

APPEARANCES:

COMMISSIONERS PRESENT:

CHAIRMAN PAT WOOD, III, Presiding

COMMISSIONER NORA MEAD BROWNELL

COMMISSIONER WILLIAM L. MASSEY

SECRETARY MAGALIE R. SALAS

ALSO PRESENT:

DAVID L. HOFFMAN, Court Reporter

P R O C E E D I N G S

(10:10 a.m.)

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

(Pledge of Allegiance recited.)

CHAIRMAN WOOD: I welcome to everybody here, to our last meeting of the Summer of 2003. I also want to use this opportunity to welcome, from our colleagues in Tokyo, Japan, Tomahisha Koyama. He is going to be here for two years with a fellowship with the Agency. In Japan, Tomahisha works as the Deputy Director of the Electricity Infrastructure Division of the Agency of Natural Resources and Energy.

This Agency is part of MITI. As Deputy Director, Tomahisha helps plan electricity market reform in Japan, and seeks to promote steady investment. Consequently, he's particularly interested in market design issues.

He'll spend time with a number of our different FERC offices here in the next few years. He's an electrical engineer with a Master's in Technology and Policy from MIT. He's our second Japanese Fellow hosted here at FERC.

We welcome you and look forward to your long stay with us.

(Applause.)

CHAIRMAN WOOD: All right, we've got a big, full agenda, as we had since I was here 12 years ago in this wonderful meeting before August, so, Madam Secretary, with no further ado, let's jump right in.

SECRETARY SALAS: Good morning, Mr. Chairman, good morning, Commissioners. Let me just note for the record that the following additions were made to this morning's agenda: Item A-4 has been added. This is an investigation regarding natural gas price behavior in February 2003; and there is E-5, previously included in the Sunshine Notice, Docket EL03212-000, Midwest Independent Transmission System operator, was also added.

The following items have been struck from this morning's agenda since the issuance of the Sunshine Notice on July 16th, and they are as follows: E-11, E-14, E-15, E-22, E-25, E-34, E-40, E-46, E-47, E-49, and C-4.

Your consent agenda for this morning is as follows: Electric Items - E-6, E-7, E-8, 9, 12, 13, 16, 17, 18, 19, 21, 28, 29, 30, 31, 32, 33, 35, 36, 38, 39, 44, 45, 50, 51, 53, 54, and 55.

Miscellaneous Items: M-3, 4, and 5.

Gas Items: G-1, 2, 3, 4, 5, 6, 8, 9, 10, 11, 12,

13, 14, 15, 16, 17, 20, 21, 22, 24, 25, 26, and 27.

Hydro Items: H-2, 3, and 4.

Certificates: C-1, 2, 3, 5, 6, 7, and 8.

The specific votes for some of these items in the consent agenda are as follows: E-9, Chairman Wood dissenting with a separate statement; E-30, Commissioner Brownell dissenting, in part, and concurring, in part, with a separate statement; G-2, Commissioner Brownell concurring with a separate statement; G-26, Commissioner Brownell concurring with a separate statement; and G-27, Commissioner Brownell dissenting with a separate statement.

Commissioner Brownell votes first this morning.

COMMISSIONER BROWNELL: Aye, noting my dissent, in part, and concurrence, in part, in E-30; my concurrence on G-2 and G-26, and my dissent on G-27.

COMMISSIONER MASSEY: Aye.

CHAIRMAN WOOD: Aye, noting my dissent on E-9.

SECRETARY SALAS: The first item for discussion this morning is H-1. This is the Hydroelectric Licensing Rulemaking under the Federal Power Act. This is a presentation by Timothy Welch, who is accompanied by Ann Miles, John Clements, and Liz Malloy.

MR. WELCH: Thank you. Good morning, everyone.

Ten months ago, we initiated a rulemaking process to reform the regulations for the issuance of hydroelectric

licenses in the Office of Energy Projects. My colleagues and I from the Office of Energy Projects and the Office of General Counsel are please to present to you today, the results of that rulemaking process, a final rule for your consideration.

(Slide.)

MR. WELCH: Before I begin talking about some of the nuances of the final rule, I wanted to say a few brief things about our process.

(Slide.)

MR. WELCH: What we wanted to do in developing this process is, we wanted to come up with something that went beyond just the normal notice and comment process. So we met with a lot of different stakeholder groups and came up with a very open and participatory rulemaking process that sort of had two aspects to it:

The first was regional forums and workshops where we actually went out and met with resource agencies, Indian tribes, public citizens and nongovernmental organizations to engage with them in discussions about the issues that they felt were important. We took those back with us when we developed both the NOPR and the final rule.

The second aspect of our process -- and I think it was the highlight of the process -- was, we had two of what we called stakeholder drafting sessions where we

invited a group of diverse stakeholders here to Washington, D.C., and basically locked them in a room for four days in one instance, and gave them some pretty tough issue to tackle.

I'm happy to report that they did an excellent job in coming up with a lot of consensus decisions on a lot of the concepts and the language that you will see in the final rule today.

So I'd like to publicly thank all of those people who participated in both the public and the tribal forums and also the stakeholder drafting group sessions.

(Slide.)

MR. WELCH: As you may already know, the focus of the final rule is a new process called the Integrated Licensing Process. That will be the Commission's third process for processing applications.

The goal of the Integrated Licensing Process is to improve the process, its efficiency, predictability, and the timeliness that balances stakeholder interests and results in improving the quality of decisionmaking for all participants, especially the Commission, resulting in a better output, in other words, a better hydro license from this Commission.

(Slide.)

MR. WELCH: I'd like to talk a little bit about

some of the benefits that we have identified with the Integrated Licensing Process. The first three bullets you see up there really go to the heart of the process's efficiency.

Kind of a cornerstone of the Integrated Process is the coordination with other state and federal processes that are often associated with hydroelectric licensing. Coming to mind most notably is the 401 Water Quality Certification process that the states conduct, things like the Endangered Species Act, Section 7 consultation from the Department of Commerce and Interior.

We've developed a process to allow those outside processes to work together in parallel with the Commission's processes, rather than sequentially.

The second bullet there also adds to the process efficiency. That's the concurrence, NEPA scoping, and application processing at the same time.

Contrast that with our traditional process where the NEPA scoping does not happen until after the application is already filed. We want the process to be able to flesh out the important issues that we're going to be looking at in our NEPA document, early on in the process while the applicant is preparing is application, so everything is included in the application.

And the final efficiency is increased public

participation, most notably, increased participation by nongovernmental organizations, once again, to get everyone's issues out on the table at a very early point in the process.

The fourth bullet really goes to the timeliness of the new process with early Commission Staff assistance. The Commission Staff will be involved with the integrated process from the very beginning to direct the process and to make sure all the steps are completed in a very timely manner, once again contrasting that with the traditional process where the Commission Staff typically doesn't get involved for about two years until the application is filed.

(Slide.)

MR. WELCH: Some of the other benefits we are looking at as far as timeliness goes, as far as that coordination with other processes, the key to that is developing a process plan, something you do right at the beginning, in coordination with those other state and federal agencies and Indian tribes.

You come up with an overall process, plan, and schedule that will direct the whole process from the beginning to the end. We are also -- in the integrated process we have early study plan development and early informal and formal dispute resolutions.

That goes to ensuring that the right studies are

done early on in the process to ensure that all the participants have the right information that everyone needs to make their decisions, especially the Commission Staff.

Finally, Liz Malloy is going to talk about this a little bit more and that is enhanced tribal consultation.

(Slide.)

MR. WELCH: As far as transition for the new rule goes, this timeline illustrates our transition plan. We're talking about a two-year transition where the final rule will become effective in three months in October of 2003.

In the beginning of that transition period, the applicant will have a choice of either the traditional licensing process, the alternative licensing process, and the new integrated process. And that will go on for two years until 2005, and at that point, the integrated process will become a default, and in order to use the other two processes, the applicant must obtain Commission approval.

(Slide.)

MR. WELCH: Based on some of our written comments and ideas from some of our workshops and stakeholder drafting groups, we made a few slight modifications to the integrated process since the issuance of the NOPR back in February.

Some of those items, very quickly, are: An improved pre-application document; more time for informal

study dispute resolution; the creation of an abbreviated preliminary licensing proposal in lieu of a draft license application, moving the application for water quality certification to after the REA notice, to ensure that the states have all the information they need for timely completion of the water quality certification.

(Slide.)

MR. WELCH: We're also keeping our existing NEPA cooperating agency policy. We're proposing, as we have always done, that an agency that wants to be a NEPA cooperator, must choose between cooperating for the NEPA document and intervention in the process.

Finally, we've added a tribal consultation meeting that will happen, as I said, early in the process, to engage the Indian tribes and learn more about their issues and have them learn more about our process.

(Slide.)

MR. WELCH: So where do we go from here? We have a number of post-rule activities planned, primarily with training and outreach, both individual project training, that is, those projects who choose to use the integrated process, we will work with them and all the participants in the process in the very beginning and throughout the process.

We will step that up a little bit and also do

some regional training as well, going to key points around the country to offer training for anyone who wants it. Finally, we will also be having some outreach sessions with Indian tribes as well.

The last bullet, Effectiveness Study, is probably one of the more important ones. We're going to be collecting, over the next five or six years, a lot of data and information on how the integrated process is working. Hopefully at the end of that period, we will be analyzing that data and putting it into some kind of report that evaluates the integrated process, and may make recommendations for any minor changes that are needed, just to be sure that we are meeting our ultimate goal of making a more timely and efficient licensing process.

That's all I have right now. I welcome your questions and comments.

COMMISSIONER BROWNELL: Well, I have nothing but congratulations to the Staff and the stakeholders. I think that when we started this process, there were some people laying on some money -- although we don't encourage gambling in this building -- that we couldn't do this in the short amount of time that we've done it in.

I think it speaks to not only the incredible leadership and support of our Staff, but quite an extraordinary phenomenon of people with very diverse

interests, some with very diverse and competing mandates, to come together and really roll up their sleeves.

I congratulate them, not only for their willingness to do that, because I think they got well organized before they walked in the door, but my understanding is that during the process and during the drafting process, they came up with some incredibly creative ideas.

I think that particularly the idea -- and maybe you could speak to this a little bit about how the study panel will work and how that will get kicked off in a very inclusive way. Could you just talk about that a little bit? There will be a technical conference on how that will work, so that people will get heard.

MR. WELCH: One of the comments that we got on the NOPR as far as the study panel goes, was, people wanted it, as you said, Commissioner Brownell, a little bit more inclusive. So we came up with the idea -- or actually the stakeholder drafting groups came up with the idea of holding a technical conference before the panel goes into its deliberations, so that everyone can sort of get their issues, the applicant and all the other participants can get their issues about that particular study out on the table, get the implementation to the study panel, and the need to make its decision.

COMMISSIONER BROWNELL: That's just one of the many good ideas that emerged from this, and having the transition and the two-year timeframe helped changed this certificate program. There are of course many people threatened by change, but this represents, if I understand it correctly, the views and wishes and policy changes supported by the majority of stakeholders, the significant majority of the stakeholders. Is that correct?

MR. WELCH: I would say so.

COMMISSIONER BROWNELL: I also still think we learned a lot during this process, certainly I did. I think we're looking at a scarce resource that has economic demands of a large part of country depends on this to sustain their economy. I think we have environmental challenges that in some cases are viewed to conflict with that. And of course we have the cultural issues of the tribes that really must be addressed.

I think this does a good job of incorporating those, and I look forward to working further. Now we did not change the NEPA cooperating aspect. Could you speak more to that? Because I think there are some legal ramifications that we examined more carefully.

MR. CLEMENTS: Our initial proposal was that we would change that policy so that cooperating agencies could also be an intervenor. We received a lot of comments from

the industry questioning not the policy desirability of that but the legality of it under the Administrative Procedures Act. We've looked again at the statute and looked at the cases that they cited, and we think they are correct that the court cases are quite clear that the sections, the applicable sections of the APA, need to be interpreted here, are now required to be read broadly consistent with achieving the purposes of that Act, and they're quite clear that an interested entity would include a cooperating agency because it's outside of the Commission.

So we're very confident that we've got the right answer to this.

COMMISSIONER BROWNELL: And although we couldn't work that out, I think that we should kind of work towards a process of continuous improvement. I think this is a terrific new start. Certainly it is a responsible administrative response that will improve the process but not change it because those are legislative changes that are I think being examined as we speak.

But I would hope that we will, for example, revisit the issue and some of the other issues we didn't deal with here, to include the settlement guidance that we talked about I think in January of 2002. And while we didn't deal with that in this document, I think a number of the stakeholders asked for that, and I think we should look

at that and other things that we learn as we get into the implementation of this to suggest that we shouldn't wait for some period of time to go by before we look at incremental improvements.

So we'll be talking more with the Staff about that settlement guidance issue, because I think that is one that will also increase the efficiency of the process, give some certainty, allow people to enter into the settlement process with a clearer idea of what's doable and what's not.

All in all, I'm really pleased to support this, and I congratulate everyone involved. It's a terrific step forward.

COMMISSIONER MASSEY: I'm pleased with this because I think it holds out the hope that we will get a better license product in a shorter period of time. We don't hope for everyone to be rhapsodic about our final license provisions. Some will like what we do, others won't. But I think this holds out the hope that everyone will have a say in a process that works much better. Our Staff will be involved much earlier. I understand from past presentations that you made when this was in NOPR form that there was a general consensus in the industry that more active, up-front Staff involvement in the process was a very good thing.

There was also a hue and cry for a more effective

dispute resolution process during the licensing, a number of decisions along the way. We achieved that goal here too.

I know that we are as a Commission somewhat frustrated with how long it takes to get the typical hydro license done, because there are so many decisions that have to be made, so many cooperating agencies that we have no ultimate control over. That's just the way the situation is now, and that won't change.

But what I like about this is, it contains a lot of good procedures to force everybody to the table early in the debate over what the appropriate provisions of the license ought to be. I like that very much, and I'd like to take a lot of credit for this, but actually you guys did this.

I appreciate all your hard work. I very much like the way in which you put this together with a lot of consultation with the industry, attempts to develop consensus. I think it's a model for how to do a rulemaking the right way. I commend you for it, and I will strongly support this ruling.

CHAIRMAN WOOD: Let's make it three of us. I have to say back in November/December of '01 when we held our first old dogs conference on the five-year plus licenses that were sitting around here, and it did become evident that probably the slight majority of the cases were due to

the fact that the state had not issued its water quality certificate, which fact is recounted here.

I can't help but think that all the steps, not every single one, but all the major steps that are reformulated here allow for early involvement to get the studies the states need, to get the input that the states need. The cooperating agency policy didn't even in the NOPR phase apply to the states. I wish we could have gotten there. But I think what we've got to do is look at, as you all have done so well and in such an expeditious timeframe, look at what process impediments are in place in the current process to the resolution of what Bill said, the people who have no control over getting the information they need to make a good decision.

And I think everything about this rule is pointed toward that, fortunately not just in the process that will over the next two years become the default process, but the subtle changes in the existing, ongoing processes as well.

And Tim, if you could just kind of flag those again for public consumption, what changes were made to the traditional process in this rule.

MR. WELCH: Yes. I think probably one of the bigger ones with the traditional process is increasing public participation. Right now the current regulations and the traditional process just have the applicants consulting

with resource agencies and Indian tribes, and we have expanded that to nongovernmental organizations and members of the public as well. So the traditional process has become much more inclusive.

The other major change would be the inclusion of the pre-application document. That's our enhanced document that describes the existing environment at the beginning of the process. We have added that as requirements for both the traditional and alternative processes so that all the information that people need to make their decisions are available up front no matter what process that you're in. So those are probably the two biggest ones.

CHAIRMAN WOOD: I do regret that we couldn't expand on the cooperating agency deal. I think that's probably going to be more of a headache than we thought in the NOPR phase. I'm not shutting the book to that, but it does look hard to do, and I regret that we couldn't do it, but I think it was worth a shot.

I think honestly, though, the other steps that were taken in the comprehensive process do allow for fundamentally the same thing to happen with the participation in framing the studies and the more up-front public participation which you laid out. I think that's good.

As a work product, this is excellent. I've seen

a rules. We've got a number on this agenda here, but the analysis, the response was extremely well done. And I know, John, you played a lead role in that with a lot of good help here. But being able to write what the whole team together has done so much hard work over the last year is a gift, and I appreciate, as one who has to read it, how well it was written.

I recognize we are constrained by the existing statute in our ability to do further streamlining and recognize that that's before the Congress now, but I think what we've got here before us is a solid product that we are well within our bounds to do under the current statute and support it.

I would have to add on a personal note. When you read these comments that fed into the document and pull some of the comments there, the divergence and the intensity of opinions felt on all sides of these issues make me look forward to getting back to the comparatively calmer waters of electricity market design as soon as possible.

(Laughter.)

CHAIRMAN WOOD: All right, folks.

COMMISSIONER BROWNELL: Aye.

COMMISSIONER MASSEY: Aye.

CHAIRMAN WOOD: Aye. And this will be called Order 2002. Thank you.

SECRETARY SALAS: The second item for discussion this morning is M-2, the Policy Statement on Consultation with Indian Tribes in Commission Proceedings. This is a presentation by Liz Molloy, who will be accompanied by Tim Welch, Anne Miles and John Clements.

MS. MOLLOY: Good morning. In addition to the hydro rule, we also worked on this policy statement over the past ten months. As Tim mentioned, the rulemaking was initiated in the fall of 2002. At that time there were regional meetings, including regional tribal meetings held.

At those meetings, there was a request that there be a tribal liaison for the Commission, and the Chairman appointed me to be the tribal liaison for purposes of the rulemaking, and he sent a letter to all the federally recognized tribes indicating this, and indicating further meetings and the existence of this rulemaking, the hydro rulemaking process.

The NOPR was issued in February, and we did have meetings in March and April, including tribal meetings around the country. We had several tribes appear and give wonderful comments to us. They were very helpful in helping us see their issues and their concerns.

We also had a separate tribal drafting group at the pleasant week we all had talking about issues that were remaining.

(Slide.)

And they did a wonderful job trying to come up with ideas on how to blend the processes and try to work better together.

(Slide.)

And we of course received comments on the NOPR as well. On the comments, several tribes noted that they appreciated that we had talked about tribal issues in the preamble.

(Slide.)

But they were concerned that a preamble becomes hidden and no one will see it all the time. So they really felt it was important to have the policy in the regs. And to accomplish that, we have done this policy statement and we will be putting in in Part II of our regs, which is the General Interpretation and Policy Section.

(Slide.)

That way, people can refer to it easily and point to it and see it exists.

And we also received several comments on the substance of tribal consultation and the role of the tribal liaison, and we tried to incorporate as much as we could into both our policy statement and the role of the liaison, the concept.

(Slide.)

The tribal policy statement is, as I said, going to be put in Part II of the regs. It will apply to all Commission regulated programs, not just hydro where it sort of evolved from, but apply to all of them.

In the policy statement, we recognize government-to-government consultation. We affirm tribal sovereignty, and the Commission's trust responsibilities to tribes, and it establishes a position of the tribal liaison.

(Slide.)

In hydro we did add a couple of additional things. We will give advanced notice of upcoming licensing proceedings to potentially affected tribes, and we will include tribal comprehensive plans similar to state and federal plans that we are required to consider under Section 15 of the Federal Power Act.

(Slide.)

The Commission is bound by APA and the Commission's own ex parte rules. And that is one caveat. We will do all this without violating those, but that is the one thing that the policy statement does note as well. That's all I have.

COMMISSIONER BROWNELL: Well, you've done a terrific job, and I know those meetings were very helpful. I just want to say that I have the wonderful opportunity to spend about ten days visiting with tribes in the Northwest

during this process and got I must say a much greater appreciation of the cultural and economic issues that they face and the importance of not only establishing this in regards to hydro, but in all other aspects of what we do, because there will be impacts I think increasingly as we build infrastructure, and it's important that they be represented.

I think in combination, both rules also address the issue that the tribes face, which is that they have a strong sense of culture and history, but they also have extraordinarily limited resources, so the early intervention and the Staff support and the inclusive involvement up front I think will make our job, but more importantly, their job easier, and their voices heard early, faced with I think some of the limitations that they have.

So I'm really excited about this and look forward to developing it further as we incorporate it into our business plan in the agency. And I appreciate your leadership on this.

COMMISSIONER MASSEY: I think this is a reminder of something that we sometimes forget, which is our policies, particularly our hydroelectric policies, affect entire cultures. They affect religious traditions and other core values of Native Americans and other peoples across the country, and we should respect that and hold that dear.

CHAIRMAN WOOD: I appreciate, Liz, your on-the-road leadership on this and Nora, the godmother of this.

Certainly you've wore out some shoeleather as well, and I appreciate the outreach that has gone on to this date, and I think it is appropriate and right to enshrine that in our policy statement part of our regulations and look forward to working with the two of you all over the next month or so to talk about how administratively we want to incorporate this in our agency other than in the more general statements that we made in the policy statement.

I do recognize that fewer than a dozen licensed or exempt projects on the hydro side occupy tribal lands within a reservation. However, the up and downstream effects of the other multiple, many other projects that we have do have the potential to affect the lands and the fisheries that affect the Indian tribes in our country, particularly in the Northwest, but also in a few other places. And with so many of these projects coming up for relicensing, it is timely to do this.

So, appreciate the work in pulling it together, the concept that you brought back from listening, which is always a good talent, and I wholeheartedly support it. So let's vote.

COMMISSIONER BROWNELL: Aye.

COMMISSIONER MASSEY: Aye.

CHAIRMAN WOOD: Aye.

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CHAIRMAN WOOD: Thank you all again.

SECRETARY SALAS: The next item is A-4. This is an investigation involving natural gas price behavior in February 2003. It's a presentation by Steve Harvey, who is accompanied by Kara Mucha, Rafael Martinez, Robert Flanders, Tom Pinkston, Marvin Rosenberg, and Daryl Blakeway.

MR. HARVEY: Good morning. On Monday, February 24th, 2003, monitors in the Commission's Office of Market Oversight and Investigations, or OMOI, observed a sharp, rapid increase in the price of natural gas in markets across the country.

OMOI immediately assembled a special monitoring team and that team spent the next week in OMOI's Market Monitoring Center, closely following a variety of market indicators, including reported index prices, physical trading on the Intercontinental Exchange, pipeline and storage capacity, usage alerts known as operational flow orders, weather reports, and other news.

By the end of the week, prices had decreased significantly and fell further over the next two weeks until they returned to their prevailing levels before the spike. Based on its analysis during the initial week, the Monitoring Team believed that prevailing extreme, though legitimate, forces of demand and supply were more than adequate to explain the countrywide price spike.

However, given the sharpness of the price spike and the concerns expressed by several observers and policymakers, the Monitoring Team concluded that further study was warranted. With the support of the other Offices of the Commission, an investigating team was formed to do three things:

The first was to review pipeline and storage operations, weather conditions, and other regional supply and demand factors.

The second was to develop a robust sample of transaction bid-and-offer data, to use to analyze the performance of relative markets and to search for evidence of any potential market manipulation.

The third was to coordinate, as needed, the Commission's efforts with those of the Commodities Futures Trading Commission staff. The investigating team has reported its progress to you in closed meetings since the beginning of that effort.

The final report we present to you today is the result of that effort. To summarize, in late February 2003, U.S. production area prices for natural gas rose sharply and quickly in response to physical market conditions resulting from low supply and high demand over a short period.

These conditions influenced prices in natural gas markets across the North American continent. In addition,

some Northeastern and Midwestern consuming areas faced additional price increases because of limits on the industry's physical capacity to deliver sufficient natural gas to meet elevated customer demand due to cold weather.

Deliveries were limited, in part because of low storage inventories. Low deliverability due to low inventories is an operational characteristic of most natural gas storage. Consequently, similar natural gas price spikes are possible when episodes of cold weather occur at times when storage inventories are low, often in late Winter.

The team's detailed analysis of a large sample of thousands of physical natural gas transactions and subsequent interviews with various market participants, yielded no evidence of market manipulation. The many physical and financial markets that, together, constitute the larger North American natural gas market, appeared to operate effectively through the spike.

Prices in these markets rose in apparent response to underlying supply and demand conditions, and in a manner consistent with those conditions. However, the natural gas markets in the last week of February 2003, consisted of relatively few buyers and sellers, too few of which were engaged in active trading.

While less robust markets increase the possibility that these markets may not respond adequately

under stress, market thinness and concentration are evidence of the potential for inefficient prices or manipulation, not evidence of these problems.

As I indicated previously, we found no such evidence. Still, increased numbers of active traders in these markets would improve liquidity and reduce concentration, and a rebound of the energy trading industry would probably improve performance.

This effort drew on many of the resources available at the Commission, including the support of several Offices. Members of the team include the team leader, Lee Chu, who is traveling today and cannot be with us.

Also with me here at the table today is Bob Flanders, Rafael Martinez, Kara Mucha, Thomas Pinkston, and Mar Rosenberg. Not with us at the table today are Darrell Blakeway, Ted Girardin, Demetrios Poulas, John Roddy, Ann Venture and Charlie Whitmore.

Many others contributed as well, but there are too many to name at this time. Thank you.

CHAIRMAN WOOD: Thank you, Steve. Questions for the team?

COMMISSIONER BROWNELL: We also worked with the CFTC on this report, did we not?

MR. HARVEY: We did.

COMMISSIONER BROWNELL: As you know, we find that increasingly important and that cooperative effort, I think helps the industry, helps customers, so they can have confidence that the cops on the beat are the cops on the beat.

I appreciate the work that you and the team have done. I would emphasize what I think I would probably emphasize till I'm boring the world, which is that the trading industry and the decline of the traders has really caused problems.

So for those who would believe that because of a few bad actors, that the exit from the trading industry is a good thing, it is not. Bad behavior needs to be dealt with, but this is an important segment that we need to restore confidence in and get back into the marketplace, because it's critical. Thank you.

CHAIRMAN WOOD: I just want to thank you all for the good work. On the one hand, I do hope that we don't have these type of events again, but, on the other hand, I appreciate the analysis and the types of review that you all did, which are explained in perhaps mind-numbing detail in the back of the document that will be made available, I think, on our website shortly.

And there will be, I think, later today, a joint statement of the Commission and the CFTC on this issue, so a

lot of people are waiting for that. Nice job, and I'm proud of the work y'all are doing and appreciate that just 11 months ago, OMOI came into being as a formal part of this Agency.

I think what I look for and hope to see over the months and years to come, is the level of analysis, the quick response, the engagement with market participants, with other agencies, with index providers, with other people who have data and a very sober and objective analysis of what that data tells us.

That's what we should have; that's what OMOI is supposed to be about. We appreciate the contribution from folks in the other parts of the Agency to this type of work.

It is going to be even more and more important going forward. This is the first. I think it will get crisper and faster, but this first effort is excellent, and I'm proud of it. Keep up the good work.

MR. HARVEY: Thank you very much.

CHAIRMAN WOOD: We'll just make the report available as a Commission report. We don't need to vote on this. Thank you all.

SECRETARY SALAS: The next item for discussion is E-52. This is American Electric Power Company, a presentation by David Hunger.

MR. HUNGER: Good morning. Today's draft Order

addresses Company submissions in Dockets Nos. PA03-1 through 11, regarding the current reporting of natural gas electricity trading data to index publishers.

First some background: On April 30th, 2003, the Commission issued an Order directing 11 companies to show they had corrected their internal processes for reporting trading data to energy price index publishers, or to show that they no longer sold natural gas at wholesale.

Those companies are: American Electric Power, Aquila Merchant Services, Coral Energy Resources, CMS Marketing Services and Trading, Dynegy, Duke Energy Trading and Marketing, El Paso Merchant Energy, Mirant America Energy Marketing, Reliant Resources, Sempra Energy Trading, and Williams Energy Marketing and Trading.

That Order adopted company-specific recommendations contained in Chapter 3 of Staff's Final Report on Price Manipulation in Western Markets.

Those recommendations are that the 11 companies show the following: One, that those employees, including trading desk heads and managers who participated in manipulations or attempted manipulations of the published price indices have been disciplined;

Two, that the company has a clear code of conduct in place for reporting price information; three, all trading data reporting is done by an entity within the company that

does not have a financial interest in the published index, preferably the Chief Risk Officer.

And, four, the company is fully cooperating with any government agency investigating its past price reporting practices. Today's draft Order accepts submissions from 11 companies and finds that they have met the requirements of the April 30th Order.

The draft Order also recognizes that some investigation into companies' price reporting practices are ongoing, therefore, while some companies state that they have included that none of their employees manipulated or attempted to manipulate the published indices, that conclusion could change.

In such cases, disciplinary action and subsequent notification to the Commission would be necessary in order to be in compliance with the April 30th Order. In addition, ongoing cooperation with any government agency investigating price reporting practices is necessary for compliance with the April 30th Order.

Finally, the draft Order notes that three of the responding companies -- Reliant, Duke Energy Trading and Marketing, and Mirant -- have exclusively endorsed the Committee of Chief Risk Officers, CCRO, the best practices for index report.

One of the issues facing the industry is the

concern that honest mistakes in reporting will be seen as attempts to manipulate the published indices. The CCRO best practices are consistent with the recommendations on the Final Report on Price Manipulation in Western Markets, reporting only transaction-level data that includes price, volume, location, buy-sell indicators, counterparty, and having audits of the reporting process.

Accordingly, the CCRO best practices have the attributes and give confidence that any reporting discrepancy would be due to human error, rather than manipulation. I'd be happy to answer any questions.

COMMISSIONER BROWNELL: Describe, if you will, some of the discussions that we've had, either in technical conferences or within the building, with the indices-providers, and the steps they have taken to address some of the issues that we've raised, and that the chief risk officers raised in their best practices.

MR. HUNGER: The publishers of the indices?

COMMISSIONER BROWNELL: Yes.

MR. HUNGER: Well, among other things, if you look at what's being published now, compared to six months or a year ago, the index publishers are reporting things like volume, number of trading parties, number of trades. That's something that wasn't always available before, and it gives you a much clearer picture of how much -- in part, how

much trading is going on and how much reporting of that trading is going on.

They're working through, the index publishers are working through issues regarding audits and access to the data. As you know, that's a thorny issue with First Amendment protections.

They have made it easy for the companies that are reporting to report to them, rather than calling the traders and saying, hey, what's it look like out there?

There are formal procedures for sending in spreadsheets with the data, asking exactly what they need in order to publish the most accurate index they can publish.

COMMISSIONER BROWNELL: And conversations are ongoing to make sure that we are clear that our expectations are being met?

MR. HUNGER: That's right. They're ongoing, and there's a proceeding in Docket No. AD03-07. Dave Perlman is going to talk in a little while about a policy statement, and so the conversation is still going.

There have been technical conferences and workshops and a lot of back-and-forth on both sides. We have come a long way.

COMMISSIONER BROWNELL: Meanwhile, the industry is also talking about perhaps some other models that might address this, so we might be looking at kind of a short-term

and then a longer-term solution that the marketplace is clearly focused on; is that correct?

MR. HUNGER: That's correct.

COMMISSIONER BROWNELL: Thank you.

MR. HUNGER: You're welcome.

COMMISSIONER MASSEY: I think this is a good Order. It has my full support.

CHAIRMAN WOOD: I second that emotion. Let's vote.

COMMISSIONER BROWNELL: Aye.

COMMISSIONER MASSEY: Aye.

CHAIRMAN WOOD: Aye. Thank you, David.

SECRETARY SALAS: Next for discussion is M-1. This is a policy statement on prices, covering natural gas and electric markets. It's a presentation by David Perlman, accompanied by David Hunger.

MR. PERLMAN: And Steve Harvey, as well. Good morning, Mr. Chairman and Commissioners. Before you is a policy statement addressing natural gas and electric price indices. This policy statement reflects a process undertaken by both market participants and the Commission to improve the quality of index formation by encouraging approved practices by index publishers and data providers, as well as increased reporting by data providers.

Price indices are used in a variety of ways in

energy markets. They are used as pricing terms in physical and financial contracts, in jurisdictional tariffs for cashouts and otherwise, for general price discovery, and for other purposes.

Issues relating to the integrity and reliability of price indices began to become apparent in the latter part of 2002, together with revelations about index reporting problems, market participants reporting to indices began to fall off.

These matters, coupled with an overall decrease in liquidity in gas and electric markets in general, have caused indices to become much less robust. The Staff's Western Markets Report also details index reporting issues.

Parties have responded to actively address this problem. In the first quarter of 2003, the Committee of Chief Risk Officers issued a white paper, setting forth best practices for index publishers and data providers.

The Commission Staff has undertaken significant outreach on this issue, including two public technical conferences held with CFTC participation, as well as a workshop. Index publishers and market participants have taken steps, individually and collectively, to try and improve index formation and data submission.

Though we've made significant strides, there is still a way to go to achieve reliable, robust indices.

This policy statement recognizes the progress made to date, and attempts to build on it. It takes steps to encourage further voluntary participation in the index compilation and data submission process by identifying certain minimum practices that, if followed by data providers, would establish a safe harbor wherein any errors occurring in data submission would be recognized as good-faith mistakes and no subsequent remedial action be taken by the Commission.

These practices include: Complete detailed reporting of all trades made by separate personnel from individuals involved in trading itself. In recognition of the representations that some elements of the best practices that the Commission and Staff and CCRO endorse, would be a disincentive to increase voluntary reporting.

The minimum practices stop short of fully moving to a best practices model to attempt to encourage the most complete reporting possible.

The policy statement also states that prospectively, indices proposed for use in jurisdictional tariffs, must meet the minimum practices for index publishers, as well as minimum levels of liquidity.

These practices include providing appropriate confidentiality and material transparency, as David discussed.

In addition, the policy statement instructs the Commission Staff to actively monitor adherence to the practices by both index publishers and data providers. The Staff is instructed to periodically update the Commission on progress made.

Finally, the policy statement notes that in the event inadequate progress is made toward robust, reliable indices through the combined efforts of the industry and regulators, the Commission has ample authority to require price reporting.

Thank you.

COMMISSIONER BROWNELL: My earlier comments would apply to this. But tell me exactly the implementation process here in terms of the prospective use. What kind of information? How will it work? What kind of timing are we looking at? How does this get implemented?

MR. PERLMAN: Implementation has two aspects to it. There is the safe harbor component which I think will take effect immediately, and parties who adopted the procedures set forth in this policy statement to demonstrate they had done so would be eligible for the safe harbor treatment. And I think they would be able to do that right away.

With respect to the index publishers component and the use in jurisdictional tariffs, as I understand our

approach would be to look for future filings that would use indices for things like cashouts, what have you, and suspend them, but undertake a process thereafter to assure through the efforts that will be conducted in this docket that the index that was proposed to be used would meet the standards required here for both index compilation and necessary liquidity for reliability so there would be an ongoing subsequent process that parties will be able to undertake in recognition of the standards the Commission is establishing, and ultimately both the indices for use in Commission tariffs and the safe harbor opportunities will be available to the parties, and there should be no disruption in the current structure of the Commission's regulations.

COMMISSIONER BROWNELL: Thank you.

COMMISSIONER MASSEY: How does the standard -- as I understand this order, this policy statement, we suggest certain standards for the price index developers. We also provide standards for those who report prices to the indices.

There are certainly some sensitive issues that have been discussed over the past few months as we have had technical conferences here at the Commission. One relates to counterparty information, for example. How do we propose to deal with that in this policy statement?

MR. PERLMAN: Well, I indicated earlier certain

best practices have been identified by both the CCRO and the Commission Staff. Those sensitive issues have been identified very strongly by certain market participants as being in effect a bar to their further participation in voluntary reporting. And the policy statement recognizes those concerns and accepts them and sees the approach that the Commission should follow to encourage the most significant volumes of voluntary reporting while meeting minimum standards that would create better and more robust indices.

So the minimum standards do have -- reflect -- let's put it this way, reflect a large consensus of the industry with respect to the elements they could agree on and have represented to us would be acceptable to them, and given a safe harbor and other Commission encouragement that's included in this order, would begin a more significant volume of voluntary reporting.

So, for example, counterparty identification would not be required to be eligible for the safe harbor.

MR. HEDERMAN: Commissioner, if I could add. The importance of counterparty information is to help assure the integrity, and part of what will be happening here is very close follow-up from OMOI, and we will be examining whether the improved liquidity helps with the integrity of the process or whether there will be a need for additional

changes, and we'll be making recommendations down the road to the Commission on that.

COMMISSIONER MASSEY: Thank you. I notice for price index developers, we suggest five standards related to confidentiality of data, completeness of the process, data verification, error correction, monitoring, verifiability of the accuracy of the indices through audits, and accessibility of the information.

I notice for the data providers, we propose standards concerning the source of the data, the data reported, an error resolution process, data retention and review. I take it these standards are not chiseled in stone and could perhaps evolve over time as we learn more and as the industry generates a greater degree of consensus on this issue. Is that what you would propose?

MR. PERLMAN: I think that's correct. I'd like to echo what Bill said. The effort that will begin subsequent to the Commission issuing its policy statement will be a further interaction with the industry to assure that the increased reporting that we expect is occurring and to determine whether there are any bars to that or issues that we have not gotten correct in this policy statement that we could work on to provide the best outcome we can for this industry.

One thing that we are very cognizant of as we

worked on this is that this is largely a voluntary effort by a vast variety of entities, some of which we have jurisdiction over and some of which we do not. And the outcome of the current structure going forward being in effect would be made more viable and to create more robust indices, is best enhanced through doing what we can do to help encourage and provide whatever service we can from a regulatory perspective to that voluntary effort being successful.

COMMISSIONER MASSEY: Now in this order do we propose that henceforth any tariffs that are filed should comply with these standards?

MR. PERLMAN: Yes.

COMMISSIONER MASSEY: Is that essentially what it is? Comply with all the standards that are set out in this order.

MR. PERLMAN: The tariff that would include an index would have to have an index that was compliant with the requirements for index compilers. And there would be the process that I indicated in that particular docket where that proposal is made to assure that that compliance has in fact been satisfied.

COMMISSIONER MASSEY: Well, I like that feature. But let me ask you this. In making its recommendation to the Commission, did Staff consider applying this condition

more broadly to existing tariffs as well?

MR. PERLMAN: The answer to that is yes. Maybe David could speak more broadly about it, but there were additional concerns that were raised by the potential disruption to continued usage of the various Commission-approved tariffs and negotiated rates, in particular, that rely upon indices that could occur that if we had done that all at one time rather than through this prospective application.

MR. HUNGER: Yes. As Dave says, the alternative is not only new tariffs coming in, but all the existing tariffs on file that did rely on indices being required to show that these indices meet the standards set in the policy statement. And it's a tradeoff between disrupting what's in place and making sure that the indexes that are being used are the most accurate indexes possible, and that's where the policy statement came down on -- looking at future tariffs, but the policy statement also has language in there that allows for the Commission to, along the lines of what Bill Hederman was saying, if it needs to revisit some of these calls because it's not happy, you know, because it's not confident in the use of the indexes, then it can and asserts that it has the authority to.

MR. HARVEY: If I could as well, there is in David's presentation, there is an additional step. It's not

simply a matter of an index provider sort of in this process getting a blanket approval. There's the additional step of is there adequate liquidity at that particular point used in a tariff was well, which makes it inherently a case-by-case conclusion. It both has to meet the standards of the way that it was developed, but it also has to show that it has adequate activity. One of the requirements in the statement is that information about that be presented when the index is developed. Once that's presented, that will then be another standard -- is it sufficiently liquid at that point to use it.

MR. PERLMAN: And let me just add to that as well that the process that we expect to see subsequent to this will result in increased reporting. So we're hopeful that as we go forward and we look at the index compilers' reaction to this as well as the market participants' reaction to this, that we will see that liquidity build going forward.

So if we impose that today, we may have a different outcome than three or four months from now.

COMMISSIONER MASSEY: I understand. I think the approach that our Staff has guided the Commission through with respect to this issue has been an iterative process for the Commission to take a step, hold a technical conference, invite the CFTC, express a great deal of interest in the

issue, help shape consensus within the industry. And I think it's been a very good approach.

What I'm focused on is when do we say, okay, we know enough to make some decisions here that are very concrete? And I think what you've recommended is a first fairly concrete step is a tariff condition applied henceforth. So I understand that process. I'm just thinking about whether it goes far enough.

Let me ask you this. What about contracts that may refer to indices? Did you consider applying the same standard to a contract that was finalized henceforth or finalized after September 1st of this year or whatever? And what was your thinking about that?

MR. PERLMAN: That was discussed. And I can tell you, more speaking for myself and I think a segment of the team -- I don't know that I can speak for everyone -- the thought was that those contracts as opposed to tariffs, which the Commission has to effectively review and determine whether are just and reasonable, are distinct in many ways from the bilateral contracts that are undertaken under blanket certificates for gas or bilateral relationships under market-based rates.

And the parties engaged in those contracts in effect have the knowledge of the indices, good, bad or indifferent, and have the opportunity to choose to use them

or not use them. And as a result, very often they have to make due with the best that they have, make the decisions that they make, and make the commercial arrangements between themselves. And to the degree that those contracts don't come before the Commission for the Commission's independent determination that they're just and reasonable, we didn't believe that it was appropriate for the Commission to preclude those participants from making the choice of using those indices. But we did see the Commission's role by taking this step forward is providing for those market participants much better indices that would be of greater value for them in those contracts.

Very often, unfortunately, they may have no other alternative but to use indices that would be available for them for things like virtual tolling arrangements on electric, for example.

COMMISSIONER MASSEY: Would be an overstatement to say that it is the Commission's hope that the index publishers comply with these standards, and it is our hope that all industry participants comply with these standards? Whether we require it or not, we think these are good standards and we're sending a signal that this is what the Commission's policy is with respect to this important area?

MR. PERLMAN: Absolutely.

COMMISSIONER MASSEY: Thank you. Your

explanations have been very helpful to me.

COMMISSIONER BROWNELL: I was just going to ask, the industry and the providers have largely communicated vis-a-vis the technical conferences that these are the standards that they have pretty much already agreed to. Is that a fair statement?

MR. PERLMAN: Yes, I think that's correct, yes.

CHAIRMAN WOOD: I think in light of Bill's last question, I think this is quite honestly what FERC has done a pretty good job of for the 15 years I've been watching it, which is providing very strong incentives to volunteer. I think the announced what I call scarlet letter approach would be helpful, which is in English the requirement that market participants let us know if they're reporting some or all of their data to index data collectors or not which we put out at the end of last month in a proposed Seven Commandments for Electricity and Gas, which are open proceedings right now.

So that's the scarlet letter approach that, while voluntary, allows us to identify who's choosing not to play. And then on the index provider side, I actually think to get the imprimatur to be used, although it's I think quite honestly a small percentage of what an index provider does in today's market to be used in a FERC tariff, has a cachet to it that I, if I were an index provider, would not want to

avoid having. I would want to avoid losing it. I think it's the same point.

In any event, we've got two tariff filings that have been made in the last month that are under 30-day clock that I would recommend to you all is when we get to them that this is the venue by which we implement the policy statement.

And I think since there are a handful of index providers, and I think between these filings and perhaps a few others that will cover everybody, this is an appropriate but definitive way to free our Staff to sit and negotiate not so much with the pipeline making the filing, but with the index provider being referenced by that pipeline in the filing, to make sure that any of the issues that may not be nailed down here from our endorsement of what an index provider needs to do in the post-policy statement world, we can work those issues out authoritatively and enshrine those in a Commission approval.

So I think that's a process way of going forward that actually is constructive, does not needlessly divert people from the core issue, which is reporting back into the market, getting liquidity back in the market. In light of, Steve, your team's report a moment ago, getting more trading going on in the market, which is the core issue. The reporting of it is the secondary effect. But the core issue

is having the trading and the customer benefits that come
from that come forth as soon as we can.

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I appreciate the leadership of you three, but what all the folks behind you in the various Offices have shown in this project. It's been an expeditious response; it's been very collaborative with the people directly affected by these decisions, and I learned a whole lot along the way sitting over on this side of the table.

So, that's the part of this job that's actually quite fun. Thanks for the toys.

COMMISSIONER BROWNELL: Aye.

COMMISSIONER MASSEY: Aye.

CHAIRMAN WOOD: Aye. Thank you.

SECRETARY SALAS: Mr. Chairman and Commissioners, next for your consideration is E-1, a rulemaking proceeding on the standardization of generator interconnection agreements and procedures. This is a presentation by Patrick Rooney, accompanied by Kirk Randall, Michael Henry, Roland Wentworth, Bruce Poole, and Kumar Agarwal.

MR. ROONEY: Good morning, Mr. Chairman and Commissioners. My name is Pat Rooney. I'm happy to be here, and with me is Kirk Randall, Mike Henry, Roland Wentworth, Bruce Poole, and Kumar Agarwal.

Next slide, please.

(Slide.)

MR. ROONEY: Item E-1 is a final rule requiring public utilities to amend their open access tariffs to

include standard generator interconnection procedures and standard interconnection agreements for generators over 20 megawatts in size.

I'd like to pause for just a moment to talk about how the final rule came about. Generators complained that the treatment they get is often not comparable to the treatment given the transmission providers' own generation. Hurdles erected by transmission providers such as binding commitments and inflexible deadlines, terms and conditions and interconnection vary from time to time and place to place.

Conversely, transmission providers complain that minimum commitments from generators are needed to weed out those who are not serious and would require transmission upgrades for generators who may, in fact, never achieve commercial operations. And, of course, they are also concerned about maintaining the reliability and safety of their systems.

Resolving these issues will reduce the cost to the customer. Standardization lowers costs, especially for alternative generating technologies such as renewable energy, and thereby lowers the cost to the customer.

Next slide, please.

(Slide.)

MR. ROONEY: The purpose of the final rule is to

reduce overall cost of electricity to customers, reduce the time and cost of interconnections for both generators and transmission providers, and limit opportunities for transmission providers to favor their own generation. Next slide.

(Slide.)

MR. ROONEY: It also expedites development of new generation infrastructure, eases entry for competitors, while promoting more efficient siting decisions, clarifying pricing of transmission enhancements for interconnections, and preserving the reliability and safety of the transmission system. Next slide.

(Slide.)

MR. ROONEY: The rulemaking process: In October 2001, the Commission initiated an innovative approach to the development of a new standardized interconnection. The advance Notice of Proposed Rulemaking: In the NOPR, the Commission proposed a strawman generator interconnection rule and initiated a consensus process to allow industry participants, consisting of large and small generators, transmission providers, NARUC, and the states, and any other interested market participants to negotiate.

In April of 2002, the Commission issued a Notice of Proposed Rulemaking, which largely incorporated the product of these negotiations. I'd like to thank the

participants for all the work they did in the consensus process itself.

We received more than 170 comments from the small generation proponents -- I'm sorry, we received more than 170 comments, including comments from small generators, asking for separate treatment.

In August 2002, the Commission issued a generation NOPR for generators up to 20 megawatts in size. Next slide.

(Slide.)

MR. ROONEY: Advantages to generators under the final rule: They can interconnect without having to request specific delivery service. Access to interconnection study databases allows them to conduct their own interconnection studies, one set of standard interconnection procedures, and one standard interconnection agreement, and legal rights and obligations are clearly laid out.

There are two interconnection options: Energy resource interconnection service, which is a low-cost interconnection; network resource interconnection service, which is a higher-cost interconnection that allows the generators to qualify as a network resource. Next slide.

(Slide.)

MR. ROONEY: Advantages to the transmission providers under the final rule: Standard interconnection

procedures; streamlining the interconnection process, and it reducing regulatory burden; RTOs and ISOs are given the flexibility to propose customization of the interconnection process during the compliance stage; access to data allows generators to study various points of interconnection, thereby reducing the number of studies that would otherwise be performed by the transmission provider. Next slide.

(Slide.)

MR. ROONEY: Pricing for non-independent transmission providers clarifies who pays for interconnections when the transmission provider is not independent; generators get their money back, with interest, after five years after achieving commercial operations.

Slide 12.

(Slide.)

MR. ROONEY: The rule allows pricing flexibility for an RTO and ISO, including the use of participant funding. Informing and RTO or ISO, an independent administrator may use participant funding for network upgrades for one year, subject to Commission and affected-state approvals. Slide 13.

(Slide.)

MR. ROONEY: The final rule applies to all interconnections to facilities subject to a transmission provider's open access transmission tariff at the time of

the interconnection request. Slide 14.

(Slide.)

MR. ROONEY: Variations from the rule: Regional variations - it would be that utilities may propose variations that are generally used throughout their region, if consistent with or superior to the final rule. Utilities may also propose variations to comply with regional councils' reliability rules, again, subject to Commission approval.

For RTOs or ISOs, the rule allows greater flexibility for an RTO or an ISO, subject to Commission approval. Slide 15.

(Slide.)

MR. ROONEY: This is regarding compliance filings. Public utilities must file amendments to their open access transmission tariff within 60 days after the final rule is published in the Federal Register. Thank you. We'd be happy to answer any questions you all might have.

COMMISSIONER BROWNELL: This team was here till 9:00 or 9:30 last night, kind of still working on the presentation, so I appreciate the fact that they are coherent today, because they have been working very hard.

CHAIRMAN WOOD: All you heard from is Rooney.

(Laughter.)

COMMISSIONER BROWNELL: I can tell. I'm looking

at the sparkle in their eyes. This is an enormous effort, and, I think that, for me, one of the most important things we've done in the last year. I'm glad it's here.

It represents a lot of work on behalf of a lot of people. It was contentious and difficult. There are different business interests who will be needing to kind of amend the way they do business here, but I think it represents a fair balance between the needs of those in the marketplace, but, most importantly, I think it brings value to customers.

I think we recognized during this process, if not before, the costs of not having this standardized. There is the cost of unnecessary studies, the cost of uneconomic siting, which we've heard a lot about in the Southeast, the costs that I have heard and that I know we've all heard from equipment manufacturers who haven't been able to bring things to market, and, frankly, the costs of discrimination and inequity in the marketplace.

I just have a couple of questions. Can you describe in just a few words, how we'll manage through those regional differences? It almost seems inconsistent to say that we are standardizing and then we're going to look at regional differences.

Also describe the process, because I think it's important. This creates an opportunity, if everyone had to

file, including the existing procedures and policies. I think it gives customers of all kinds, an opportunity to comment on that, but could you talk a little bit about that?

MR. HENRY: The standard is what appears in the final rule. That effectively becomes the proxy for what's just and reasonable according to the Commission. We've incorporated a couple of mechanisms, as Mr. Rooney described, to accommodate changes.

One is the sort of standard consistent with the "superior to" standard, which allows us to make sure that a non-independent entity is proposing variations that are not based on regional differences, but nevertheless are consistent with or superior to what actually appears in the final rule.

The regional differences will allow people to propose variations that are based on established and proven regional practices, but, again, there are variations that would still be subject to Commission review. Those are both principles that we would apply to non-independent transmission providers.

For independent transmission providers, there's a kind of regional variation that would allow us to assess what they are submitting to us in compliance with this final rule. And while there will be a slightly different evaluation from what was ordinarily applied to regional

variations, nevertheless, we will apply scrutiny and practices that we deem to be non-just and unreasonable, we would address.

COMMISSIONER BROWNELL: But that would put some value on the independents.

MR. HENRY: Certainly.

COMMISSIONER BROWNELL: I think some of the challenges that we face, in addition to cost and inefficiency and discrimination, have also been about the lack of infrastructure, adequate infrastructure, to support the marketplace. And I think that this and the next rule will go a long way towards a proposed rule, to sending some assurance to the marketplace that they will have an opportunity to participate in a fair, equitable, and cost-efficient way.

But in the end, it's all about customers. I appreciate what this does.

COMMISSIONER MASSEY: What percentage of this rule, the large generator rule, for example, is a consensus document, would you say?

MR. POOLE: Having sat through all the negotiations, my guess would be about 80 percent, okay, is fully consensus. I'd have to go back and add up paragraphs here and there, but I think that would be about the number, in my guesstimation.

COMMISSIONER MASSEY: I know we were having a lot of meetings, a lot of outreach with the industry over time, just as we did with the hydro in an attempt to achieve a consensus on the fundamental features. And there's a lot of process in this rule, as I read it: What the transmission provider does, what the generator does, the timeframes for responding to each other, the studies that must be performed, and so forth and so on.

I think this is a banner day for generator interconnection. This is a rule the Commission has been working on for quite some time. It's very important rule in eliminating some of the leisure domain that existed over the years in the interconnection process.

And so this rule has my full support. I support it wholeheartedly.

If I'm a transmission provider, once this rule is issued, what do I do? What's the next step for me?

MR. HENRY: Within 60 days, you would file to amend your open access transmission tariff to add the large generator interconnection procedures and the large generator interconnection agreement.

COMMISSIONER MASSEY: So we have a pro forma agreement that's attached to this rule that is 80 percent a consensus document, and we have a pro forma process document; is that right?

MR. HENRY: That is correct.

COMMISSIONER MASSEY: And under this rule, each transmission provider, whether it's an independent transmission provider or a regular transmission provider, would file those documents with us, or they would file something that they proposed to be superior to those documents that is within the limits of the regional variation that were set in this final rule.

MR. HENRY: That's correct.

COMMISSIONER MASSEY: If I'm a generator and this ruling is finalized, what do I do? Be happy?

(Laughter.)

MR. HENRY: We certainly hope a generator would locate the interconnection request that is a part of the subject transmission provider's interconnection procedures. It appears as an attachment to those procedures and it would submit that interconnection request and get the ball rolling.

MS. MARLETTE: Commissioner Massey, if I could just clarify on the compliance, my understanding is that these would be compliance filings, not Section 205 filings with a 60-day clock on it. It would be purely compliance, just to get that clear.

COMMISSIONER MASSEY: So what does the 60 days mean?

MS. MARLETTE: They have 60 days to come in, but that wouldn't impose a 60-day clock on us, is my understanding.

COMMISSIONER MASSEY: I understand. Well, as we've done with every panel before us today, thank you for your hard work. We're pushing a lot of business out the door today, but this is a very, very significant effort. I thank you for your hard work.

CHAIRMAN WOOD: As you all know, it was probably two years ago this month that I had a concurrence as a new kid here. I was mystified about all the interconnection policy and confused as to why I think, for that meeting, one quarter of the posted items on the docket dealt with some aspect of interconnection disputes, not just pricing, which, of course, is the most comprehensible one, but a number of other ones that were very obscure and yet critical to the different business plans of the generators or the providers.

Based on my own experience at ERCOT, which is getting the standard out there and letting everybody hash it out and the Commission break the ties or break the impasse on the 20 percent of the items, that this was really the right way to go.

It's been a long haul, and the ANOPR process was our first effort to use that here. It was probably a mixed success from the view of the participants. It did get some

issues out on the table. Perhaps the traditional NOPR process with some more accessions in between, could have done the same.

Nonetheless, we did get to a consensus-ish document that we ended up in six critical areas from the memo last year, proposed resolution to six baskets of items in the NOPR that people cannot solve in the ANOPR process. We put that out, you folks hashed through about 170-plus comments on this, and I think we made some changes where necessary. I wouldn't say that they are major overhauls, but we clarified, for example, the evolving participant funding issue and made it clear for the first time in rulemaking here today, that that's an option that we entertained from independent organizations, independent providers.

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We'll make a number of different policy calls here on every different aspect of this entire contract. It is tedious, but it's what regulators do. Our job is to find where there's common ground to grab it, as we did with the price index issues, but to resolve disputes before they just become agenda consumers, which they were two years ago.

I don't live in a dream world and think that we're never going to see an interconnection dispute again. However, we set this up to reduce costs, to reduce time, to reduce the hassle that comes with trying to interconnect on a privately owned and operated grid, which we have in our country by and large, and to really get the benefits of both worlds, of the privately owned sector in transmission and the independent sector in generation, have them come together where the negotiation playing field is level, where issues of reliability, of cost, of process, of dispute resolution are thought through in advance so that they're relatively, as most anything that we have standardized around here, move faster.

We're open, as Bill and Nora's questions pointed out, to improvements in the process. That's why I hope this statement that over the years to come it will become better and better. It becomes perhaps even more pro-customer than it is, because we do have to be balanced and fair. I know that generators didn't get everything they wanted and the

providers didn't get everything they want, and that means we probably did our job right. But this was thought through, well done, and I know it took a whole lot of time. I took a lot of time to read it once. I can imagine how many times it took to analyze all the comments that fed into this.

So it's a big day. I'm proud to be on you guys' team when we vote for it, so let's do so.

COMMISSIONER BROWNELL: Before I vote, I just want to make one comment. I think this rule will also make the job of the market monitors to some extent easier, and I hope they are aggressive and assertive in analyzing and auditing the implementation of this. I think we can begin to look at trend information to see who is getting interconnected and how fast so it brings certainty I think to the process. It brings value to the customer, but I think it allows us to oversee the marketplace more effectively.

With the differences in rules and the interpretations of those rules that are out there, it's been enormously difficult to figure out who hit Bob and what's working and what's not. I hope we use it effectively, and I support this order.

Aye.

COMMISSIONER MASSEY: Aye.

CHAIRMAN WOOD: Aye. This will be Order Number

2003. A lot of people worked on this at our end of the table and are deeply appreciated as well.

SECRETARY SALAS: Next for discussion, the same Staff team will present E-2 Notice of Proposed Rulemaking on the Standardization of Small Generator Interconnection Agreements and Procedures. Mr. Kirk Randall will make the presentation for the team.

MR. RANDALL: Good morning. My name is Kirk Randall, and I'm the team leader for the Small Generator Interconnection Project.

Item E-2 is a Notice of Proposed Rulemaking to amend the open access transmission tariffs of jurisdictional public utilities, to include standard interconnection procedures and a standard interconnection agreement for generators no larger than 20 megawatts on size. Slide 2.

(Slide.)

This proposed rule follows in the footsteps of the large generator interconnection proceeding, Docket Number RM02-1. The goals of the proposed small generator interconnection rule are:

To facilitate the interconnection of small generators with a rule designed for their special features and needs;

To lower wholesale prices for customers by increasing the number and variety of new generation

resources that compete in the wholesale electricity market;

To reduce interconnection time and costs for small generators for small generators and transmission providers;

To prevent undue discrimination whereby a transmission provider may show favoritism to interconnecting its own generator or that of an affiliate.

Slide 3.

(Slide.)

To preserve the reliability of the transmission system;

To increase electric energy infrastructure; and finally

To facilitate the development of nonpolluting alternative energy sources such as wind, solar and distributed generation.

(Slide.)

It's no surprise that many of these goals are common to the large generator interconnection final rule that you just voted out. The proposed rule issued last year in that proceeding would have applied to generators of all sizes. However, as Pat told you already, many commentors told us that there were significant differences in the interconnection needs of small generators compared with large generators.

The Commission agreed and determined that small generators needed their own set of interconnection procedures and agreements which would address their unique needs. Accordingly, the Commission spun off the consideration of interconnection rules for generators no larger than 20 megawatts into this separate proceeding.

The Commission invited all interested parties, including small generators, transmission providers, equipment manufacturers, equipment testing organizations, and state regulators to meet, to develop consensus, propose small generator interconnection procedures and interconnection agreements.

When the parties couldn't meet in person, they communicated through a Web-based internet sponsored by the Commission, which I would note worked quite well. Over 350 persons are currently participating in the small generator internet.

The final products of these negotiating sessions were then submitted by the coalition to the Commission. This proposal, together with the comments filed by other interested parties, and Staff's own analysis and input, formed the basis of the proposed rule that you now see before you.

If I may digress for a moment, the project team wants to acknowledge the assistance of all of the

stakeholders who contributed hundreds of hours of hard work on behalf of this collaborative effort. The result of their work is truly impressive and was a significant step to the team and a significant help to the team in its preparation of this proposed rule.

We would like to acknowledge in particular the assistance of our state regulator participants and NARUC, who enthusiastically participated in the collaborative process.

The coalition proposed two interconnection procedures and two interconnection agreements -- one set for generators no larger than 2 megawatts, and the other for generators larger than 2 megawatts but no larger than 20 megawatts. The state regulators and NARUC wanted to simplify the process as much as possible for the small generators, and accordingly supported a single set of procedures and agreement. The proposal before you reflects that recommendation.

The first of the two proposed documents is the small generator interconnection agreement. It sets forth the legal rights and obligations of the generator and the transmission provider. It assigns cost responsibility for interconnection facilities and upgrades of the transmission provider's electric system. It lays out agreed-upon milestones for completing the interconnection, and it sets

forth a process for dispute resolution.

While the agreement shares many similarities with the large generator interconnection agreement, the team paid particular attention to producing a streamlined agreement for small generators which reflects their unique needs.

(Slide.)

The proposed rule also includes small generator interconnection procedures that set out steps that the transmission provider and the generator must follow during the interconnection process. It includes three primary processes:

First, accelerated procedures for interconnecting small generators to a high voltage electric system, or generators larger than 10 megawatts to a low voltage electric system.

Second, expedited procedures for interconnecting generators between 2 and 10 megawatts to a low voltage electric system; and

Third, super-expedited procedures for interconnecting generators 2 megawatts or smaller to a low voltage electric system.

Generators that qualify for either the super-expedited or expedited procedures can be interconnected in very short order with little or no impact upon the transmission providers' electric system. Interconnection

requests for generators that do not qualify for either the super-expedited or expedited procedures are evaluated using standard interconnection studies that are similar to those used for large generators.

However, since the timelines for completion of these studies are significantly shorter than for the large generators, small generators should be interconnected more quickly under these procedures than under the large generator interconnection procedures.

There are other similarities between this proposed rule and the large generator interconnection final rule. For example, the pricing policies are the same. The proposed rule applies to the same kinds of interconnections as those specified in the large generator rule.

There are also many circumstances where the proposed rule would not apply. For example, for interconnections subject to state jurisdiction. For these kinds of circumstances, we offer the proposed rule as a model for adoption or modification by any entity that may find it useful. Such adoption should increase standardization of interconnection procedures across the nation, which we believe will help the development of renewable resources and alternative fuel technologies.

Slide 9.

(Side.)

Comments on the proposed rule are due 45 days after it's published in the Federal Register, which generally takes a few days. Now if folks just can't wait for the Federal Register publication, the proposed rule will be available very shortly on the Commission's Web page in its electronic document retrieval system, FERRIS.

In order to facilitate the dissemination of comments among the stakeholders and their analysis by everyone, including Commission Staff, we strongly encourage all parties to file their comments electronically using the Commission's Web site.

Finally, I want to note that the project team includes staff from the Office of Markets, Tariffs and Rates, the Office of General Counsel, the Office of Administrative Litigation, and the Office of the Executive Director. While we are not all present at the table today, those of us who are welcome your comments and suggestions.

Thank you very much.

COMMISSIONER BROWNELL: Three hundred and fifty people. That's an unbelievable dialogue. Thank you for managing that and giving us the end results, because I'm not sure that we could have.

I'm particularly interested in -- I mean, actually, I was a little bit reluctant when we decided to sever these two orders, and I was wrong. I hate to admit

that. Because I think the product is very, very significantly different because the issues are different. So, yes, many of the things are the same, but I think that you have done a great job in recognizing the opportunities and the differences for the small generator.

And I'm particularly pleased to see the, although I was giving the troops a little grief last night, the differences between accelerated, expedited and super-expedited. I think that is T-shirt material.

(Laughter.)

COMMISSIONER BROWNELL: And I think we ought to emphasize that one of the issues that you dealt with is the reliability issue, and one of the other issues you dealt with is that this is often a state issue and that this as a model I think will go a long way towards eliminating the barriers to entry for distributed generation particularly, but other smaller renewable projects as well. And I think that's one of the most positive outcomes. And we'll look forward to hearing the responses, particularly from those sectors.

But I emphasize the reliability, because I heard during the discussion of some of the processes out on the road that it reminded me of when we restructured the telephone market, and remember, if we didn't have those black rotary phones that weighed 400 pounds and that we

rented over and over again, that the whole system was going to crash? We don't need to hear that comment here. We've dealt with that. So I just want to be sure that everyone is clear on that.

This is a great opportunity particularly for certain constrained areas. It's a great opportunity to introduce technology that deals with and responds to environmental issues. And I think that the introduction of technology is what really drives change and restructuring in an industry, all the rules notwithstanding.

So I think this too is exciting, and as Bill said, you know, a banner moment for the Commission and a banner moment for the stakeholders. And to the work that the state commissions did, I think this really is all reflected here, although they had slight differences, they're not significant.

So I hope we can move this forward very quickly.

COMMISSIONER MASSEY: Now jurisdictionally, what we propose here is generally the same as what we finalized for the large generators. Is that correct? And as you stated in your presentation, if I'm a generator under this proposed rule and I'm interconnecting at the transmission level, this rule applies?

MR. RANDALL: That's correct.

COMMISSIONER MASSEY: And if I'm interconnecting

at the distribution level, it applies if the facilities are currently being used to make a jurisdictional wholesale sale. Is that correct?

MR. RANDALL: Yes.

COMMISSIONER MASSEY: If those distribution facilities are not now being used to make a jurisdictional sale but my facility would make a jurisdictional sale, the facility that I'm interconnecting, is this applicable or not?

MR. HENRY: No, it wouldn't be. What we're proposing is as a result of your interconnection request, you cannot make an otherwise nonjurisdictional facility jurisdictional.

COMMISSIONER MASSEY: I see. Is this a different proposal from what was in the ANOPR, or is it the same thing?

MR. HENRY: It is slightly different. I'd prefer to refer to it as a refinement of what we said in the large gen NOPR and the small gen NOPR on account of the comments we received.

COMMISSIONER MASSEY: Primarily from the states, I would assume?

MR. HENRY: True, yes.

COMMISSIONER MASSEY: Okay. And we say of course that this product could be used as a model by state

commissions, which is always true I suppose, but we offer it as a model because the state commissions have worked so closely with us in developing this, I take it.

I think this is a very good proposal. I look forward to the comments. Again, I would ask what percentage of this proposal would you say is a consensus document among industry participants I guess?

MR. POOLE: Not as high as the large gen, maybe 55 percent in the total consensus.

COMMISSIONER MASSEY: I would have said 56 myself.

(Laughter.)

COMMISSIONER MASSEY: We'll see what the comments are. I'm glad that we severed the small generators from the larger interconnection rule. I think it was a good thing to do. It allowed us to focus on their particular needs, and we have done so with a lot of good features in this proposed rule, so it has my full support.

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CHAIRMAN WOOD: As it does mine, I acknowledge.

I think it was one of the questions Bill asked on jurisdiction. I acknowledge that this would have less applicability as a FERC interconnection protocol and interconnection agreement than the last rule that we just voted out, Will.

On the other hand, knowing, certainly from the NARUC participation here -- very few states have actually done this at all. I really think that this would be really probably the lead, whether it's required to be or not. This will be the lead process and document in the country.

I appreciate the cooperation of the states and the back-and-forth. I remember the day we had our first workshop. When was that? Last August for the small? Was it September, coming down here and welcoming the participation of the NARUC Commissioners?

It's between us and them, really, this whole ability of a very new disaggregated type of technology. It becomes a routine part of the American electrical landscape.

I look forward to that day very much, for both reliability purposes and environmental purposes, customer choice purposes. I think there are a lot of things about small-scale generation that are not fully tapped in our country, that have a lot to contribute.

I think that ten years from now we'll look back

and this will actually, of all the things we do here, probably be the most significant thing we've done, and I appreciate the professionalism, the collaborative approach that you guys have taken and that the rest of you have taken with folks on the outside, and will continue through the proposed rule process.

And I do think we can take those comments and then we'll move them in a pretty expeditious timeframe and get this rule out there, like we did the last time. Thank you for your leadership and that of all of the Offices, and your support for this certainly makes this a whole lot easier to do, particularly where, quite frankly, the benefits may not be so screamingly urgent.

We don't have 25 percent of our agenda dominated by cases of small generators trying to interconnect yet.

COMMISSIONER BROWNELL: That's because they haven't been.

CHAIRMAN WOOD: Right. They need to get over the hurdle. It's hard to be discriminated against when you don't even get in the door. So this will get them in the door and make sure that they are treated well, and I think that's what regulators need to be about. Good job. I support it.

COMMISSIONER BROWNELL: Aye.

COMMISSIONER MASSEY: Aye.

CHAIRMAN WOOD: Aye. Thank you all. Let's take a quick break.

(Recess.)

SECRETARY SALAS: The next item on the discussion agenda is E-4, which is Pacer Power LLC, in a presentation by David Perlman, accompanied by Jason Stanek.

MR. PERLMAN: Good afternoon. Jim Akers and Mark Rosenberg are with me as well. In this effort we also had the support of Laura Valens, Dick O'Neil, Lee Chu and Steve Harvey.

The Order before you addresses a petition for a Declaratory Order from a prospective power trading platform, Pacer Power. In its petition, Pacer requests that the Commission find its operations will not be jurisdictional, but also offers to provide the Commission with the same quality of information it would provide if it had been found to be jurisdictional. The draft Order grants Pacer's request and accepts its offer to provide data.

In addition to addressing the specifics of Pacer's request, this matter provided the opportunity for Staff to assess the scope of entities that facilitate jurisdictional transactions, determine how they interact with the market and determine what was needed to assure the Commission can adequately fulfill its regulatory responsibilities. We also looked at the Commission's

precedent regarding when the Commission will exercise jurisdiction over entities that facilitate market transactions.

In our review, we looked at previously-operating trading platforms, currently-operating trading platforms, which have very different models, voice brokers, futures exchanges and RTO-enabled markets.

We recognize these entities and markets represent a large, potentially growing component of the matter in which jurisdictional transactions from both gas and electricity are entered into. We considered whether such entities are regulated and the manner of such regulation.

We also considered the Commission's regulatory goals. Over time, the Commission has implemented a regulatory scheme that allows more competitive markets to assure just and reasonable rates.

In addition to working to create market structures and institutions that promote competition, the Commission has worked to enhance its market monitoring capabilities. An important tool in undertaking market monitoring to assure just and reasonable rates, is access to information.

While there are arguments to more broadly assert jurisdiction under certain transactional facilitators, we concluded that if the Commission could obtain adequate

access to needed information, its regulatory goals would be met.

The Commission's precedent holds that a transaction facilitator may be jurisdictional, if it exercises effective control over jurisdictional facilities or transactions, or is integral to the transaction chain. There have been specific instances where certain transaction facilitators have been found to meet this test, and others where it did not.

We believe that when applied within appropriate limitations, this standard is not static and its application must be tailored to reflect the facts and circumstances then present.

As such, the Order before you grants Pacer's petition, and, importantly, takes Pacer up on its offer to provide the same quality of data it would provide, were it deemed to be jurisdictional. The Order also indicates that the Commission may reassess its jurisdictional determination of Pacer's operations change or are different from those represented.

Finally, the Order states that the Commission will track the evolution of the market and the role of transaction facilitators to determine whether any refinements to its policies are required in the future.

Thank you.

We'd be happy to answer any questions that you may have.

COMMISSIONER BROWNELL: Say a little more about -- when you said -- I wasn't clear what you were talking about what is not static, and you're going to apply in the goal of giving certainty to the marketplace, and then saying we're going to change our mind and then saying it's not static. Clarify that, if you will, please.

MR. PERLMAN: I certainly didn't mean to create confusion along those lines. All I was saying -- and I appreciate the opportunity to clarify -- is that the Commission's precedent with respect to the scope of this jurisdiction over these types of entities, is premised upon the Commission's determination that these entities exercise effective control over jurisdictional facilities or transactions, or are integral to the transaction chain.

And the facts and circumstances that we find ourselves presented with in the needs of the regulatory responsibilities of the Commission, could evolve such that the circumstances that we reviewed when we've made calls on these issues before, could cause us to find the then-present facts and circumstances that could cause the Commission to make a determination that something that heretofore had been found not to be jurisdictional, could have reasons that the Commission should exercise jurisdiction.

We don't think that's the case at the moment, but it's something that needs to be looked at as these entities continue to evolve and become potentially more significant components of the market in which our jurisdictional transactions are consummated.

COMMISSIONER BROWNELL: What's your estimate of the number of similarly situated platforms out there? Do we have any idea, kind of what the scope looks like?

MR. PERLMAN: It's hard to say who is similarly situated, but we see the market choosing whether these entities will succeed or fail. Currently, we have the Intercontinental Exchange, which is a viable entity that is a little different from this one, but is facilitating a lot of transactions.

The New York Mercantile Exchange has an OTC component to its activities that does a similar thing. APX has been authorized by the Commission, because it did engage in the exercise of effective control and does have a platform, that one has less volume than, for example, Intercontinental Exchange.

There's another one called Trade Spark that exists, and the Bloomberg platform, I believe still exists but is not all that widely used. Those are the ones I'm familiar with, and I believe we identified them in our review.

COMMISSIONER BROWNELL: Thank you. I think this is the right conclusion. I know it took us a long time to get here. I appreciate Pacer's willingness to volunteer that they will share information.

Given the chaos in the marketplace and what we've learned in the last year, I think there is an instinct to say we're going to kind of grab everything. But if we're going to grab something, we have to grab everything. I think we have to be equitable, and I think we need, as Congress is sorting through this issue, to hear their thoughts, and, as we've talked about, worked with our sister agencies.

I think this is the right conclusion and it is a work in progress, but I think we need to be clear about what standards we're going to apply, and then apply them equally.

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COMMISSIONER MASSEY: I will be dissenting from today's Order, based on the recent history of the gas and electricity markets with sometimes turmoil, volatility, certainly increased complexity in the marketplace.

Also, based upon our duty to ensure that market-based rates were just and reasonable, and that there is no undue discrimination. I believe the time has come to assert jurisdiction over Pacer and all similar trading platforms.

Over time, these trading platforms have become

increasingly important. As the presentation pointed out and as today's Order points out, significant numbers of electricity and energy transactions in general are facilitated and confirmed through market facilitators such as Pacer.

The products transacted on such platforms are becoming increasingly integral to energy suppliers and their customers and the prices that are charged to the marketplace and the terms and conditions of such transactions.

As the importance and influences of such platforms grow, so does the need for effective Commission oversight. We have seen what can happen when platforms are not operated in a fair way, thus, I believe the Commission has a significant interest in performing a reasonable degree of oversight of trading platforms to assure that the markets that they operate are fair and competitive.

It's clear that asserting jurisdiction over trading platforms would amount to a evolution of the Commission's jurisdictional reach, but I firmly believe that the Commission has this jurisdiction.

In situations involving trading platforms such as Pacer, the key consideration, in my judgment, is the degree to which the platform operator affects trade. Pacer is not merely a passive bulletin board provider; it sets certain standards for the trades that may be transacted on it, and

certain standards regarding who may participate in its operations.

Through such standards, Pacer may affect which jurisdictional transactions are made and the prices of those transactions. This significant effect on jurisdictional transactions renders Pacer's platform a jurisdictional facility.

I also believe that routine assured Commission access to trading data from platforms such as Pacer is integral to the Commission's oversight of wholesale markets. While Pacer has commendably agreed to provide some of this information to us, such access depends on the promise of a non-jurisdictional entity and thus is not assured that it does not apply to other non-jurisdictional entities, either.

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So I believe the Commission should assert its jurisdiction here. We need to assure, through some type of oversight, that such platform markets are operated fairly, so that prices to customers are just and reasonable, so that there is no discrimination.

We need two things: One is an assured way for the Commission to access transaction data in a routine way. The other is to be able to review membership agreements or requirements that entities must meet to be able to trade on a platform to ensure that those requirements are not

discriminatory.

Currently, there is no legally enforceable way for the Commission to access such information. While today's Order is conditioned on Pacer providing such data, the Order does not apply to all of the other platform operators who do not ask for a disclaimer of jurisdiction.

That raises the question of how we should exercise our jurisdiction. There is no need for intrusive regulation of fees and intrusive regulation of the practices of the platforms and exchanges.

Instead, we need to craft an appropriately light-handed approach. That is what I would advocate.

I believe the need right now is solely to have some degree of oversight of the platform markets. This can be satisfied with reporting requirements that could be done on a confidential basis and that are legally enforceable.

At this point in the industry's evolution toward robust market solutions, I believe that asserting our jurisdiction over trading platforms and then judiciously exercising that jurisdiction in a light-handed and appropriate way, is the prudent course. For these reasons, Mr. Chairman, I will be respectfully dissenting from today's Order.

CHAIRMAN WOOD: We looked at this in January. I was inclined to find that we had jurisdiction, as well, but

asked the Staff to step back, as we did last week with the local market power mitigation issue, step back and let's look at these big issues that are very specifically bothering the industry.

Let's look at them globally, kind of with the analysis that's incorporated in this Order, Paragraphs 6 through 30, and kind of lay out what is the universal effect. Have we looked at the APX, Cal PX decisions? What have we learned through the Gelinas report and everything that we asked?

I have to confess that it would have been and is tempting to just say let's err on the side of caution and take this entity under our definition of regulated public utilities.

I do distinguish, and I think you did a nice job, too, Bill, of distinguishing between the data collection aspect, which I do think actually in this Order, we did lay out, substantially, as we discovered, through the price index proceeding, that we did have quite a bit more substantial authority to get all sorts of data, even more so in the gas industry than the electric, of the type of data that OMOI needs to oversee the markets. I'm confident that will go forward, and whether they volunteer it or not to me is actually immaterial.

In the draft here we say, We accept your offer.

Oh, by the way, we can get it anyway. You accept a gift when you have it. As you know, Tom, we have ten more of the same items in the garage. We do have the authority to do that, and I think, quite frankly, the line between deeming someone is a regulated public entity and engaging in a more restricted view of what that requires, per your discussion, and where this Order ends up, may not be so far off after all.

Particularly with this business plan, the overall view of the world is as laid out in this Order. I do think in the discussions in these Paragraphs 6 through 31 of the Order, that incorporated some research that Dave and the team has done since January, and where have we been in it, that Pacer actually has a pretty small role in what it's doing.

I think, as our understanding of their business plan indicates, they really do skirt below it, or the lower boundaries of what is a public utility under the law. If that business plan becomes more robust and the facts do change, I think you start looking more like a Cal PX and APX and that could change the regulatory treatment.

I do think, though, Nora, that that doesn't mean that the whole world has to be upset and changed. I understand that people have an intrinsic desire not to be jurisdictional to a regulator, but I do think we've got to

prepare for the day when there will be folks that do actually do more than minimal activities such as Pacer proposes to do here that would bring them under any fair reading of the Act.

Preparing for that day does not mean we dump the whole burden of everything on top of you, which is something I do think we need to be mindful of, but that we will fairly interpret our law and apply it.

I do note with interest, in a case I actually dissented on, that in APX, which is an exchange that we have claimed jurisdiction, the concerns, Bill, that I think you have in the marketplace of an exchange also having an impact on juts and reasonable rates, that the decision that you all made on that, to say that they don't have market-based rates, is, in fact, the right way to deal with this issue.

Frankly, don't mix and mingle the exchange business with participation in the market. I just think we kind of limited that participation in the market, but the point is broader, and one that I embrace, there and here, that the analysis of these exchanges is an important step we ought to take on our own.

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I do think this will evolve. This is our first, or actually our third data point here. We've got Cal PX and APX which we have claimed jurisdiction over, because they do take a bit deeper role in the market, this one a little bit less, though the line is fuzzy. I acknowledge that, Bill. I think your point is a fair one. I think here I would -- I think this decision is good and I think with some oversight monitoring as this part of the industry develops, it will be something that we keep up with on our surveillance briefings over time, and I think we'll keep up with it through that approach.

I think this is a good place to start, and I think this particular business plan and business segment have a lot to offer in this new environment that's kind of post-Enron, post-California world, and I'd like to see, to the extent possible, that we let that develop. Hopefully this decision will be a positive approach in that regard, not a negative.

COMMISSIONER BROWNELL: Aye.

COMMISSIONER MASSEY: No.

CHAIRMAN WOOD: Aye.

SECRETARY SALAS: The next item in the discussion agenda is E-5. This is Midwest Independent Transmission System Operator. It's a presentation by Steve Pointer, accompanied by Michael Donnini, Richard Hudson, Gilda

Rodriguez Thompson and Larry Greenfield.

MR. POINTER: Good afternoon, Mr. Chairman and Commissioners. In its order dated July 31st, 2002, the Commission accepted the RTO choices of the former Alliance companies subject to certain conditions, including the resolution of concerns about the regional through and out rates of the Midwest ISO and PJM.

The Commission initiated an investigation and hearing regarding the regional through and out rates. They held the hearing in abeyance. The Commission encouraged the parties to resolve the regional through and out rate issue. But when the summit talks failed, the hearing process began.

The draft order addresses an initial decision where the Presiding Judge determined that he had no precedential authority that would permit him to eliminate the regional through and out rates between the Midwest ISO and PJM. The draft order disagrees with the Presiding Judge's finding and concludes that the Midwest ISO and PJM regional through and out rates would apply to transactions sinking within the proposed Midwest ISO/PJM footprint are unjust and unreasonable.

The order directs PM and Midwest ISO to make a compliance filing eliminating these regional through and out rates effective November 1st, 2003. By eliminating these regional through and out rates, this order will enhance

efficiency in competitive markets in the Midwest.

The order also finds that the through and out rates under the tariffs of certain individual former Alliance companies may be unjust, unreasonable or unduly discriminatory or preferential, and the order initiates an investigation and hearing under Section 206 of the Federal Power Act regarding these rates.

The Commission will conduct an expedited paper hearing to determine whether such rates are just and reasonable and not unduly discriminatory or preferential, and thus provides parties with an opportunity to explain why the rates are or are not unjust and unreasonable.

The order also states that the Commission will entertain Section 205 filings to establish traditional cost recovery mechanisms once the regional through and out rates are eliminated, and the order provides guidance in this regard.

Thank you.

COMMISSIONER BROWNELL: Would we be confronting these issues in quite the same way if the choices had been different, if we didn't have these ragged seams?

MR. POINTER: Probably not because given the configuration requirements of Order 2000 that include such factors as encompassing one contiguous area, encompassing a highly interconnected portion of the grid and recognizing

trading patterns. If the choices were different, then the companies within the PJM/Midwest ISO footprint would have met Order 2000 configuration requirements and then this may have been unnecessary.

COMMISSIONER BROWNELL: Thank you. Describe if you will the process here for the PJM MISO members and the nonmembers. And the issue has been raised by certain states in MISO, particularly that they were concerned that whatever the process was, it would have a negative effect on them. How have we dealt with that and how do we envision kind of this moving forward, if you wouldn't mind describing that?

MR. POINTER: We will be willing to consider Section 205 filings that will allow companies to recover lost revenues that may result from the elimination of the through and out rates to in a sense hold them harmless.

MR. LARCAMP: But I mean, we don't have those filings yet, and everyone will have an opportunity to comment pro and con based upon any proposals that come in, so that to the extent that a state believes that their utilities need one, you know, they'll support, to the extent that they believe that other utilities don't, they'll have a forum here and we'll thoroughly consider any comments that are made at that time.

COMMISSIONER BROWNELL: Thank you.

CHAIRMAN WOOD: It was my hope honestly that when

we issued the hearing order last year that people would have gotten to that point in this proceeding as opposed to creating another one. I hope we won't be as ambiguous in the future when we've really made a policy decision to eliminate rates and just want to pick up the pieces. And I regret that, because it's taken now a year to get a resolution here and taken some effort to go through the record to try to get that done ourselves, even after having sent it to a hearing.

Nonetheless, I think this is the right way to eliminate the rate issues, which are really at the core of what I think is driving some of the integration obstacles that still exist in the heartland of the country. And I think this will definitively resolve that issue while providing an opportunity for transmission owners to get their just and reasonable rate recovery for providing transmission service, as well as acknowledge the fact that not everybody has finished delivering on their commitment to get into RTOs yet, we go ahead and kind of deal with that issue with the separate 206 proceeding which is posted here today, and which we'll move on in a very expeditious manner.

So this actually is quite big. I think dealing with rate issues is such a core, you know, it's why we're here, because no one will ever resolve these things amicably.

So why pussyfoot around and send it to settlement. These will probably be litigated. Let's just after it. I'm ready for it, and I think we need to get those economic barriers to commerce in this huge part of the country resolved, because it is a lingering festering sore, and we need to get the surgery overwith.

I appreciate the back-and-forth over the past two weeks that we've all done to get the right process in place here to keep this on track and expeditious and in conformance with the Power Act. So this looks good to me.

COMMISSIONER MASSEY: Yes. This order it seems to me really showcases the immense complexity that's involved in trying to facilitate a single market in this part of the country that is not, as the order points out, riddled with seams and toll gates that impede efficient markets and preserve a competitive advantage for affiliated merchants.

As I understand these regional through and out rates, and we've discussed them before at the table, they're the rates that apply between the regions essentially to move power from one region through another and out. MISO has through and out rates. PJM has through and out rates. The new PJM companies themselves have their own individual through and out rates, and we're trying to throw all of that in the soup and stir it and come out with a just and

reasonable product that eliminates the seams, eliminates the so-called rate toll gates in that region of the country.

And it is a very complex process.

But I find this order to be refreshingly straightforward in its conclusions and findings. I commend it to the reading of all market participants in that region. The Commission is very serious about solving these problems, and this is a major step in moving forward. It has my support.

CHAIRMAN WOOD: I do note that the elimination date is tied to the revised date for comments integration with PJM, which I know is probably the source of a lot of the seam issue there on the economic side at least, and may well be a month after the Grid America companies if we've got some other proceedings there that have to be dealt with, the month after that.

So this I think timely might actually lead to just a few other companies being involved in the separate 206, because they will have by the time of the elimination of through and out rates already be incorporated into an RTO. So that could keep the effort even more focused. So I hope we can move forward on those dockets, and I know we plan to.

So, I like it too.

COMMISSIONER BROWNELL: Aye.

COMMISSIONER MASSEY: Aye.

CHAIRMAN WOOD: Aye.

SECRETARY SALAS: Next for discussion is E-10.

This is PJM Interconnection LLC. This is a presentation by Kevin Sumpter, accompanied by Alice Fernandez, Michael Goldenberg and David Mead.

MR. SUMPTER: Good afternoon, Mr. Chairman, Commissioner Brownell, Commissioner Massey. This draft order takes three actions with regard to the PJM Regional Transmission Organization.

First, it denies the request for rehearing of the Commission's order of December 20th and clarifies the procedure the Commission will follow in the event that a transmission owner does not enlarge its facilities after PJM determines through its regional transmission expansion plan process that such enlargement is necessary.

New York transmission owners sought rehearing of the Commission's directive to PJM to explain how PJM's planning process will identify expansions that are needed to support competition and to provide authority in PJM's regional transmission plan for PJM to require upgrades both to ensure system reliability and to support competition.

Second, the draft order accepts PJM's compliance filing setting forth its procedure for determining upgrades necessary for competition. However, it requires further

information and clarification from PJM with regard to the definition of "hedgeable" and "unhedgeable" congestion. How PJM would determine the cost of congestion, how financible transmission rights or auction revenue rights that might be created as a result of such new upgrades will be allocated and whether PJM will allocate costs to customers on a zonal or subzonal basis.

The draft order also requires PJM to clarify how the cost allocation provisions for the upgrades proposed through the regional transmission expansion plan process compare with the cost allocation provisions for merchant transmission projects in PJM.

Third, in a related docket, the draft order rejects the mechanism filed by PJM's transmission owners to recover the costs of any upgrades which might be found necessary as a result of the regional transmission expansion plan process.

The PJM transmission owners propose the use of a single average carrying charge developed using the same return on equity for all PJM TOs, a capital structure based on the average of all PJM TOs and charges for expenses based on average of certain other costs of the PJM TOs.

The draft order states that the Commission would consider proposals along with the individual transmission owners to timely recover the cost of transmission expansions

which could include the use of a carrying charge for expansions based on the cost of an individual utility.

Thank you.

CHAIRMAN WOOD: Thank you, Kevin. Bill, anything?

(No response.)

CHAIRMAN WOOD: I do want to say I think it is very important. One of the things we put in the whitepaper, it is important to let the TOs and the world know how costs will be recovered on a going forward basis when expansions are done. And although we reject the filing here of the TOs for the reasons Kevin laid out and the others that are more detailed in the proceeding, or in this order at the very end, I think we do want to welcome those filings to come back in so that there is a predictable and methodological -- well established method to get these costs recovered so that they're actually made.

I do note that we cite with approval the use of formula rates and we updated in the MISO tariff, and I think those not only ensure the timely recovery of costs for expansions on the TO side, which is an interest, but also address customer interests that there might be over-earnings. I notice we use these not only in RTOs but I think both Southern and Entergy have annual cost trackers.

So this is not something we're allergic to in

either nonindependent or in independent regions. They're a useful way to I think make sure the TOs get their money but the customers don't have to worry about overpaying on a going forward basis.

So I think the incentives, the use of a PJM-wide transmission rate. We asked a question here about perhaps if the 100 basis point adder that is mentioned in our proposed policy statement should be considered here. We haven't adopted the policy statement, so it's not an automatic, but indicating in the very last sentence of the order should the adder just apply to every type of new expansion, or should be limited as we asked in our proposed policy statement to the implementation of the new technologies that we're hearing a lot about in the transmission industry.

So I would say to the filers of the tariff, come back with something along the lines that we've done here, but it is important to have a cost recovery mechanism established. And I think actually there is an underlying docket, correct, that has gone forward, and this is a subsequent?

MS. FERNANDEZ: PJM in its compliance filing set out a new schedule for transmission enhancement charges that left a lot of the details. And that's part of the RTO compliance filing. That's in the first part.

CHAIRMAN WOOD: So we've got the docket to really answer the question. It's just we've said here, these details don't work for us, come back with?

MS. FERNANDEZ: The particular method that was proposed by the PJM transmission owners. The order says that's unjust and unreasonable and tries to give guidance as to what would be acceptable ways and that would fit within the general framework of the transmission enhancement charge that PJM had filed.

CHAIRMAN WOOD: Which is in the second item that Kevin laid out today?

MS. FERNANDEZ: Right.

CHAIRMAN WOOD: Which is the compliance to the RTO decision in December?

MS. FERNANDEZ: Right.

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CHAIRMAN WOOD: The forum is open. We just need an alternative proposal to plug in on the details.

MS. FERNANDEZ: Yes.

COMMISSIONER MASSEY: I do think I will take the opportunity to comment on this. I do think this is a very important Order.

There's a lot of interest in the industry, of course, now in the wake of the DOE study of last year about how transmission investments are lagging behind the needs of the marketplace.

How can we assure that sufficient transmission upgrades are made and paid for? Where does the RTO fit into that process? Where do the existing transmission owners fit into that process? What about merchant transmission?

I think this Order provides a good summary of what I think is a reasonably proficient planning process in PJM, that I think, if properly implemented, will lead to substantial upgrades of necessary transmission facilities. It's a process that, as we lay out in the Order, PJM will identify areas where an upgrade may be needed, inform participants of the problem, perform a cost-benefit study to see if a transmission upgrade, as compared to some other solution, if a transmission upgrade is the optimal solution, and then act only if the market does not come forth with a solution, but wait a year, is that right, under the planning

process?

MS. FERNANDEZ: I think it's generally thought to be a year, but I think that's one of the areas where the details really are not clearly spelled out. The Order is asking for a bit more detail.

COMMISSIONER MASSEY: I see. Then if there is not a different market solution that comes forth, other than a transmission project, but a transmission upgrade is necessary, then the RTO has the authority to require that the upgrade be made.

MS. FERNANDEZ: The RTO would basically then go to the transmission owner and identify the transmission owners that should construct. The Order does leave open, what would happen if the specific transmission owner refused to construct and would not voluntarily construct, and then basically says, in those instances, PJM would have to come back to the Commission.

The Commission would then decide on appropriate steps to take. I think it's set up with the anticipation that if you have the right incentives and right rate mechanisms, hopefully you wouldn't get into that situation, but in the event that there is, it basically comes back to the Commission.

COMMISSIONER MASSEY: Where does merchant transmission fit into these processes?

MS. FERNANDEZ: Well, I think that if there is an area where there's congestion, merchant transmission would be one of the ways of relieving it.

COMMISSIONER MASSEY: That would be considered more of a market solution.

MS. FERNANDEZ: The market solution, yes.

MR. GOLDBERG: I will also ask for further clarification on how merchant transmission would fit in after the lag period is over, and whether or not PJM would consider merchant transmission under some sort of a rate structure, as a way of creating the construction necessary to alleviate the congestion. That's one of the questions that's in the Order.

COMMISSIONER MASSEY: What about this issue of un-hedgeable congestion? Can someone explain that to me?

MS. FERNANDEZ: That is another area where the draft Order would require additional information. It seems like un-hedgeable congestion would be where there is congestion and a load-serving entity that wanted to get or procure financial transmission rights, but could not do it; they simply were not available.

It's not a question of they're available to buy, but they chose not to buy; it's that they just aren't available. That's what we think is the definition of un-hedgeable congestion.

But, again, this is one where there are a lot of details of what the proposal is that need to be further defined.

COMMISSIONER MASSEY: It's not as if there are certain kinds of congestion that can't be hedged; it's what are the appropriate procedures for dealing with this?

MS. FERNANDEZ: If they're not, if you cannot buy the FTRs, and you can't get into situations where, given just sort of the configuration, that you could not buy sufficient ones to hedge the transactions and you could have un-hedgeable congestion.

There are other situations where you may be able to procure the FTRs or get allocated the auction revenue rights under the regular procedures. We viewed this as going to the instances where in a transmission system, basically there was a demand. The congestion was showing there was a demand for a potential new financial transmission right that could not be accommodated.

In that sense, if that occurred, you would then look at what the costs versus the benefits would be of a solution to solve the congestion.

COMMISSIONER MASSEY: Thank you.

COMMISSIONER BROWNELL: I think it's important to note that there were those who were participating in the Delmarva Peninsula market who raised a number of issues that

we're not addressing here, but that's on a separate track.

We expect a report from the Judge in early August, and then what?

MS. FERNANDEZ: We expect a report from the Judge, on, I think, August 12th. The Order specifically notes that that proceeding is going on and that rather than making some specific rulings on the Delmarva issue, that the Commission would await, I guess, to see what comes out in the report.

I can't remember exactly what the process was that was set up in terms of when the Judge comes out with a report. There would then be opportunity for comment, of if it simply comes up to the Commission and then the Commission could institute proceedings based on the recommendations.

CHAIRMAN WOOD: What's nice is that that will come up about the same time that the answers to the open questions in this docket that were laid out earlier will come back to us, as well. So that will be a good opportunity, if necessary, to revisit the thinking on that. This is kind of a big deal, and I appreciate the nice effort that was brought forth on it.

COMMISSIONER BROWNELL: Aye.

COMMISSIONER MASSEY: Aye.

CHAIRMAN WOOD: Aye. Thank you all.

SECRETARY SALAS: Mr. Chairman and Commissioners,

the final item in your discussion agenda this morning is the Western Energy Infrastructure Conference, a presentation by Jeff Wright, accompanied by Camilla Ng, Meesha Bond, and Raymond James.

MR. WRIGHT: Good afternoon. I'm Jeff Wright. With me at the table are Camilla Ng, Meesha Bond, and Raymond James. We'll be presenting an overview of the energy infrastructure in the Western Region of the United States.

(Slide.)

MR. WRIGHT: For this overview, the Western Region in the United States comprises the 11 states shown on this slide. We also consider the contributions of the Canadian Provinces of Alberta and British Columbia to the energy mix of the West, as well as those in Northern Mexico.

In brief, the Western U.S. contains 62.7 million people or 22 percent of the total U.S. population, and has a gross state product of \$2.3 trillion, over 23 percent of the total U.S. gross state product. And in the most recent year for which complete data was available, the West accounted for 17 percent of total U.S. energy consumption.

Camilla will now address electric generation in the West. Meesha will follow with a look at reserve margins and electric transmission. Ray will address natural gas infrastructure.

MS. NG: Next slide, please.

(Slide.)

MS. NG: Starting with electric generation capacity, as seen on the left, the tall stacked columns show that from January 2000 to May 2003, the West increased its electric generation capacity by 15 percent to 165,000 megawatts.

In the West, both natural gas and hydro dominated the fuel mix; 35 percent of the total generation capacity is gas-fired, followed closely by hydro with 32 percent. Coal-fired generation makes up 25 percent of capacity, and nuclear, six percent.

On your right is a map of the four subregions in the West. The Desert Southwest has grown the most since 2000; 39 percent of the Southwest capacity is fueled by natural gas and 34 percent is coal-fired.

California has the most capacity in the West; over half of California's generation capacity is gas-fired.

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In the Northwest, hydro fuels 60 percent of the generation, with coal fueling 22 percent. The Northwest has the slowest growth rate of seven percent.

Although the Rocky Mountain subregion has only eight percent of the West's total generation capacity, its growth rate is 21 percent since 2000. Coal-fired generation

dominates this region, with over half of its capacity, with gas-fired generation next at 27 percent.

Next slide, please.

MS. NG: Here we are looking at the trends in capacity and retirements. The bars are color-coded by the four subregions in the West where 21,000 megawatts of generation capacity has been added since 2000 in response to electricity supply shortages in 2000 and 2001. Almost all new capacity is gas-fired.

Now, 16,700 megawatts of capacity is expected to come online between now and 2005. California and Arizona have the largest amounts of additions, however, additions will drop sharply after 2003.

On the chart, below the zero line, are retirements. In the next couple of years, over 3,000 megawatts of retirement will be in the California-Mexico subregion. Most of these retirements are aging gas-fired units, however, a large coal plant in southern Nevada is also expected to be retired.

Very few coal and hydroelectric generating plants are expected to retire, as these plants are inexpensive to run because of low fuel costs. In the case of some coal-fired generators, scrubbers are installed to meet environmental requirements.

Next slide, please.

(Slide.)

MS. NG: This chart shows the historical fuel mix in the West from 1995, with projection to 2005. It shows that load growth in hydro, coal, and nuclear generation. In 1995, hydro fueled 42 percent of the West's generation. By 2005, due to increases in gas-fired generation, natural gas will fuel more electric generation in the West, with 37 percent of electric generation, while hydro drops to 32 percent.

(Slide.)

MS. NG: Moving next to net generation output, here we are looking at a comparison of net generation output in gigawatt hours for 2000 and 2002. That generation output has decreased six percent from the high 2000 levels.

The decrease reflects a reduction in demand due to economic downturn. Generation output in California and the Northwest decreased by 11 percent and seven percent, respectively.

Generation output increased slightly in the other two regions. Next slide, please.

(Slide.)

MS. NG: The map on the right shows the location of hydropower plants in the West. The table on the left shows that hydropower makes up over 80 percent of the capacity in Washington, Oregon, and Idaho.

Since hydroelectric generation varies seasonally, draught can reduce available hydroelectric generation capacity by 25 to 30 percent West-wide. During the Summer, available energy from hydroelectric facilities is approximately 50 percent. Near-normal hydro levels in California and slightly below-normal hydro levels in the Pacific Northwest, should result in a near-normal 2003 hydro year for the West. Next slide, please.

(Slide.)

MS. NG: This chart compares energy consumption in the Northwest with exports to California. The upward trend of the solid red line indicates increases in energy demand in the Northwest, while the downward trend of the solid blue line shows that there is a correlated decrease in the amount of power available for export to California.

This implies that as the source of import from the Northwest decreases for California, California will have to build more generation instate in the future, or become increasingly dependent upon the Desert Southwest for electric imports. Next slide.

(Slide.)

MS. NG: Coal-fired generation comprises 21 percent of total capacity in the West. More than 75 percent of the electricity output from coal generation is from the five states listed on the chart. A number of the Western

coal-fired plants in these states are mine-mouth operations where plants are built near a coal mine or fuel source to decrease transportation and drastically cut costs to plant owners and consumers.

California's coal energy is mostly coal-by-wire from coal-fired generation plants located near coal mines in the Western coal producing states. Wyoming is the biggest coal producing state in the nation, accounting for about a third of total U.S. coal production in 2002.

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Over 70 percent of Western coal is exported to the Midwest, the East and the Southeast. Driven by incentives to reduce air pollution from coal-fired power plants, demand for clean-burning Western coal has increased almost 30 percent since 1995.

Next slide, please.

(Slide.)

The non-hydro renewables primarily are mostly wind, geothermal and solar. This category comprises 5 percent of the total generation mix in the West. From the map you can see that renewables are concentrated in California, Washington, and Oregon.

Of the various non-hydro renewables, wind power has grown the fastest in recent years due to tax subsidies, major improvements in wind turbine technology and public support for green energy. Wind power generation in the West has doubled since 1990.

(Slide.)

This concludes the portion on generation capacity. Meesha will talk to you about reserve margins and transmission next.

Thank you.

MS. BOND: Good morning. First I would like to explain a few points about reserve margin charts. The reserve margin charts were calculated without imports.

Dedicated out-of-state facilities were included in the net resources for the dedicated subregion, and the resources are restricted to the United States system.

The darker blue indicates the total load, which includes firm load and interruptible load. The lighter blue areas indicate net resources. The actual net resources are a total of the total resources minus the actual outages that were posted for that month.

The projected net resources include D-rated outages based on historical data. Looking at the charts, you will notice a seasonable fluctuation in the reserve margins. You see in the summer the California-Mexico area, the chart located in the lower left-hand corner, and Arizona and New Mexico and Southern Nevada area, the chart located in the lower right-hand corner, have a very tight reserve margin.

The net resources in Arizona, New Mexico and Southern Nevada are expected to increase faster than their load, resulting in an increasing reserve margin. The California-Mexico area is also adding new resources, but not enough to increase their reserve margin. As a result the California-Mexico area will continue to depend heavily on cross-regional flows during the summer months.

Next slide, please.

(Slide.)

This slide takes a look at the utilization of several major electric transmission paths in the West. The orange squares indicate the paths that were loaded to 75 percent of their operating transfer capacity more than 50 percent of the time from the summer of 1999 to 2001. The location of the heavily utilized paths indicate the West continued reliance on cross-regional power flows.

The patterns have changed over time, and with the addition of new generation, the pattern will continue to change.

Next slide, please.

CHAIRMAN WOOD: Wait. The orange ones would be the most congested lines there?

MS. BOND: Yes. The most heavily utilized. Seventy-five percent of the time they were at -- I'm sorry. Fifty percent of the time or more they're at 75 percent of their capacity.

CHAIRMAN WOOD: Kind of in a different place than you would have thought.

COMMISSIONER MASSEY: None of them is in California.

MS. BOND: Well, when we were looking at the data, what you see in California is the difference between the difference in congestion for reliability purposes and congestion more so for commercial or retail purposes.

Some of the area, like in Southern -- and plus with the addition of generation in Mexico and Southern Nevada, in the future we expect to see the transmission lines, the paths in the lower part of the state and in the southern part of Nevada to be more heavily loaded than they currently are or have been historically.

Next slide, please.

(Slide.)

Several electric transmission projects have been scheduled to be completed in 2003. The projects were aimed at localized needs and will not help to relieve congestion in the West. The Western subregions continue to depend heavily on cross-regional flows but have very few projects to help increase their intertie capacity.

Now I'll turn the presentation over to Ray.

Thank you.

MR. JAMES: May I have the next slide, please?

(Slide.)

Electric generation has been the fastest growing sector in the West and is now the largest gas-consuming sector. In 1991 electric generation represented 19 percent of the natural gas consumed in the West. Electric generation trailed the residential and industrial sectors in the usage of natural gas.

In 2001, electric generation represented 37

percent of the natural gas consumed in the West. California uses more gas for electric generation than any other Western state.

Next slide, please.

(Slide.)

As shown on the map, planned gas-fired electric plants, which is 95 percent of the total new generation in the West, will be located along major interstate natural gas pipelines and along the intrastate natural gas pipelines in California. The table provides an estimate of the amount of proposed generation coming in on line and in the advanced development stage along with the amount of natural gas required to fuel this new generation load for the period of May 2003 through 2005.

Over the next three years, a total of 16,708 megawatts of proposed electric generation could come on line. Depending on the heat rate of these facilities, the amount of natural gas needed to serve these facilities could be in the range of 1.3 to 1.6 Bcf per day.

The majority of this electric generation will be located in the Desert Southwest and California. The Desert Southwest consists of the states of Arizona, New Mexico and Southern Nevada. The Desert Southwest is projected to have the largest increase in new generation.

Next slide, please.

(Slide.)

This Gas Facts table provides a comparison of the natural gas consumption, production, reserves, storage and Canadian and Mexican imports and exports in the West, with the total U.S. for 2001. Four states -- New Mexico, Wyoming, Colorado and Utah -- account for 88 percent of the total U.S. production of coal bed methane, and 83 percent of the total U.S. coal bed methane proved reserves in 2001.

California and Montana account for 1 Tcf or over 70 percent of the total 1.3 Tcf of storage capacity in the West. Currently the storage situation in the West is better than the rest of the United States. According to the EIA for the week ending July 11, 2003, storage in the West was close to the five-year average. In California, total working gas in storage was 185 Bcf or 76 percent of the total working gas capacity of 243 Bcf as of July 16th, 2003.

California injections remained behind last year's levels at this time but ahead of the 2001 levels. The trade press reports that a major expansion of an existing storage facility in Northern California is nearing completion and will increase the facility's withdrawal capability from 200 Mmcf per day to 320 Mmcf per day in time for the 2003-2004 winter season. California anticipates it will require more storage capacity both inside and outside of California to meet its future requirements. Also, new storage facilities

are contemplated in Arizona.

The Commission has scheduled a storage conference to discuss issues related to natural gas storage development in the Desert Southwest on August 26th, 2003 in Phoenix, Arizona.

Since reaching a high of almost 1.3 Tcf in 1998, net Canadian imports into the West have declined each year, including 2001, which recorded less than 1.2 Tcf of Canadian imports. While Canadian imports continued to decline, deliveries of natural gas to Mexico from Western export points continued to increase from its 4 Bcf level in 1997 to its 31 Bcf level in 2001. These trends continued in 2002 and are projected to continue in the future.

May I have the next slide, please.

(Slide.)

There are 17 major pipelines that traverse the West. The West is dependent on natural gas deliveries from Canada and Texas and from natural gas produced within the West, particularly the Rocky Mountain region.

As Canadian supplies and production from the Permian and Anadarko Basins decrease, the West will become more dependent on natural gas supplies produced in the Rocky Mountain region. Such dependency is illustrated with the Kern River expansion flowing Rocky Mountain supplies into Nevada and California.

However, the West will be competing for these Rocky Mountain supplies with increasing demand for natural gas in the East. New pipeline projects are being proposed to move Rocky Mountain natural gas in an easterly direction. One such proposal, the Cheyenne Plains Project, was recently filed with the Commission.

Next slide, please.

(Slide.)

Pending pipeline projects will create new capacity to serve electric generation loads and deliver gas from producing areas. Thanks to 28 pipeline expansion projects certificated since 2001, pipeline capacity in the West increased by 6.5 Bcf per day. 3.6 Bcf per day of this new capacity was intended to serve electric generation load.

Of these 28 expansion projects, 15 projects added 3.4 Bcf of new capacity from the Rocky Mountain region. Of the 15 projects, 10 of these projects added 2.8 Bcf per day of new capacity from Wyoming.

Five projects are pending before the Commission with a projected capacity of close to 1 Bcf per day. The largest of these projects, the Cheyenne Plains Project, would add 560 Mmcf per day of new capacity and impact the Rockies in Wyoming. Thirteen projects are on the horizon with potential capacity of 7.2 Bcf per day. Nine of these projects have a potential capacity of 4.2 Bcf per day to

move Rockies gas.

The largest potential project is the Enbridge Project, with a capacity of 1 Bcf per day which would transport gas from Wyoming to Chicago.

The next slide, please.

(Slide.)

There are eight potential LNG import terminals in the West. Current Mitsubishi's Long Beach LNG project, which is number six on the map, has been granted use of the Commission's pre-filing process in Docket Number PF03-6. The construction of all or a portion of these LNG import facilities would contribute substantially to California's future gas supplies and would alter the existing flow dynamics in the West by allowing displacement of gas now being delivered into California to other Western markets.

This concludes my portion of the assessment, and I'll turn it over to Jeff.

MR. WRIGHT: Next slide, please.

(Slide.)

In conclusion, our assessment finds that planned generation additions after 2003 will not keep up with California's demand. We believe that new California-based generation and load response programs could help in meeting future loads.

The Northwest, the Rockies and the Desert

Southwest appear to have adequate power resources for the near future and surplus electric capacity in these regions could help meet future California shortages if transmission lines are upgraded.

There are significant interregional transmission weaknesses that remain which require major backbone transmission to meet long-term needs. Also, any reliance on power from the Northwest is dependent on the year-to-year hydro situation.

New generation is almost totally gas-fired. Diversification of generation fuel sources could help ensure available capacity during either natural gas or hydro shortages. The West is dependent on gas production from the Rockies, Southwestern Texas and Canada. Rockies production should become the dominant gas source as supplies from Canada and the Southwest Texas area flatten or decline, and LNG will be a future source of natural gas to California.

Natural gas capacity appears adequate to serve the region's demand at this time. However, potential demand caused by an increase in gas-fired generation will have to be met with increased pipeline capacity. We believe that storage should be increased in the West to meet peak demands that power generation loads will require. And many pipeline projects are anticipated to be filed in the near future to serve potential demand. But the question is whether the

capacity will be available in time to meet this demand.

That concludes our presentation. And in addition to the staff members before you, I'd like to acknowledge the contributions of John Schnagel and James Spencer to this assessment, as well as the assistance of James Caruso of the Office of Market Oversight and Investigations. We're available for questions. Thank you.

COMMISSIONER BROWNELL: Thank you. Great presentation. And I have to say that at a couple of places on the road this summer, I received great commendation for both the creation of the energy infrastructure group and the work that you do. So congratulations. You've been recognized, not only internally.

I just have a couple of questions. On page 19 when you talk about the LNG plants, how real are those?

MR. WRIGHT: Ray, did you speak about the prefilings?

MR. JAMES: Yes. I guess by reality is how much permitting has been produced so far. The one plant, the Long Beach plant, of course is in for the prefilings initiative, so it's probably further along than some of the other ones.

I'm not too sure with regards to the ones in Baja. I know there has been at least two where there's been some sort of permitting issued by the Mexican government,

either environmental or a storage permit. Other than those three, I couldn't really tell you how long these projects are or whether they'll be built or not.

MR. ROBINSON: Commissioner, we've been keeping track of this with the CRE in Mexico. They're pretty far along. They have granted some of their permits for LNG development in Baja. Along with that, just recently the CPUC and the CEC have both recognized the need for LNG for firing California generation, and we are in the initial stages of interacting with those groups to ensure that our process and their process or state process are integrated, and hopefully will streamline both to get some of these LNGs, if appropriate, approved.

COMMISSIONER BROWNELL: Good. Because that's one of the things we've heard from some of the project developers is the importance given the huge financial commitments involved in the whole chain that we work closely with the states. And I know California has been working on this, and they're looking at various plants.

I have a question on page 8, and it may just be that I'm not understanding this slide. The title is Hydropower Experts from the Pacific Northwest to California have Declined as Energy Demand in this Region has Increased. Does that mean that the Northwest itself has greater need for that hydropower and therefore is reducing its exports

and that availability will decline over time, or does it also reflect that California is looking at new gas-fired plants because we saw their reliance on gas? I just want to be sure I understand that.

And does this include kind of the continued depressed economy in both of those areas, or do we factor in potentially some growth spurts which we hope we'll all see soon?

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MS. NG: To the first part of your question, this chart basically shows the increases in native load in the Northwest Region, so more of the hydropower is staying home to serve its customers. Therefore, there are less projections -- the projections of continued increases in the Northwest energy needs, there will be less energy to export for California.

And the second part of your question?

COMMISSIONER BROWNELL: What economic estimates are we making? Does this assume kind of the continued economic slow growth, no growth, that we've been seeing in this part of the country? Do we assume a pickup in the economy, for example, in California?

I'm just trying to get an idea of what this reflects.

MS. NG: Okay, this chart does not cover the economic aspect. Jeff will address that question.

MR. WRIGHT: All I was going to add is that what this does is, it takes historic numbers and projects a trend line, so there's no effect of economics or economic forecasts upon these trends; it's just historic and how it looks like it will track out in the future.

COMMISSIONER BROWNELL: Okay. You referred in your conclusions to the need for backbone transmission needs in the future. Could you speak a little more to that, if

you would?

MR. WRIGHT: I think what we're looking at is interregional capacity, say, for instance, especially in the Desert Southwest and California. We will not be able to accommodate the increased generation loads that would be generated in the Desert Southwest to get to the market in California.

We see an enormous amount of generation capacity getting built that has been proposed in the Desert Southwest. It just doesn't seem that the transmission capacity is there to get it to the market.

COMMISSIONER BROWNELL: Interesting to talk about that issue and the LNG issue when we get to our conference. Thank you. That's all I have.

MR. HEDERMAN: I'd like to follow up on the Commissioner's question on the page 8 slide, just to clarify something. In other words, the factors that we hear about demand destruction and so forth, are not taken into account here. It's strictly historic trend line?

MS. NG: Yes.

MR. WRIGHT: It's an historic trend. Obviously, in some of the demand reduction, say, in aluminum smelters, is captured in the last couple of years.

MR. HEDERMAN: Okay. And on page 5, on the capacity mix, where the hydro generation capacity is

essentially the same through the whole period, have you made any progress on how to take account of the fact that there's the capacity of the dams, but there's still a question of whether there's water there to create that generation? Are we making any progress on how to track that?

MR. WRIGHT: This is purely talking about installed capacity.

MR. HEDERMAN: So it doesn't really help you look at what the situation is for the coming season, unless you take account of that, as well?

MR. WRIGHT: No. We can't track out to 2005, what the coming season will be.

MR. ROBINSON: I think one of the things that we all learned this past year is that when you try to make projections about what the production of hydropower will be in the Northwest, if you do it in January, it will be different than your projections in February, which will be different than your projections in March.

And if you really have done this for a number of years, you wait till April before you say anything about what the production is likely to be, and this is nothing more than what's there. You're going to have to wait till next April to see what the production in the Northwest is going to be for hydropower capacity, hydropower generation next year.

CHAIRMAN WOOD: How does the investor in a competing fuel source out there, deal with the fact that so much is dependent on a highly variable competitor like hydro? Does that have an investment impact? If you're the PJM or in Texas or somewhere else where it's all fossil fuel or nuclear, you kind of know if you've got a market opportunity to go in there and build or not.

There's just a lot. I mean, you mentioned, I think, Camilla, 20,000 gigawatts or 20 gigawatts of power got built in the last three years up there, which is pretty phenomenal, but it's competing against a resource that could either wipe them out with cheap power flow to the market, or being very scarce.

It just seems like a pretty volatile investment climate.

MR. WRIGHT: I think some people are rolling the dice pretty heavily out West. You want to make sure you have adequate capacity, for instance, within California's borders.

But how do you combat a high water year where the prices are just going to be dirt cheap?

CHAIRMAN WOOD: I think a capacity obligation out there might be a wonderful way to fight that battle.

MR. ROBINSON: It also screams for gas storage.

CHAIRMAN WOOD: Our friends at Red Lake now want

to come back with recourse rates with negotiated rates.

We're open for business.

(Laughter.)

MS. NG: Also, I mentioned in one of the slides for hydro, about during summertime, the available energy from hydroelectric facilities can be 50 percent of installed.

MR. WRIGHT: And that can be because of non-hydro-related reasons in terms of environmental requirements for your fish runs, et cetera, navigational problems and that kind of thing.

CHAIRMAN WOOD: This is ery good. We're going to present this largely as the kickoff to our conference next week?

MR. WRIGHT: Yes, in Denver.

CHAIRMAN WOOD: That will frame a good debate out there.

Thank you all very much, nice job. Meeting adjourned.

(Whereupon, at 1:30 p.m., the open meeting was adjourned.)