarifies that applicants do not bear the
5 burden to justify unchanged rates. Rather, that burden
6 would be on intervenors or the Commission under Section 206
7 of the Federal Power Act.

8 This order also affirms that Section 205
9 incentive rate proceedings will not be delayed by a separate
10 206 hearing. This draft order reaffirms order number 679 on
11 all other issues.

12 Thank you. The team would be happy to answer any
13 questions.

14 CHAIRMAN KELLIHER: Questions from my colleagues?
15 Commissioner Wellinghoff.

16 COMMISSIONER WELLINGHOFF: Thank you, Mr.
17 Chairman.

18 I expect this order, Mr. Chairman, to promote
19 efficient transmission investment. With the issuance of
20 today's order we'll be taking an important step in
21 implementing the 2005 remand.

22 The final rule, of course, was issued July 4.
23 And today's order makes what I can see is a number of
24 important improvements. For example, today's order
25 clarifies that when an applicant requires a package of

1 pricing incentives it must provide sufficient explanation
2 and support to allow the Commission to evaluate both each
3 element of that package and the interrelationship of those.
4 Today's order properly highlights the importance of
5 economically and technologically efficient transmission
6 infrastructure.

7 With that I would like to particularly thank you,
8 Mr. Chairman, for your collaboration and cooperation on
9 these issues. I would also very much like to thank your
10 staff, although we're fated with my staff and my fellow
11 Commissioners to craft these improvements.

12 Thank you.

13 CHAIRMAN KELLIHER: Colleagues?

14 Marc.

15 COMMISSIONER SPITZER: Thank you, Mr. Chairman.

16 As Commissioner Wellinghoff pointed out, this was
17 one of the final decisions. I must say I'm a little
18 troubled by that because I don't think the Commission is
19 currently as turbulent as France in 1787. Within the band
20 of new Commissioners I do not wish to be the Robespierre.

21 It is interesting how the process unfolds where
22 there were multiple requests for rehearing and clarification
23 that came in -- and I think the Commission's responsiveness
24 to those concerns speaks well of the attentiveness of the
25 Commission staff in sorting through this -- clearly there

1 was a requirement to implement faithfully the law of the
2 United States in a manner that achieved the purpose and yet
3 did not open the door to potential unjust and unreasonable
4 rates. And I think we've achieved that balancing of
5 competing interests.

6 I would say the lawyer in me is particularly
7 amenable to what has been achieved in the draft order, which
8 is instead of inflexible requirements with respect to the
9 burden of proof on a nexus for each particular setting, the
10 Commission can evaluate the package as a whole and consider
11 the cases -- look at the incentives as a package and balance
12 the granting of one incentive against the granting or denial
13 of another. That focus on the totality of the circumstances
14 is very consistent with the law and consistent with the
15 judicial practice at this Commission.

16 So I'm pleased the Commission has been able to
17 deal with the issues raised by NARUC that were discussed and
18 again balance the competing interests and faithfully
19 implement the intent of Section 219 and provide for
20 additional transmission where those packages or incentive
21 packages will facilitate some desperately needed
22 transmission in this country.

23 I'm pleased to support the order.

24 CHAIRMAN KELLIHER: Phil.

25 COMMISSIONER MOELLER: Mr. Chairman, for the

1 members of the public listening, you may need to be reminded
2 that three of us were not present on Bastille Day.

3 (Laughter.)

4 COMMISSIONER MOELLER: I, too, was not here when
5 the order was initially approved. But I support this
6 decision. As you've heard me say before I think it's catch-
7 up time for the nation in terms of the transmission
8 infrastructure.

9 Congress told us to do this, to get some
10 incentives in place to encourage more transmission. I think
11 the rehearing process went well. We heard from a lot of
12 folks, from state commissioners to consumer groups,
13 investor-owned utilities, consumer-owned utilities,
14 investors. And the modified rules reflect that.

15 Again, I support it.

16 CHAIRMAN KELLIHER: Thank you.

17 Commissioner Kelly.

18 COMMISSIONER KELLY: The Federal Power Act,
19 Section 219, calls for the Commission to develop an
20 incentive-based rate treatment to achieve three goals. And
21 I'd like to focus on those three goals: One, to benefit
22 consumers; two, to reduce the cost of delivered power;
23 three, to promote economically efficient transmission and
24 generation of electricity.

25 I'm very pleased to join my colleagues today in

1 supporting this order. It makes clear that these important
2 goals of Section 219 are indeed as important as is the goal
3 of getting more transmission built. In short, it makes
4 several significant clarifications to the final rule that go
5 to the very heart of Section 219. That is that ultimately
6 the consumer must benefit from this rule.

7 A number of commenters on the final rule who
8 raised concerns that the final rule did not clearly reflect
9 the fact that the incentive direct costs will ultimately be
10 borne by consumers. In all likelihood because of the
11 incentives, the costs to build transmission will be more
12 than it would have been under the old regime -- not the
13 ancien regime.

14 (Laughter.)

15 COMMISSIONER KELLY: But the previous ratemaking
16 policy.

17 On the other hand, if the previous policies
18 aren't resulting in getting transmission built or are in
19 fact a hindrance to getting transmission built, we really
20 need to do something. That's the balance we need to strike.
21 And we agreed with the commenters and this order addresses
22 their concerns that the rule reflect the fact that
23 incentives, direct costs will borne by consumers in two
24 significant ways.

25 First, it sets forth a clear nexus test that is

1 demanding. And second, it clarifies that return on equity
2 incentives in particular will not be handed out lightly.

3 It makes clear that applicants will not receive
4 incentives simply by asking for them or by merely stating
5 that incentives are needed to attract capital. Nor will
6 applicants be rewarded just for the sake of building new
7 transmission. On the other hand, incentives are available
8 to applicants who need them.

9 As today's order makes clear, applicants must
10 show a meaningful causal connection between a requested
11 incentive and the demonstrated risks and challenges it faces
12 in building proposed transmission facilities. I believe the
13 nexus test is consistent with the underlying principles of
14 incentive rate treatment. That is, that these incentives
15 will incite applicants to action, not simply reward them for
16 doing what they would otherwise do.

17 I think also good are the clarifications
18 regarding the process for approving requests for incentive
19 ROEs. Today's order points out what where an applicant
20 seeks multiple incentives under the final rule the
21 Commission will consider the effect that these incentives
22 may have on risk and whether these incentives will lower
23 overall risk such that a request for an ROE in the upper end
24 of the zone of reasonableness may not be appropriate.

25 I think equally important, this order states that

1 we will not routinely grant ROE incentives. But when we do
2 grant them we have no expectation of routinely granting them
3 at the top end of the zone of reasonableness. Indeed,
4 applicants must justify a higher ROE and also justify where
5 in the zone of reasonableness that return should be.

6 I believe that the significant clarifications are
7 consistent with meeting the consumer-benefiting purposes of
8 Section 219, but still do not undercut the additional goal
9 of providing incentive-based rate treatments when they're
10 necessary. They're also consistent with board** precedent
11 where the Commission considers non-cost factors in setting
12 rates. We must always relate our action to the primary aim
13 of the Act in guarding consumers against excessive rates.

14 The devil is always in the details. Because
15 we're looking at these requests for incentive rate
16 treatments under Section 219 on a case by case basis, there
17 are many important issues that the rule cannot specifically
18 address, but, rather, that are more appropriately considered
19 at the implementation stage. For example, when an applicant
20 seeks a package of incentives, and we determine that the
21 applicant has asked for more than is necessary, for example,
22 then it may not result in a rate that is just and reasonable
23 and not unduly discriminatory. The current rule is silent as
24 to how we pick and choose among the requested incentives.

25 In keeping with Section 219's directive that he

1 consumer must ultimately benefit, it is my expectation that
2 under such circumstances we would adopt those incentives
3 that best advance that directive.

4 As one commenter noted, an applicant may place
5 too many incentives on its wish list or may select incentive
6 options that are poorly tailored to its factual situation.
7 I agree with commenters that, faced with any incentive
8 requests, the Commission should recognize that it possibly
9 could be inflated and should always ask whether every dollar
10 the applicant would collect represents the most congestion-
11 reducing or reliability-ensuring way to spend the next
12 dollars of society's investment in transmission facilities
13 and technology.

14 In other words, the Commission should choose the
15 incentives that in a particular case will best advance the
16 purpose of Section 219. And indeed, the applicants in
17 making their application should go through the process of
18 specifically choosing the incentives that will best meet
19 these hurdles and the risks and the challenges of their
20 project.

21 This is particularly important because the final
22 rule does not require applicants to provide a cost-benefit
23 analysis for incentive-based rate treatment. And I agree
24 with that determination in the final rule. I do so because
25 I believe that our implementation of the final rule, which

1 includes an analysis that identifies which incentives are
2 best tailored to address the risks and challenges facing the
3 project, will result in a process that is an appropriate
4 substitute for cost-benefit analysis and in effect will be a
5 cost-benefit analysis.

6 I did want to add a note or two in response to
7 concerns raised over our determination that we will allow
8 single-issue ratemaking for new transmission projects.

9 First, I want to emphasize that single-issue
10 ratemaking is a significant incentive in and of itself, and
11 one that the Commission has allowed only under very limited
12 circumstances in the past. I think that it is appropriate
13 to make that available in this kind of situation where our
14 country does need significant investment in transmission
15 infrastructure.

16 However, we will on a case by case basis balance
17 the need for new infrastructure, if you will, and the
18 importance of allowing single-issue ratemaking in support of
19 that infrastructure with the concerns over whether a
20 specific mechanism is required to reopen existing rates, or
21 whether the traditional complaint processes, such as those
22 we saw working in Southwest Gas, are sufficient for that
23 purpose.

24 Finally, as we acknowledged in issuing the final
25 rule, we have identified specific incentives that will be

1 allowed under certain circumstances, some of which reflect a
2 departure from the kind of incentives we allowed in the
3 past. The final rule also departs from prior Commission
4 practice by providing greater flexibility with respect to
5 the nature and timing of the rate recovery for needed
6 transmission facilities. And I approve of these provisions.

7 There are significant changes to the way the
8 Commission has done business represented in this order on
9 rehearing. And in my view today's order goes a long way
10 towards ensuring that with firm implementation a final rule
11 will benefit the consumers by getting more transmission
12 built and by ensuring reliability and reducing the cost of
13 delivered by power by reducing transmission congestion
14 across the country.

15 In closing, I did want to express my sincere
16 appreciation to staff for its Herculean efforts from start
17 to finish on this rule. I know it wasn't easy, and it
18 perhaps wasn't particularly fun. But your hard work has
19 resulted in a final rule that we can all be proud of. And I
20 thank you.

21 CHAIRMAN KELLIHER: Thank you.

22 I'm going to make some comments as well.

23 Today the Commission takes final action to
24 implement an important provision of the Energy Policy Act of
25 2005 relating to transmission investment. I am thankful

1 that your efforts have been Herculean rather than Sisyphean.

2 But it's taken a long time for us to get to this
3 point. I think it's appropriate that the last vote of the
4 last meeting of the year is on transmission pricing reform.
5 This process really actually began well before Suedeen and I
6 even arrived at the Commission. It began in January 2003.
7 I'd like to know how many staff actually touched
8 transmission pricing reform orders over the past four years.
9 It would probably be a large contingent.

10 It's really been a different focus. The focus of
11 the initial pricing reform effort was on the independence of
12 transmission really rather than investment. We focused the
13 effort after the Energy Policy Act on investments.

14 The former Commission -- I won't use ancien any
15 more -- worked collaboratively on the rulemaking. And both
16 the proposal and the final rule were issued by unanimous
17 votes.

18 In the rehearing order we do make some changes to
19 the final rule. I think those changes reflect two factors.
20 First of all, the strength of the rehearing requests. They
21 were well-reasoned and persuasive, especially the arguments
22 advanced by the American Public Power Association, National
23 Rural Electric Cooperative Association, and the National
24 Association of Regulatory Utility Commissioners. In
25 particular, we largely grant the rehearing requests of

1 NARUC.

2 Secondly, changes in the composition of the
3 Commission itself. The Commission is to some extent a
4 living entity, and it changes whenever the composition
5 changes. It changed in a big way on Bastille Day.

6 The new Commissioners brought a new perspective
7 to our deliberations. And as Jon mentioned, the hearing
8 order reflects on the deliberation of all five offices. It
9 really is the product of all five offices. I think if there
10 had been a panel in our deliberations people would have been
11 comforted.

12 It really was a good process. They might have
13 been scared a couple of times.

14 (Laughter.)

15 CHAIRMAN KELLIHER: But they probably would have
16 been comforted. They would have thought, that's the way
17 government is supposed to work. But really, it did reflect
18 very good interaction among the five officers.

19 But I am pleased to note, as others have, that I
20 expect a unanimous vote. I'll be surprised if it's not, but
21 we'll know when the votes are cast.

22 (Laughter.)

23 CHAIRMAN KELLIHER: The Commission has always had
24 a responsibility when it sets rates under Section 205 to set
25 rates at a level that attracts investment. That was true

1 before enactment of Section 219 and section 1241 of the
2 EPAct. And it remains true after enactment of Section 219.

3 It is concerned, as has already been noted -- and
4 the staff has noted -- about systemic under-investment in
5 transmission. Under-investment threatens reliability and
6 impairs competitive wholesale power markets. Congress
7 concluded that under-investment in transmission was a
8 national problem that required a national solution.
9 Congress wanted change. They did not want a continuation of
10 the status quo.

11 I really think that was the Congressional intent
12 behind this provision.

13 Under the rules of statutory construction
14 Congress is presumed to understand the law when it writes
15 new law, so Congress knew when it enacted Section 219 that
16 we had broad discretion under Section 205 to set rates.
17 Congress, though, importantly, declined to amend Section 205
18 to require us to set higher rates to attract transmission
19 investment. The solution adopted by Congress was Section
20 219, which directed us to conduct a rulemaking to increase
21 transmission investment in order to benefit consumers by
22 ensuring reliability and reducing grid congestion.

23 In effect, what Congress did was require us to
24 use our broad discretion under Section 205 to set rates at a
25 level that spur increased investment. That's exactly what

1 we did with the final rule and that's exactly what we do
2 with today's rehearing order.

3 By not amending Section 205 to require us to set
4 higher rates Congress trusted in our judgment on exactly how
5 to set incentive rates.

6 In my view the final rule and the rehearing order
7 are fully consistent with Congressional intent. Our
8 approach also does protect the consumer. Any incentive
9 rates approved by the Commission in the wake of enactment of
10 Section 219 remain bounded by the zone of reasonableness.
11 That provides the greatest consumer protection.

12 We also make some changes on rehearing that
13 strengthen the consumer protections in this area. We grant
14 the rehearing requests filed by NARUC regarding the
15 rebuttable presumption.

16 We clarify that the nexus test requires an
17 applicant to demonstrate that the incentives sought are
18 tailored to address the demonstrable risks and challenges
19 faced by the applicant. This makes it clear that an
20 applicant must show a close link between incentives
21 requested and the risks and challenges that are capable of
22 being proved.

23 We also clarify that we will balance an
24 applicant's total package of requested incentives. If an
25 applicant, for example, seeks a higher return to reflect the

1 higher risk of a project, but also seeks recovery of
2 construction work in progress and abandoned plant, which
3 reduce project risk, the return granted may be lower than
4 that requested.

5 In my view the rehearing order is consistent with
6 Congressional intent and provides ample consumer
7 protections. And again, given how long this process has
8 taken, I think it is appropriate for the last vote at the
9 last meeting.

10 Any other comments from colleagues?

11 COMMISSIONER KELLY: Joe, if I could follow up.

12 I think it's important that we monitor the
13 activity under this final rule so that we'll know how it
14 meets the important goals set out in Section 219. It's my
15 hope that in adopting an annual reporting requirement in
16 FERC Form 730 for utilities that receive incentive rate
17 treatment for specific transmission projects the Commission
18 will have the necessary information regarding projected
19 investments as well as information about completed projects
20 to accurately monitor the success of the ratemaking reforms
21 set forth in the final rule.

22 I am interested in exploring with my colleagues
23 avenues for ensuring that the annual reporting requirement
24 sufficiently monitors the final rule and perhaps even
25 consider preparing reports that reflect the results of such

1 monitoring.

2 I'd like to add my thanks to Joe and this
3 Commission for working on a process here that allowed us to
4 come to consensus on this final rule. As Joe mentioned,
5 it's had a long history, probably only similar to Mobil
6 Sierra.

7 (Laughter.)

8 COMMISSIONER KELLY: It drives you to achieve
9 consensus. That's because the goals are all worthy. And
10 it's very difficult to come up in advance with a standard
11 and a process that attempts to balance all of those goals:
12 having transmission where we need it, not overcharging
13 consumers to get it, having a process that moves fast enough
14 so that the transmission owners can have the certainty they
15 need about the finances that they will be able to obtain to
16 build the transmission, and at the same time having enough
17 checks on the system so that we make the right decision.
18 That truly is a challenge.

19 I'm pleased with where we've come out in the end.

20 CHAIRMAN KELLIHER: As I said, I think it is
21 really a good process. And we work well together on the
22 proposed rules, the final rule, and on the rehearing.
23 Hopefully this will be one of the EPAct orders that escapes
24 judicial review and will become the law of the land
25 immediately.

1 With that, shall we vote?

2 SECRETARY SALAS: Commissioner Wellinghoff.

3 COMMISSIONER WELLINGHOFF: Aye.

4 SECRETARY SALAS: Commissioner Moeller.

5 COMMISSIONER MOELLER: Aye.

6 SECRETARY SALAS: Commissioner Spitzer.

7 COMMISSIONER SPITZER: Aye.

8 SECRETARY SALAS: Commissioner Kelly.

9 COMMISSIONER KELLY: Aye.

10 SECRETARY SALAS: Chairman Kelliher.

11 CHAIRMAN KELLIHER: Aye.

12 In the other business category, I want to discuss
13 the MRTU comments from last week.

14 COMMISSIONER MOELLER: I merely wanted to mention
15 the fact --

16 CHAIRMAN KELLIHER: Thank the staff, you and all
17 of your predecessors for the work you've done.

18 (Laughter.)

19 COMMISSIONER MOELLER: The Commission and the
20 staff made a significant effort last week to travel to
21 Phoenix for the seams conference that we promised. We were
22 unofficially hosted by the Arizona Commission and they were
23 very gracious. I thought it was an excellent use of our
24 time. The dialogue was good. I think we have some
25 accountability for parties who work together to resolve

1 those seams issues that weren't created by the order but
2 still need to be addressed. I'm very happy that we took the
3 significant effort to go out there.

4 Thank you, Mr. Chairman.

5 CHAIRMAN KELLIHER: Commissioner Kelly.

6 COMMISSIONER KELLY: Thank you, Joe.

7 I think the primary reason that the conference
8 was so successful is because of our staff and what a superb
9 job they did in identifying the stakeholders and putting
10 together panels that represented all diverse points of view
11 on seams issues.

12 In addition, I thought the panelists, frankly, in
13 spite of their various issues, were cordial, respectful of
14 one another's views, and very helpful to us in the event we
15 need to settle any disputes regarding the resolution of
16 seams issues the panelists addressed the commercial and
17 financial and operational aspects of the market.

18 And I was pleased, but frankly not surprised, to
19 discover that no panelist clearly identified any specific
20 seams issues that must be resolved before MRTU
21 implementation. That's not to say that there aren't some
22 seams that do need to be addressed. But the overwhelming
23 majority of panelists believe that any seams issues
24 identified can be resolved through collaborative work among
25 the parties.

1 And in fact, a number of panelists encouraged one
2 on one meetings between the California ISO and its neighbors
3 to resolve seams issues. And we also heard from many that
4 seams issues could be resolved via interconnecting control
5 area agreements.

6 We also heard from an overwhelming number of
7 panelists that most seams issues are west-wide seams issues
8 and are more appropriately addressed by WEC, not by the
9 California ISO.

10 I believe all of these are appropriate avenues
11 for resolving seams issues. And I look forward to continued
12 progress from the parties. As we required in our MRTU
13 order, the California ISO and others with seams issues will
14 continue their ongoing meetings. And we expect and
15 encourage these meetings.

16 As to the next steps, Mr. Chairman, you might
17 want to mention about the notice that we were working on. I
18 think that's important to let parties know that we're
19 serious about getting these seams issued resolved in a
20 collaborative way.

21 CHAIRMAN KELLIHER: I'll take you up on that
22 invitation.

23 I think it was an important conference. Our MRT
24 order was an important order. The central role of the MRT
25 order is to reduce the likelihood of a recurrence of the

1 western power crisis. We did that in different ways. We
2 reformed the market rules that govern the California market.
3 The MRT order should provide a greater assurance that
4 California will increase its electricity supply.

5 So the goal is one that no one disputed. At the
6 technical conference no one said MRTU is somehow the wrong
7 direction or it's not the right policy goal.

8 There was discussion, very practical discussion.
9 There was recognition that seams exist in the west. They
10 existed before the MRT order was approved. They existed
11 even before Cal ISO organized markets were established.
12 They exist in the west in any event, even if there wasn't an
13 organized market in the west. And actually we won't ever
14 have a seamless western power market.

15 But our practical focus was identifying what's
16 the seams that are caused by the MRTU filing, and, more
17 importantly, what's the subset. It could be a null set, but
18 what's the subset of seams caused by MRTU would have to be
19 addressed and resolved before market startup.

20 To me that's really the focus, and that's what
21 we'd like to hear comments on. There's a 30-day comment
22 period that I assume runs from last Friday -- I'm guessing
23 it runs from last Friday or last Thursday.

24 But we are asking parties for written comments
25 really with that in mind to identify what are the seams

1 caused by MRTU. Most significantly, what are the seams, if
2 any, that would have to be resolved before startup. And so
3 I thought the whole tone of the conversation was good and
4 that people had that as their focus.

5 Once we've identified the broader universe and
6 subset then the question will be what are the means to
7 resolve whatever seams are identified. In some cases it
8 might be a west-wide approach. With the WEC seams
9 subcommittee it could be through unilateral action by the
10 ISO on amending their filing with us.

11 So we'll see what are the universe of seams and
12 then it will become obvious whether a bilateral approach, a
13 unilateral approach, or a multilateral approach is the right
14 way to resolve them.

15 People should know the clock is running. Thirty
16 days is running.

17 COMMISSIONER KELLY: Joe, I wanted to express
18 publicly my thanks to the individual members on the team. I
19 did it privately. But in particular this team rose above
20 and beyond the call of duty.

21 They had, for example, a number of technical
22 reports that were submitted to us right before the seams
23 conference that were dense and difficult. And the team that
24 was working on the seams issues recruited others from
25 outside the team and added to their already heavy work load

1 in getting ready for our last meeting of the year.

2 So I just wanted to thank Saif, Hudi Helman,
3 Heidi Neilton, Steve Rogers, Harry Singh, Jennifer Shipley,
4 and Mike McLaughlin for their outstanding work in connection
5 with the conference.

6 CHAIRMAN KELLIHER: I want to thank the hometown
7 favorite Commission Spitzer for welcoming us and arranging
8 the hospitality. And I want to welcome apparently the
9 unofficial mayor of Phoenix, Mr. Dina.

10 (Laughter.)

11 CHAIRMAN KELLIHER: He was the hospitality
12 officer. If you wanted Cuban food he knew where to go.

13 But we felt very welcome. And I was very
14 impressed with how many of the Arizona Commissioners stayed
15 there for most of the day. We really had to be there.

16 (Laughter.)

17 CHAIRMAN KELLIHER: But they didn't have to be
18 there. They chose to be there for hours. That was very
19 impressive.

20 Mark.

21 COMMISSIONER SPITZER: Thank you, Mr. Chairman.

22 You know, you alluded to the recent unpleasant
23 history in the west. Feelings still run very high; emotions
24 run high. The fact that this Commission has been so
25 attentive to a very complicated order is well regarded in

1 the west.

2 I was reading the Teddy Roosevelt biography on
3 the plane coming over. There was a discussion of TR's first
4 major legislative undertaking: The Reclamation Act of 1902,
5 which gave rise to a number of entities in the west.

6 President Roosevelt understood the very unique
7 climate and geography of that region. And that underscored
8 some of the challenges in terms of providing reliable
9 electricity at reasonable prices.

10 The fact that this Commission is willing to
11 extend itself to the extent it did reflected by its presence
12 in Phoenix last week is reflective of this Commission's
13 great interest in the issue. There's a lot of history, a
14 lot of complexities, a massive order, as Commissioner Kelly
15 pointed out. I'm still working on some of those charts and
16 diagrams. But that was again reflective of the great
17 interest on the part of the Commission to solve these
18 problems.

19 And in earlier iterations and filings on the
20 order in the summer before I even took this position there
21 was very -- I don't want to use the word drastic comments
22 made by some of the participants -- there was great concern.
23 And what I think is notable, most notable, is the degree to
24 which many of those concerns have been addressed already.
25 And the range of disagreements at the conference was

1 comparatively narrow considering, again, the history of this
2 proceeding.

3 And the issues raised were technical: In many
4 cases engineering issues as opposed to broad political
5 policy issues. And those technical issues were able to be
6 addressed both by one on one regional or subregional
7 discussions among some of the participants. I think we're
8 beyond being the end or the beginning. I think we're
9 looking at the beginning of the end in terms of fair
10 wholesale markets in California and resolution of some of
11 the impacts on changes in California on the west.

12 And I am pleased that the Commission and my
13 colleagues were able to enjoy some of the hospitality. I
14 would agree that Mr. Dina has achieved greater political
15 status than I ever did.

16 (Laughter.)

17 COMMISSIONER SPITZER: I would also, on behalf of
18 the western hosts, want to thank our eastern Chairman.

19 CHAIRMAN KELLIHER: Any other comments?

20 (No response.)

21 CHAIRMAN KELLIHER: If not, this last meeting of
22 the year is adjourned. Thank you.

23 (Whereupon, at 12:05 p.m., the 911th Commission
24 meeting was adjourned.)

25