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BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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IN THE MATTER OF: :
CONSENT MARKETS, TARIFFS AND RATES - ELECTRIC :
CONSENT MARKETS, TARIFFS AND RATES - GAS :
CONSENT ENERGY PROJECTS - HYDRO :
CONSENT ENERGY PROJECTS - CERTIFICATES :
DISCUSSION ITEMS :
STRICKEN ITEMS :
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COMMISSION MEETING - 787TH REGULAR MEETING

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

Wednesday, March 13, 2002
10:00 a.m.

1 APPEARANCES :

2 COMMISSIONERS PRESENT :

3 CHAIRMAN PAT WOOD, III, Presiding

4 COMMISSIONER LINDA KEY BREATHITT

5 COMMISSIONER NORA MEAD BROWNELL

6 COMMISSIONER WILLIAM L. MASSEY

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8 SECRETARY MAGALIE ROMAN SALAS

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16 ALSO PRESENT :

17 DAVID HOFFMAN, Court Reporter

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P R O C E E D I N G S

(10:10 a.m.)

CHAIRMAN WOOD: Good morning. This open meeting of the Federal Energy Regulatory Commission will come to order to consider the matters duly posted in accordance with the Government In The Sunshine Act. Please join me in the pledge to the flag.

(Pledge of Allegiance recited.)

CHAIRMAN WOOD: Madam Secretary.

SECRETARY SALAS: Good morning, Mr. Chairman, and good morning Commissioners. Before we proceed to vote on the substantive issues presented in the Consent Agenda for today, we need from the Commission a separate vote concerning a procedural issue in Consent Item E-10, Pacific Gas & Electric Company.

Specifically, the Commission needs to vote to waive the provisions of the Government In The Sunshine Act, 5 USC 5552b(e)(1), to permit the following docket number to be added to E-10. It is docket number EL02-64-000, Northern California Power Agency vs. Pacific Gas and Electric Company and the California Independent System Operator Corporation.

Commissioner Breathitt votes first.

COMMISSIONER BREATHITT: Aye.

COMMISSIONER BROWNELL: Aye.

COMMISSIONER MASSEY: Aye.

1 CHAIRMAN WOOD: Aye.

2 SECRETARY SALAS: Commissioners and Mr.

3 Chairman, your consent agenda for this morning is as
4 follows:

5 Electric: E-2 through E-7, E-9 through E-11,
6 E-13, E-15 through E-19, E-23, E-27 through E-29, E-31, E-
7 33, E-37, E-38, E-40, E-41 and E-42.

8 Gas: G-2, G-4 through G-7, G-9 and G-11 through
9 G-16.

10 Hydro: H-2 through H-8 and H-10.

11 Certificates: C-1 through C-4, C-6 and C-7.

12 Commissioner Breathitt votes first.

13 COMMISSIONER BREATHITT: Aye.

14 COMMISSIONER BROWNELL: Aye.

15 COMMISSIONER MASSEY: Aye.

16 CHAIRMAN WOOD: Aye.

17 SECRETARY SALAS: The first item on your
18 discussion agenda for this morning is E-1, Standard Market
19 Design Scoping. In E-1 there is a presentation by Alice
20 Fernandez, Mark Hegerle, David Mead, David Withnell, and
21 Andrea Wolfman.

22 MS. FERNANDEZ: Good morning. If we can get the
23 Power Point up. Thank you.

24 For sort of this first slide, my presentation
25 today in E-1 is a Working Paper on Standardized Transmission

1 Services and Wholesale Electric Market Design.

2 (Slide.)

3 The names that you see there on this first page
4 are the staff who were diligently working on this over the
5 last several weeks.

6 (Slide.)

7 The next slide is sort of what the paper does.
8 What the paper does is lay out sort of the general policy
9 framework that would be used in developing the NOPR. It
10 makes a number of policy calls in some areas where there has
11 been a good deal of discussion.

12 It also identifies some other areas where there
13 is additional discussion necessary before those types of
14 policy calls can be made. It also lays out some general
15 principles that would be used in designing a Standard Market
16 Design. Things like, basically items that are sort of good
17 ideas, good principles to use in designing market rules, to
18 also say that things like fairness, treating supply sources
19 equitably, and various other principles that would be used
20 in working on the NOPR.

21 (Slide.)

22 I would emphasize that the policy calls in the
23 paper are preliminary decisions. There would still be a
24 Notice of Proposed Rulemaking that would be issued. There
25 also would be an opportunity for comment on this paper, and

1 further opportunities for comment with the NOPR. So that
2 these are preliminary decisions. If people believe that
3 there are major problems with it, there is opportunity for
4 making changes.

5 One thing the paper does not do is address issues
6 such as scope and governance. Those consistent with the
7 Commission's earlier Order in November will be dealt with in
8 individual RT cases.

9 In terms of the paper, this is just sort of the
10 general highlights of the major areas. I will go down those
11 specific ones.

12 The updated single transmission tariff is the
13 first one. Next slide.

14 (Slide.)

15 One of the products that would be included in the
16 NOPR is a revised Open Access Transmission Tariff. It would
17 be updated for Standard Market Design, and also for
18 comparability. It would be available for all service,
19 wholesale as well as it could also be used for taking
20 service for retail load.

21 There also would be a phased implementation. One
22 thing that we heard in some of the outreach discussions is
23 that there are a number of problems with the current Open
24 Access Transmission Tariff. Some of those could be
25 corrected fairly quickly.

1 The actual implementation of Standard Market
2 Design may take longer, just because of all the software
3 development and changes required. So what is discussed in
4 the paper is sort of a two-phased approach, seeing that
5 there are changes that could be made quickly to improve
6 market operations.

7 (Slide.)

8 The paper discusses a new transmission service
9 that would be more flexible than the current transmission
10 services in the Open Access Tariff. It would have access to
11 all sources and sinks. Customers could decide how much
12 price certainty they want. It would use a system of
13 Locational Marginal Pricing for congestion management.
14 Customers could get transmission rights to hedge against the
15 cost of congestion.

16 Because of the congestion management system that
17 is being used, it would have a transmission service. That
18 sort of scheduling would be very much integrated with the
19 various energy markets that I will discuss next.

20 There also would be provisions--there would be an
21 access charge or some similar rate design used to recover
22 the embedded cost. Next slide.

23 (Slide.)

24 In terms of the energy markets that would be used
25 for handling imbalances, there would be two markets: a day-

1 ahead market that would be voluntary. People could elect to
2 either do bilateral arrangements or self-supply, or they
3 could buy power through the day-ahead market.

4 It would be bid-based and security-constrained.
5 The results of the day-ahead market would be financially
6 binding. There would also be a real-time market that would
7 also be bid-based and security-constrained that would be
8 used to settle all imbalances.

9 One of the other things that we are trying to
10 work into the market rules in the discussion in the paper is
11 that we need to be sort of technology and fuel neutral; and
12 that both supply and demand resources should be able to
13 participate in the market, and the market rules should be
14 designed to permit that. Next slide.

15 (Slide.)

16 Operating Reserves: Because many of the
17 generators could either be selling or demand sources, too, I
18 do want to be technology neutral, could be selling either
19 energy or reserves so that there would also be markets that
20 would be for operating reserves that would be operated
21 together with the energy markets.

22 And again this just sort of describes a lot of
23 the basic characteristics of the bid-based markets. Next.

24 (Slide.)

25 On Monitoring and Mitigation the paper outlines

1 some principles and has a discussion of the types of
2 mitigation measures that would be appropriate, and under
3 what circumstances they would be appropriate.

4 One thing the paper does try and emphasize is
5 that market rules should enhance competition, but there
6 should also be, when there is market power, that should be
7 factored into the rules and the rules should include
8 measures to mitigate that type of market power.

9 The paper also discusses the role of the Market
10 Monitoring Unit, the main points being that it has to be
11 independent, an independent monitoring unit, and it also
12 tries to focus on--the unit should focus on withholding and
13 market efficiency.

14 (Slide.)

15 The paper also outlines a role that state
16 representatives could play in terms of RTO activities, and
17 in some of the decisions. The paper suggests that there
18 should be a formal role established.

19 It recommends that there be advisory committees
20 to the RTO boards that would have state representatives so
21 that state representatives would be able to participate in
22 some of the decision-making process on important issues such
23 as rates. Next slide.

24 (Slide.)

25 And sort of another item that this does is that,

1 I think with the heightened interest in system security, the
2 paper recognizes this and recommends that there be some
3 provisions that the Commission basically revise the Open
4 Access Tariff to sort of state the expectation that the
5 various market participants will comply with appropriate
6 security measures and reliability measures.

7 It is neutral as to who would develop these
8 specific measures.

9 (Slide.)

10 And in terms of Next Steps, some of these have
11 dates and some of these do not. I think the objective is
12 that the paper would be released relatively soon, and that
13 there would be an opportunity for people to file comments on
14 the paper by March 27th.

15 In the process of doing it, it is clear that
16 there are some additional steps that we need to take that we
17 are still working on the exact process for doing.

18 There are some issues that need further
19 discussion such as the allocation of imbedded costs and the
20 allocation of transmission rights, and a number of
21 implementation issues.

22 Since one of the products would be a new tariff,
23 Open Access Tariff, we are going to need a process to deal
24 with that. And I think the first step is going to be a
25 staff strawman tariff that will be issued sometime in the

1 next several weeks or so.

2 And then finally, this leads to a Notice of
3 Proposed Rulemaking with a tariff included as part of the
4 Notice of Proposed Rulemaking by summer.

5 That concludes my presentation. Do you have
6 questions?

7 CHAIRMAN WOOD: I would like to say I have waited
8 for this day for a long time on a number of levels.

9 (Laughter.)

10 CHAIRMAN WOOD: Her water has not broken yet.
11 That is why the phone is out. But I just think it is so
12 important for our agency to provide the leadership and the
13 detail work of what we need to have as a Nation to make the
14 energy markets on the power side work as well as they have
15 on the gas side as a product of the 636 effort that this
16 Commission did ten years ago, almost exactly ten years ago
17 to the week, to the month.

18 This is timely, and needed. We need to provide
19 new choices to customers. We need to preserve current
20 choices. We need to widen geographic markets. We need to
21 reduce transaction costs so that those dollars stay in
22 customers' pockets. And we need to establish the rules of
23 the road.

24 I think this all started in October of this last
25 year when we had a presentation during RTO week from the

1 Electronic Scheduling Collaborative, which is the little red
2 book on my table. On page 26 of that document, the members
3 of the Collaborative asked us to make some major policy cuts
4 so that they could then go forward and do the grunt work to
5 convert policy into operational details of the daily market.

6 So I hope this answers their questions. Because
7 what this paper is are the policy calls. I think Alice
8 pointed out accurately that there are a few yet to make, and
9 that is what the further process of working down the funnel
10 does.

11 I consider this probably to be a step halfway
12 down the funnel from where we were in October when we
13 started, and hope that by the time we propose a rule this
14 summer that we will be all the way down the funnel and run
15 through the rulemaking process as expeditiously as possible.

16 As to the policy cuts in this document, the
17 market design paper here is based on a real-time LMP
18 platform. I must say, as a state regulator charged with
19 setting up the wholesale market in ERCOT, LMP was not my
20 first choice and we did not adopt it, to my now dismay,
21 because I see that any time you vary from the basic
22 principle that cost responsibility should follow cost
23 incurrence you have opportunities for arbitrage and gaming
24 that disadvantage the market.

25 I think while others may have argued back and

1 forth that LMP is too complicated, and this, that, and the
2 other, I have not seen in this very open and permeable
3 process an alternative to LMP that even rises to the level
4 of being credible.

5 So I think at this stage, as in many other policy
6 cuts here, we have got to go with what works. Adopt it.
7 Own it. And move on. I think the LMP decision certainly as
8 a central one is one of those.

9 One of the things that also came out here, and I
10 think we find this as we drill down to details, I mentioned
11 this in a speech last week. I like drilling down to details
12 because I am a classic conflict avoider. When you drill
13 down to details, a lot of people realize that what may be
14 philosophical gulfs at the top when they are talking nice
15 aphorisms and bumper stickers, that there is really a common
16 answer at the bottom.

17 I think one example of that is the nature of
18 transmission rights. There is this big debate between
19 physical rights and financial rights where you kind of get
20 down to it. And even over the past 10 days, as we all have
21 worked through our staffs on this document, you realize that
22 there is really not a huge difference.

23 This proposal in fact embraces both physical and
24 financial, and I encourage parties to consider this new
25 proposal and to see whether the specific needs of you as a

1 wholesale customer or a wholesale seller are accommodated
2 here.

3 We evaluated what Staff believed were the
4 underlying concerns of a range of parties in different
5 regions of the country and tried to develop a hybrid
6 proposal that addresses these concerns consistent with good
7 economic policy.

8 These rights are intended to provide all people
9 the physical access and transmission price certainty that
10 customers say they want without reducing the amount of the
11 grid that can actually be utilized.

12 This proposal does not abrogate contracts. We
13 tried to preserve and build on the same level and the same
14 quality of service that exists today in all natures of
15 transmission service. And I think we are very interested,
16 and I will be certainly in the further proceedings that we
17 set up here as to how rights and customers' current
18 provisions are converted over into the new world.

19 I think that certainly argues for perhaps a
20 regional approach that may look different with each RT
21 finally as it comes in the door. This does not change
22 policy on imbedded cost recovery. We continue to make sure
23 that cost shifting is minimized, as this Commission has done
24 long before I got here.

25 During transitions it is important to make sure

1 that people kind of keep where they are, and that we start
2 to build on it. That may take more time, but I think it
3 allows people to buy in sooner and deeper.

4 Markets should always be voluntary, which means
5 that nothing in our rule should discourage people from
6 engaging in long-term contracts with suppliers of their
7 choice that allows them to lock in supplies and hedge risk
8 in advance.

9 In fact, this rule encourages that. We do not
10 address some important issues like generation adequacy and
11 market power in this document.

12 My problem with ICAP, for example, is that it,
13 unlike LMP, does not seem to rise to the top. As an
14 unarguable alternative, that is the best one out there. So
15 I have an open mind on that.

16 Certainly in ERCOT we did not adopt an ICAP or
17 anything like it. I am not convinced we got it wrong, but I
18 am also open to thinking that perhaps it may have been just
19 a one-time event, that there was that much overbuild down
20 there and sufficient competition to allow those wholesale
21 prices to be the lowest in the country.

22 During the process since October we heard a lot.
23 We talked a lot, and we listened a lot. This table here
24 became more like a psychotherapy couch than it did for any
25 conduct of public business, and that is as it should be.

1 People should feel comfortable laying out their thoughts and
2 angst here before us to work with so we can pull together
3 some solutions that work for everybody.

4 I do think that many of the people that came here
5 were heard and listened to, and we look forward to a process
6 that continues to build on that in the coming weeks.

7 Simplicity to the customer. Again, it is all
8 about the customer. What we are about here is to reduce
9 transaction costs and make it easy to make sure that the
10 benefits of a national power market accrue to the
11 individuals that take power from the Nation's load-serving
12 entities.

13 I want to emphasize that, although the market
14 design here has required some of the best staff, and some of
15 the smartest people in the industry to implement it, it can
16 and must be simple to the customer.

17 Yes, lots of technology and software is required
18 to make this work, but the customer needs to know that it
19 works simply. That will be my goal as we go through the
20 further implementation of this process.

21 I do not think customers should need to watch
22 real-time price signals if they have no interest in doing
23 so. Customers should be able to buy simple transmission
24 service in a transparent market and be able to trust that it
25 will work according to their needs.

1 Small customers with existing contracts do not
2 need to hire sophisticated middlemen to manage their
3 operations. They should be able to receive the same service
4 that they had before.

5 Customers, as I mentioned before, can self-supply
6 energy and lock in prices under the long-term as they want
7 to, but if their schedule is out of balance, I do not think
8 they should have to pay penalties because the SMD offers
9 them an open competitive market for imbalanced energy to be
10 procured.

11 If transactions were curtailed on no notice with
12 no recourse, as they are today under transmission loading
13 release, those days should be over. I want them to be.

14 Experience has shown that TLRs do not happen in
15 places where independent operators administer rules that
16 look like these that we have here. If customers choose to
17 purchase renewable energy, they can do so without having to
18 pay imbalance penalties as well.

19 If they want to buy power from an efficient new
20 clean power plant instead of an older one, then those older
21 plants might just get shut down because they do not match.
22 That is competition. That is the way it should be. Choice
23 is what we are all about.

24 I want to thank the Staff for their hard work in
25 both public and private meetings in my office, in my

1 colleagues' offices, in the pre-agenda room downstairs. I
2 know it has been a lot of work of drafting and meeting and
3 negotiating and researching overtime and weekends, and I
4 thank you for it. And I thank you in advance for more to
5 come.

6 It was hard work, and is hard work to bring
7 parties together and keep them in the corral. But what we
8 are doing here is we are effecting changes to make the
9 Nation's markets work for the customer. That is in the best
10 tradition of what we do around here.

11 Ten years ago we wrote the third book of the gas
12 trilogy and I am glad we are embarking, I guess, with the
13 outline here of the third book of the power trilogy.

14 So thank you all. I look forward to getting the
15 paper out and letting people digest it and getting to work
16 on the details.

17 COMMISSIONER BREATHITT: Thank you, Pat. And to
18 the team that was listed on one of the slides, and to my
19 colleagues for everybody's hard work.

20 I sort of view this as draft one, really, of the
21 rulemaking process. I view this discussion paper as one of
22 this Commission's initial steps in developing a second
23 generation OATT for electric utilities.

24 A goal of the effort is, to the greatest extent
25 possible, to implement more uniform transmission energy

1 markets and ancillary services, while not hindering
2 innovation.

3 The revised market rules will also establish
4 common principles for market monitoring and mitigation.
5 These market design changes are intended to address seams'
6 issues that result from the diverse market rules that we
7 presently have across the country.

8 A Standardized Market Design should act to allow
9 inter-regional transactions to occur more easily. The paper
10 also aims to improve reliability through better grid
11 operations. That is always a good thing.

12 In addition, the paper encourages the development
13 of more market hubs, which should provide greater congestion
14 pricing transparency. More transparency allows the
15 Commission to better monitor market activities. And the
16 transitional approach that Alice talked about, presented in
17 the paper, recognizes that because of the extensive nature
18 of the proposed changes it is going to take some time to
19 implement these new transmission tariffs and market designs.

20 Specifically, the paper recommends a phased
21 approach to the implementation. We envision first requiring
22 transmission providers to file proposals to offer physical
23 trading hubs, as well as updating the tariff to reflect
24 policies that have been made in the six years since the
25 issuance of 888.

1 Let me ask Staff. Will these trading hubs that
2 will be implemented in the first phase primarily be in areas
3 of the country where there are not organized ISOs or RTOs?

4 MS. FERNANDEZ: Yes.

5 COMMISSIONER BREATHITT: That is what I thought.
6 But I wanted to get that clarified.

7 The other market design changes are going to come
8 later. They allow for a transition period to full
9 implementation.

10 The discussion paper contains some principles
11 that I believe are noteworthy. Pat talked about quite a few
12 of them.

13 First, customers under existing contracts
14 continue to receive the same level and quality of service
15 under a Standard Market Design. As we heard during our
16 conferences on SMD, this is an area of great concern across
17 the country and is an essential aspect of the proposal for
18 me.

19 A second key principle is that demand resources
20 and intermittent supply resources such as hydro and
21 renewables should be able to participate fully in energy
22 ancillary services and capacity markets.

23 Finally, the paper recognizes the need to permit
24 regional differences and market innovation. With these
25 principles, I am comfortable lending my support to the

1 document.

2 That being said, I am not convinced that you can
3 take Locational Marginal Pricing, or the LMP model, and make
4 it work on day one in all markets across the country.

5 There are regional differences such as the
6 presence of hydro resources, and people argue that that is
7 not really valid for not being able to implement that. But
8 nevertheless, there are others who do believe that that is a
9 valid practical reason for not being able to implement that
10 on day one.

11 So the paper provides for some flexibility in
12 implementation. The concerns expressed by transmission-
13 dependent utilities in the public power sector will continue
14 to be important to me as this develops.

15 I am also fully aware that there are market
16 participants in various regions of the country who may not
17 embrace certain features of this document. Consequently, I
18 believe it is important to note that we are still in the
19 early stages of this rulemaking process.

20 This is a new method for developing a rulemaking
21 for me. I wish to state that I am keeping an open mind
22 until we issue our final rule. I have always relied on the
23 comment period to better inform me.

24 Nevertheless, the weeks of public discourse that
25 we have had have brought all of us along quite a bit. And

1 there is a lot to like here.

2 The process, though, will continue to allow for a
3 great deal of public participation by state commissions and
4 all others as we move from this initial paper to the actual
5 Notice of Proposed Rulemaking to the Final Rule.

6 With that, I will end. Again, I would like to
7 thank everybody for all the hard work that has happened thus
8 far.

9 COMMISSIONER BROWNELL: I am going to be quick,
10 because I think my colleagues have summarized the value of
11 this paper.

12 I commend staff not only for being here 24 hours
13 a day for the last several weeks, including last night as we
14 were making changes, but I think you have taken what we
15 heard from a very diverse range of market participants,
16 often with competing interests, and I think you have
17 accommodated those in many different ways, regional
18 differences being one of them.

19 You have clearly thought about the co-ops and the
20 TBUs and have been able to incorporate I think some very
21 specific comments that they made.

22 And as we move forward, I think that is something
23 that we all ought to keep in mind; that what we are doing is
24 dealing with issues on a basis of what people need to
25 succeed in the market with the outcome being a better market

1 for all consumers.

2 So that while there are things in here that I am
3 sure that people may not appreciate, they have to make the
4 cut about what it is they need as opposed to what it is they
5 want. And I would hope that that kind of underlying thought
6 process will guide us as we seek more public comment and
7 flesh out the details.

8 I think we have already seen in visits to our
9 office some innovative approaches for example to dealing
10 with LMP where there are fairly significant regional
11 differences because of the size of the different systems
12 that need to be accommodated.

13 So I think you have been able to hit those
14 consensus points very clearly, and give people now an
15 opportunity to be as innovative as they have been in kind of
16 not moving forward for 10 these many years.

17 I am heartened by all of our commitment to
18 keeping the focus, which is the consumer. It is the end-use
19 consumer, and it is the economic development of this
20 country. I think one of the things this also does is create
21 the investment environment in which we can see capital
22 flowing not only to enhancing our transmission grid, which
23 on its best days is now I think viewed as fragile, but all
24 of the other new opportunities that will come our way in
25 terms of technologies.

1 I am particularly pleased, obviously, to see
2 demand-side and intermittent resources get recognized as an
3 important and integral part of the market. Because if there
4 was consensus on anything during RTO season, there was
5 consensus on route.

6 The challenge of course will be working with our
7 state colleagues to make sure that we are making this part
8 of the market design, and that the implementation details,
9 many of which will be left to them, will work. And we can
10 work together in doing that.

11 I am enormously impressed by the intellectual
12 talent in this building, and your ability to take a huge
13 amount of information and present it in a way I think that
14 is cogent, is focused, and certainly addresses a wide
15 variety of needs.

16 So, thanks.

17 COMMISSIONER MASSEY: Those who have been
18 following this market design debate at this agency for the
19 past few months will not, I don't believe, find any big
20 surprises in this document.

21 I think the agency has telegraphed in one or more
22 ways, particularly with the staff working paper that was
23 issued, when was that, a couple of months ago?

24 MS. FERNANDEZ: December.

25 COMMISSIONER MASSEY: In December, what was a

1 briefer document than this. But that telegraphed at least
2 what the staff's recommendations would be about the
3 direction in which the Commission should move. The staff's
4 recommendation at that time was we ought to be moving, as we
5 get closer and closer to real-time, toward a bid-based
6 security constrained dispatch market that clears based on
7 locational marginal prices.

8 That is essentially what is outlined in this
9 paper. That is a concept that is easy to state in one
10 sentence, but getting all the details right and making sure
11 that all the pieces fit together is very complicated because
12 we are not just talking about generation markets; we are
13 talking about transmission markets as well.

14 I don't think that there are any big surprises in
15 this document, any unusual terms that those of you who have
16 been following this debate will see. My own perspective on
17 this is that we have had several years now of experience
18 with some good market designs, and we now know what does not
19 work well.

20 We know that market design is very important.
21 All think a few years ago we weren't quite so convinced.
22 But we are now. We now realize that letting many flowers
23 bloom in market design can cause great difficulty, lots of
24 price volatility, and can decrease the sense of confidence
25 in the market.

1 A poorly designed market is in fact worse than no
2 market at all, in my judgment. So we know it works now. We
3 know that as the market gets closer and closer to real-time,
4 a market that is based on the concept of bid-based security
5 constrained dispatch with locational marginal pricing works
6 very well.

7 We have had experience with that. There seems to
8 be a rough consensus on the concepts in this paper among, I
9 would say, the great majority of the scores of witnesses
10 that we have heard from over the past few months, and I
11 would like to commend Chairman Wood for the exhaustive
12 outreach that the agency has done over the past few months
13 to try to come to grips with these complicated questions.

14 Virtually anyone who had an opinion to express on
15 market design we have heard from. And it is my view that a
16 generator, say anywhere in the Eastern Connection for
17 example, should be able to trade anywhere in the
18 interconnection and know that the rules will be the same, or
19 roughly the same.

20 The generator may contract forward for all or
21 part of its capacity, may bid in the day-ahead market, may
22 bid to sell ancillary services, may bid energy in the real-
23 time markets, and it is essentially his choice.

24 We also want a market design that facilitates to
25 the maximum extent possible the participation of demand

1 resources and demand bidders.

2 One of the fundamental principles of this market
3 design is that demand resources can participate equally in
4 this market. We value them. The demand side is literally
5 half of the market, and I believe we have done virtually
6 everything we can to ensure that this market design is very
7 friendly to the demand side of the market, participating
8 very fully.

9 This is very complicated stuff, and I do want to
10 commend our staff for the hard work on this effort and the
11 effort is not over. We have taken strong steps in the right
12 direction, but there is still a lot of work to be done.
13 This is a working paper that says to the world: This is the
14 direction this agency is headed.

15 So we do not want there to be any surprises here.
16 We want you to continue to comment about the aspects of this
17 that you like and the aspects that you do not like.
18 Primarily I want comment about whether this works, whether
19 all the pieces that we outline in this working paper
20 actually fit together with a cohesive market design, and
21 that is the aspect of this that I desire comment on.

22 I think the entire agency is pulling with a
23 strong oar here to get this done and get it done by the end
24 of this year. I respect all the staff's hard work on this
25 very important effort, and this document has my full

1 support.

2 CHAIRMAN WOOD: So our thought then is to finish
3 up the edits from this morning, and work back through
4 tomorrow and have it released by the end of the week.
5 Anybody could respond online, as Bill did, or in any regard
6 by two weeks from today so that we have got the feedback
7 from parties about this as we start to plunge into
8 converting this to detailed tariff language.

9 Does that sound good to you?

10 COMMISSIONER BREATHITT: Qualification. Two
11 weeks from today, or two weeks from the day it issues?

12 CHAIRMAN WOOD: The 27th. I'm open, either way.
13 If they need to, I think if we have got them by Wednesday
14 the 27th, I think we will be engaged in a dialogue
15 throughout the construction period. So the 27th is not a
16 one-and-final date, but I think if we encouraged people to
17 respond to the broad principles by then, then we could do
18 one last check before we dive in the pool and start drafting
19 the tariff language.

20 Does that sound doable? Okay, let's get it out.
21 Again, thank you all very much.

22 SECRETARY SALAS: The second item for discussion
23 this morning is G-1, El Paso Natural Gas Company, with a
24 presentation by Robert Petrocelli, Elizabeth Zerby, Ingrid
25 Olson, Andrew Lyle, Ellen Shaw, and John Carlson.

1 MS. OLSON: Good morning, Mr. Chairman and
2 Commissioners. Bob Petrocelli, Elizabeth Zerby and I are
3 the three staff members presenting the proposal for capacity
4 allocation on the El Paso Natural Gas System.

5 For the past several months, the staff has been
6 analyzing the issue on four separate systems, all of which
7 relate to the capacity allocation on El Paso. El Paso
8 filed, at the Commission's direction, a proposal addressing
9 the system-wide capacity allocation issue in its Order No.
10 637 Compliance Proceeding.

11 In addition, several customer groups filed
12 complaints against El Paso, a group of El Paso's California
13 customers with a set contract demand, and we will refer to
14 the contract demand as CD, alleged that capacity allocation
15 on El Paso was unjust and unreasonable because they are
16 subject to frequent pro rata cuts and do not receive the
17 firm service that they are paying for.

18 A group of El Paso's East-of-California Full
19 Requirements' customers--and we refer to 'full requirements'
20 as FR--allege that El Paso has failed to maintain sufficient
21 facilities to meet its Firm Service obligations.

22 Each of these proceedings raises the question of
23 whether Full Requirements Contracts on El Paso have become
24 unjust and unreasonable.

25 Staff held two technical conferences and received

1 comments and counterproposals by shippers, as well as
2 responses to data requests filed by El Paso. The last set
3 of comments was filed on December 15th, 2001.

4 The current allocation methodology on El Paso was
5 developed as part of a ten-year settlement executed in 1996
6 when there was excess capacity on the system.

7 Since 1996, growth and demand has caused
8 significant allocation problems, and staff believes that any
9 solution must restore reliability to Firm Service.

10 Staff has concluded that in the unique
11 circumstances on El Paso, Commission action under Section 5
12 of the Natural Gas Act to allocate capacity is in the public
13 interest because the current methodology is no longer just
14 and reasonable.

15 Elizabeth Zerby will now provide you with some
16 background on the causes of the capacity allocation problems
17 on El Paso. Bob Petrocelli will then discuss some of the
18 staff's recommendations for resolving these issues.

19 MS. ZERBY: Good morning, Commissioners.

20 The El Paso System consists of two main East-West
21 lines that stretch from Texas to California.

22 (Slide.)

23 The system transports gas from three supply
24 basins: San Juan, Anadarko, and Permian, shown as green
25 ovals on the map. El Paso serves three classes of

1 customers: FT-2 shippers are all Full Requirements'
2 customers who pay a volumetric rate.

3 FT-1 Full Requirements' shippers pay a fixed
4 annual charge agreed to in the 1996 settlement, and a
5 commodity charge based on what they transport.

6 They pay the same annual charge regardless of how
7 much their load has grown since the settlement. The final
8 and largest class of customers is the FT-1 CD shippers.
9 They pay a two-part rate.

10 The squares on the map show the major delivery
11 points.

12 (Slide.)

13 The FR shippers shown in blue are based
14 primarily in Arizona and New Mexico. All the CD shippers
15 primarily ship gas to markets in California showing rent.
16 Most shippers have system-wide flexible receipt point
17 rights as opposed to specific rights at individual receipt
18 points.

19 This has provided shippers with flexibility to
20 ship supplies among the three basins and take advantage of
21 changing markets and supplies.

22 System-wide flexibility worked to the benefit of
23 shippers when El Paso had a substantial amount of
24 unsubscribed capacity in the mid-1990s. Now, however, the
25 system is fully utilized and that flexibility has caused

1 ongoing problems.

2 When nominations at a receipt point or pool
3 exceed the capacity, El Paso's tariff provides that the
4 shippers' nominations will be cut pro rata. For the past
5 two years, those pro rata cuts have become routine.

6 Shippers no longer can be certain whether their
7 nominations will flow. In late 2000 in the Amoco-Burlington
8 Complaint case, the Commission found that this uncertainty
9 created an unjust and unreasonable situation with regard to
10 delivery on El Paso's system and ordered a one-time
11 allocation of capacity on delivery points.

12 The Commission further directed El Paso to file a
13 proposal to allocate capacity at its receipt points, which
14 is the subject of this proceeding. So what happened on El
15 Paso's system to create these operational problems?

16 (Slide.)

17 This graph shows the changes in Contract demand
18 and Full Requirements demand since the settlement. Capacity
19 reserved and paid for by contract demand or CD contracts are
20 shown in blue. FR demand is shown in red. The hashed
21 portion of the 1995 bar shows that a sizeable portion of the
22 CD load was unsubscribed. This was the result of several CD
23 contracts that were turned back.

24 At that time, the parties reached a settlement to
25 help El Paso get through the period of substantial excess

1 capacity. In return for sharing the cost of the
2 unsubscribed capacity, the parties agreed, among other
3 things, to freeze system rates for ten years.

4 The FR shippers negotiated annual payments that
5 correspond to building determinant levels shown in red in
6 the 1995 bar. At the time, the settlement was a reasonable
7 solution to the problems facing the El Paso System.

8 It appears that the parties did not envision the
9 dramatic changes that would occur before the end of the ten
10 year settlement.

11 By 2001, that unsubscribed capacity had been
12 resold. In addition, FR demand had likewise grown
13 substantially since 1995. The 2001 red block shows the
14 noncoincidental peak, or NCP, demand which is the aggregate
15 peak demands of El Paso's FR shippers.

16 By 2001, peak demand for FR shippers had almost
17 doubled in March, partly by growth in the Southwest. The
18 2002 bar represents the projected NCP for El Paso's FR
19 shippers, and shows that FR demand is projected to increase
20 further this year.

21 The graph also shows that the relationship
22 between demand growth and capacity of the El Paso System,
23 the growth in FR load combined with full utilization
24 of the CD load, has created capacity constraints on the
25 system.

1 On those days when the combined demand exceeds
2 capacity, firm shippers' nominations are cut pro rata. CD
3 shippers are therefore paying demand charges for firm
4 service, yet they are unable to receive. Because the
5 rates are frozen, El Paso has no high natural
6 incentive to construct new capacity to serve existing
7 customers.

8 Without a change, the FR load will continue to
9 strain the system and further erode firm CD service.

10 (Slide.)

11 MR. PETROCELLI: Good morning, Commissioners.
12 That provides you with a brief sketch of the problems on El
13 Paso's System today where Firm Service is no longer reliable
14 and is certainly uncertain.

15 The question before the Commission is: Should
16 the Commission use its excise authority under Section 5 of
17 the Natural Gas Act to convert the FR service customers to a
18 CD type service?

19 The staff recommends that the Commission convert
20 these customers from FR service to CD service, while
21 maintaining the existing rate structure from the 1996
22 settlement and maintaining rate schedule FT-2 service, which
23 is a small customer for requirements' service for
24 municipalities and small cities with an overall cap on the
25 rate schedule.

1 We believe that there are many benefits to such
2 recommendations, including bringing back certainty to the
3 shippers on El Paso, providing needed incentive to expand
4 infrastructure, the elimination of unspecified rights which
5 degrade firm service, and this recommendation should
6 enhance the relationship between rates paid and services
7 rendered.

8 We believe that our recommendations balance the
9 interests of all the parties on the system and will restore
10 firm service on El Paso.

11 Having decided to convert the service from Full
12 Requirements to CD, the question before the Commission is:
13 What is the best methodology to assign capacity rights to
14 the new CD customers?

15 Over the past several months, we have received
16 much input from all of the parties and examined many
17 options. The four major options are presented for you today
18 on this slide.

19 They include the use of the Settlement Billing
20 Determinants from 1996.

21 (Slide.)

22 The use of the System Peak commonly referred to
23 as Coincidental Peak, CP.

24 The use of each individual customer's own peak,
25 or commonly referred to as Non-Coincidental Peak.

1 Or, some combination of the above.

2 The staff recommends that the Commission use the
3 greater of the December 12th, 2001, system peak CP, or the
4 higher of the customer's billing determinant from the 1996
5 settlement.

6 (Slide.)

7 The basis for our recommendation is we believe
8 that using the December 12th, 2001, system peak, you
9 actually frame pictures of customers current usage patterns
10 so that people get to use what they have been using most
11 recently.

12 However, we mitigate that with the higher of the
13 customer's billing determinants so that no customer will
14 receive a capacity allocation of less than what they are
15 paying for.

16 We believe that our recommendation will maintain
17 the CD service at its current contract levels. There will
18 be no necessary reduction to current CD shippers as a result
19 of these recommendations.

20 We believe that that is because it will match the
21 demand with the system capacity. Our recommendations will
22 place all customers on an equal footing and send the proper
23 price signals for expansion so that any shipper who desires
24 added capacity will be able to purchase that capacity
25 through capacity release from El Paso or another

1 pipeline whose incentive to expand in the region now
2 exists.

3 We believe that the options selected present
4 certainty and is fair to all shippers.

5 Once the Commission has converted FR service to a
6 CD service, many issues are resolved. However, steps
7 remain. One of those steps is assigning specific rights
8 within the basins.

9 Staff believes that the Commission must approve a
10 policy that requires specific receipt rights be assigned
11 within the basin.

12 We believe that this policy is consistent with
13 what the Commission approved in the Topock/Amoco complaint
14 case where it assigned specific rights at the delivery
15 points.

16 We believe that this recommendation will assign
17 certainty for all supply for all firm shippers.

18 (Slide.)

19 And it will eliminate daily pro-rata curtailments
20 in the basin. We also believe that this recommendation will
21 enhance the value of tradeability of capacity for its
22 customers into the future.

23 Of course when you talk about receipt rights on
24 El Paso, El Paso has what it calls pooling in the basins.

25 (Slide.)

1 A practice that has been in place since pre-Order
2 636 where they allow shippers to aggregate supplies behind
3 the basin points, and then move them to their transportation
4 points.

5 Currently El Paso utilizes six pools in its three
6 basins. El Paso, in order to help with the certainty on its
7 system, has now proposed expanding or actually now its
8 geographic pools to now 20.

9 (Slide.)

10 El Paso indicates that by narrowing its
11 geographic pools to 20 geographic pools it will be able to
12 provide customers with their supply choices without
13 complicated mathematical scheduling formulas that seem
14 to baffle everybody. And they propose not to have any
15 more curtailments due to compression or wellhead
16 constraints.

17 It is the staff's recommendation that you accept
18 El Paso's proposal and allow for the use of the 20 pools.
19 We believe it is a compromise between actual receipt point
20 rights and large geographic pools.

21 It will provide certainty to shippers and supply,
22 but at the same time it will still allow customers the
23 flexibility to aggregate supply behind their receipt-point
24 rights.

25 (Slide.)

1 In summary, we recommend that the Commission
2 convert FR service to a CD type service. We recommend that
3 the Commission allocate CD service based upon the higher of
4 their 1996 billing determinants or the coincidental peak of
5 December 12th, 2001.

6 and we recommend that the Commission assign
7 specific receipt rights to the 20 pools.

8 We believe these recommendations will aid
9 shippers by restoring firm service and equal access to
10 supplies for all shippers. We believe it will ensure the
11 relationship between rates paid and services rendered.

12 We further recommend that the Commission convene
13 a conference as a next step in order to receive comments on
14 the staff's recommendations so that every party should have
15 an opportunity to be heard.

16 Therefore, in summary we recommend the Commission
17 issue a notice establishing such a conference.

18 I thank you, and we are open to any questions you
19 might have.

20 CHAIRMAN WOOD: I want to thank you all for doing
21 that. I know this has been a long process. I guess if
22 there ever was a case for Section 5, this is it. And I
23 guess the corollary to that is: Don't ever put before me a
24 10-year settlement of anything to vote for. I will just
25 tell you right now, I can't do it. That is way too long in

1 a business that is transitioning as much as these energy
2 markets are.

3 But it is broke, and I guess the appropriate
4 question is, is this the best fix? I would invite parties
5 to come to the tech conference and show us, if you don't
6 like this, what would fix it better and maybe more
7 surgically than what is recommended here.

8 I am willing to let it go out and let's hear back
9 from parties what they really think, and then let's move
10 forward and resolve these cases before us as soon as we
11 can.

12 COMMISSIONER BROWNELL: I just have a couple of
13 questions. Can you quantify, or did any of the Interveners
14 quantify, the extent to which there have been interruptions
15 over nominations, all of the problems we are trying to fix
16 here?

17 MR. PETROCELLI: Yes, Commissioner. Of course
18 many customers submitted affidavits and comments regarding
19 the number of cuts. But it is important to understand,
20 first of all, that all shippers, including the FR shippers
21 in their complaint filed with the Commission, indicate that
22 firm service is no longer reliable. And all shippers,
23 including FR shippers, are receiving cuts at their delivery
24 points and not receiving service.

25 Conoco in its comments indicates that it has

1 received cuts to its transport of up 37 percent in some
2 months.

3 Burlington indicates that it has received cuts in
4 its Topock deliveries as much as 66 percent in some months.
5 Texaco indicates that several of its suppliers have backed
6 out of contracts because Texaco is no longer dependable as a
7 purchaser of gas in the basins because of cuts.

8 These affidavits and comments go unchallenged by
9 any party. El Paso's explanation in its CPUC vs. El Paso
10 complaint, is that the reason they could not deliver these
11 contracts is the growth of FR service.

12 COMMISSIONER BROWNELL: When I look at the
13 schedule I, I see a wide range of customers. Have you
14 considered making some distinguishing cut based on size?
15 I mean, there are some clearly big users of the system here.
16 There are some pretty small ones in the same range.

17 You are proposing to move them all. Have you
18 looked at any alternative to kind of look at who is really
19 using the system and who is not such a big user?

20 MR. PETROCELLI: Certainly I think it is
21 important to remember that El Paso has a rate schedule
22 called FT-2, which is a Full Requirements' Rate schedule on
23 a volumetric basis where you pay for what you take. That is
24 available.

25 I don't know the parameters of why a customer

1 would pick one versus the other. Some of the small
2 customers, for example the City of Largeville, look to be
3 small enough where it might want to fit in to the FT-2 rate
4 schedule.

5 There are, I am sure, individual incentives by the
6 customers to choose one of the other.

7 COMMISSIONER BROWNELL: So during the technical
8 conference you will consider rather than moving everyone on
9 schedule 1 to the CD, that we will have some kind of a
10 discussion about what their real needs are.

11 And if they fit into the T-2 schedule, you will
12 consider that?

13 MR. PETROCELLI: I think that would be a
14 certainty. I think that it is important to remember that
15 the 636(a) that indicated there should be a small customer
16 rate schedule of \$10,000 and o8nder. It seems to me that if
17 customers fit into that mold and want to move to FT-2, they
18 should be allowed to.

19 COMMISSIONER BROWNELL: Good. It looked in the
20 proposal as though that was not going to be out there. This
21 is a broader question.

22 I agree with Pat on ten-year settlements and the
23 inability to anticipate growth are not a very good idea. It
24 looked to me, when I saw some numbers, that even with this
25 we are good until about 2002-2003 in terms of maxing out on

1 capacity.

2 Are we looking at infrastructure? I think this
3 will give some economic incentives to build. I am just
4 concerned we will be back in a similar situation in terms of
5 the capacity in an area that has I think a number of new
6 generating plants planned or in the works.

7 Are you taking a look at that?

8 MR. PETROCELLI: I think it is important to
9 remember in the natural gas industry we have always used
10 economic incentives and markets as a basis for expansion of
11 infrastructure.

12 The problem with the ten-year settlement freezing
13 rates and giving El Paso no incentive to add capacity to
14 meet demand is the issue that has kind of raised these
15 problems.

16 I believe that once you have capped the service
17 and customers have to buy service either through capacity
18 release or through added infrastructure, the incentives will
19 be back in the marketplace where the marketplace itself will
20 decide whether new capacity is needed or not.

21 There are several proposals on the table to
22 expand into the Southwest region of the country. Open
23 seasons go by, and nobody nominates because they have free
24 capacity rights on El Paso now and you don't pay for
25 something you get for free.

1 Staff's recommendation should put an end to that
2 and develop a system where economic incentives are in place
3 to expand the needed infrastructure.

4 COMMISSIONER BROWNELL: It speaks to me of a
5 focus I think, Pat, that you have had which is we ought to
6 be looking out for the infrastructure not only the public
7 policies but those economic incentives.

8 It also says to me that the RTO planning process
9 really needs to be broad and inclusive. While we did not
10 deal with that extensively in our paper, I am hoping that
11 that will get fully fleshed out.

12 Tell me about the take-away capacity at Topock.
13 Remind me. Is that still going to be an issue? We can
14 solve all these problems but it gets to the border and it
15 can't get there.

16 MR. PETROCELLI: The current Topock situation is
17 still slightly constrained. I don't think it was a problem
18 as much this winter as the previous winter because demand
19 was reduced.

20 I don't know what proposals California has on the
21 table inside California to expand that, but I do hear
22 through the grapevine that there are proposals by SoCal to
23 aid capacity which would aid the take-away.

24 Also, El Paso has a proposal on the table that
25 would move gas from Kern River and Topock down to Southern

1 California into some of the expanding power plants in the
2 Southern California-Mexico border area.

3 So there are proposals on the table to alleviate
4 some of the take-away issues both outside of California and
5 inside of California.

6 COMMISSIONER BROWNELL: Thank you.

7 CHAIRMAN WOOD: Just to jump in, on your second
8 slide the capacity hash mark is flat. You indicated that
9 there was no economic incentive, and I think Nora's question
10 just brought out some of that.

11 I guess we have approved, at least since I have
12 been here, a number of additions to El Paso capacity. How
13 would that be reflected? Are they just so small you don't
14 see them on the line?

15 MR. PETROCELLI: El Paso recently purchased a
16 company called All American Oil Pipeline along the southern
17 line of El Paso's System.

18 They have put into place one of the segments of
19 that oil pipeline as a gas pipeline which brings 230 a day
20 to the market, and it is reflected in the hash mark. But it
21 is so small that it did not make a sizeable change in the
22 scale there.

23 That is the only major addition that El Paso has
24 done since I can't even remember. Maybe the Havasu cross-
25 over, but there is more capacity being added.

1 El Paso has proposed to add 320,000 decatherms a
2 day. It is what is called its power-up. It is going to add
3 compression on that All American line.

4 But currently it is unwilling to do that absent
5 an incremental rate. I think that is what it is looking for
6 is the proper incentive to add more capacity there.

7 CHAIRMAN WOOD: I guess in reforming the contract
8 I would just encourage parties, including El Paso, at the
9 technical conference to recognize that El Paso agreed to the
10 10-year deal, too.

11 But how is the economic incentive going to be
12 different as a result of converting everyone to CD? How is
13 that going to result in a better economic signal to get that
14 hash mark up above the peak-day demand?

15 MR. PETROCELLI: I think it is very important to
16 take note of the fact that there is really no bad actors
17 here. It is not like one party is wrong and one part is
18 right. The problem here is all parties are right, and all
19 parties are acting reasonably under the terms of the
20 Settlement.

21 It is that circumstances have changed. In 1995
22 there was turnback capacity, and El Paso was about half
23 full. Nobody envisioned this dramatic a swing in the short
24 period of time that it has taken place.

25 The economic incentive in 1995 was how do we keep

1 El Paso a viable pipeline and recover its costs? The
2 incentive now is we need more capacity.

3 So because times have changed, we need to change
4 the incentives in the Settlement. And this new
5 recommendation would require customers to actually
6 purchase. And our old unfreeze rate structure would stay
7 the same.

8 But what it would do is for any new needs the
9 customers would have to purchase.

10 COMMISSIONER MASSEY: As I recall, back in the
11 1995 time frame El Paso was, as you say, half full. And
12 they actually applied for stranded costs, as I recall.

13 MR. PETROCELLI: Yes. I think they had over \$250
14 million of stranded costs at the time.

15 COMMISSIONER MASSEY: My, how things have
16 changed. It used to be the conventional wisdom that
17 California was overpipied.

18 MR. PETROCELLI: As a note, that hash mark
19 capacity was selling for about 7 on the dollar about three
20 years ago. It has now all been resold at max rate.

21 COMMISSIONER MASSEY: If we do nothing, what we
22 can expect to happen over the next two or three years,
23 during the last four years of the Settlement?

24 MR. PETROCELLI: I think the slide the Chairman
25 just put up shows that the growth projected for 2002 will

1 exceed capacity substantially, and with the additions of the
2 generation plants some people's capacity needs will go up by
3 over 200 percent.

4 So you try to squeeze a size 15 foot into a size
5 10 shoe.

6 COMMISSIONER MASSEY: I am persuaded, at least at
7 this point, that you have got a reasonable plan. And you
8 propose to hold a technical conference on the full range of
9 issues that you have raised today.

10 It seems to me that the current situation
11 cannot--I mean it is intolerable, long term. I guess you
12 could say the parties have gotten at least six years of the
13 benefit of their bargain under the settlement.

14 Is that correct?

15 MR. PETROCELLI: Well, Commissioner, we would
16 propose that the Settlement remain in place in most aspects
17 because the Settlement envisions a mechanism called 'the
18 risk-sharing mechanism' that returns contributions that a
19 lot of these customers made to El Paso when they were
20 under-sold when they were making up that \$250 million
21 shortfall.

22 A lot of the capacity is sold at max rate. El
23 Paso is--it's not refunding, but the mechanism works, and
24 it is returning some of those contributions to those
25 shippers.

1 We would like to see the Settlement run its
2 course on some of those mechanisms so that all of the
3 shippers get the benefit of the bargain in that
4 respect.

5 And the other respect was there was a tradeoff of
6 a ten-year moratorium on rates, and that is why we have
7 recommended that the rate structure for capacity that is
8 being allocated today remain the same through the life of
9 the Settlement.

10 COMMISSIONER MASSEY: You have persuaded me based
11 upon the material that you provided me, and based upon what
12 I have heard so far, that bold Commission action is
13 necessary here.

14 So my own view is: Go forward. Get comments.
15 And come back to us.

16 Is that your plan?

17 MR. PETROCELLI: Yes, Commissioner.

18

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1 COMMISSIONER BREATHITT: I have one quick
2 question. Do you envision the technical conference to be
3 the customary technical conference where we're not present,
4 or are you inviting us to be present?

5 MR. LARCAMP: We're inviting you to be present.

6 COMMISSIONER BREATHITT: Okay. So it would be in
7 this room most likely?

8 MR. LARCAMP: Yes.

9 COMMISSIONER BREATHITT: Okay. Are there many
10 pipelines left that use full requirement service? The
11 answer is?

12 MR. PETROCELLI: No, not for large customers.
13 There are some municipals that are unlike an FT-2 rate
14 schedule volumetric that are full requirements and they just
15 pay for what they take, but not on the demand commodity rate
16 basis, no. No, ma'am.

17 COMMISSIONER BREATHITT: If you need an
18 affirmative signal by me, I think that this is a reasonable
19 approach to take, and I will participate.

20 CHAIRMAN WOOD: I would just observe had they
21 complied with 636, this probably would not be here today.
22 So that's maybe a very good lesson for us to learn on the
23 power side about carving out exceptions. Adios.

24 Since you've been chairman, you're now chairman.

25 (Laughter.)

1 COMMISSIONER BREATHITT: Bill, you got to be
2 chairman for a day. I think might get to be chairman for
3 ten minutes.

4 (Laughter.)

5 COMMISSIONER MASSEY: I was chairman for three of
6 the finest days in Commission history.

7 (Laughter.)

8 COMMISSIONER MASSEY: We didn't have to work, did
9 we?

10 COMMISSIONER BREATHITT: (Presiding) Can we get
11 into a little mischief, the three of us? We have two items
12 remaining.

13 SECRETARY SALAS: The next item for discussion
14 this morning is A-3, the California infrastructure update,
15 with a presentation by Dave Langenfelder, Brian Harrington
16 and Brian Craig.

17 MR. LANGENFELDER: Thank you and good morning.
18 I'm Dave Langenfelder accompanied by Brian Harrington and
19 Brian Craig. We're from the Division of Market Development
20 within the Office of Markets, Tariffs and Rates. We are
21 here today to provide you with an update of the California
22 markets. This will include a look at the natural gas supply
23 and demand, electric and natural gas supply and demand
24 projections for the next five years, the recent hydro
25 conditions in the Northwest and throughout California, and

1 recent transmission developments within California.

2 We will conclude the presentation by highlighting
3 market sensitivities that may impact the supply and demand
4 situation in California within the next three to five years.
5 Next slide, please.

6 (Slide.)

7 MR. LANGENFELDER: For background, we're going to
8 start out with looking at what happened to California in the
9 past five years. Basically consumption and economic growth
10 caused energy demand to outpace supply from 1995 through
11 2000. During this time, California electricity consumption
12 swelled it by 16 percent. In contrast, new generating
13 capacity grew at a mere 3 percent.

14 Prices for electricity and natural gas started to
15 take off in the summer of 2000, as we all know. In the
16 spring of 2001, California enacted several policies to
17 reduce energy demand and increase supply. Governor Davis
18 claimed at that time that generating capacity must be
19 increased by 20,000 megawatts over the next three to four
20 years to resolve California's energy crisis.

21 While these efforts were initially met with great
22 success, market conditions have changed. In the summer of
23 2001, FERC imposed wholesale price mitigation throughout the
24 entire Western System Coordinating Council, and later that
25 summer, California witnessed an extraordinary decline in

1 energy demand, and prices subsided.

2 From here, our presentation will focus on the
3 projected market conditions for California over the next
4 three to five years. While California's energy needs are
5 being met today, this could change for the worse under
6 certain market conditions. Brian will continue with looking
7 at the electric and supply demand situation in California.
8 Next slide, please.

9 (Slide.)

10 MR. HARRINGTON: Good morning, Commissioners.
11 This graph represents the California Energy Commission's
12 most likely projection for electric supply and demand
13 through 2004. The columns represent total supply for
14 California during summer peak. Blue equals existing in-
15 state demonstrated capacity. Pink, net imports. Black,
16 megawatts available through demand response programs. And
17 yellow, cumulative capacity additions.

18 The lines, on the other hand, represent summer
19 peak demand. The brown is the California ISO area only,
20 while the green is the entire state of California.

21 Looking at the California demand line only, the
22 green line, you can see that existing in-state capacity will
23 be insufficient for meeting California's peak demand this
24 summer and in subsequent summers. California will continue
25 to heavily rely upon imports and utilization of demand

1 response programs to meet peak demand until additional
2 capacity is brought on line. Next slide, please.

3 (Slide.)

4 MR. HARRINGTON: This graph shows the status of
5 projected generation in California from 2001 through 2006.
6 The yellow bars provide the best perspective of the new
7 capacity that is on line or will come on line by 2006. As
8 you can see, a total of 3,200 megawatts of new capacity came
9 on line during 2001, while an additional 6,500 megawatts is
10 under construction.

11 The red bars in the graph provide the megawatts
12 for projects that have been tabled and canceled. These
13 projects represent almost 15,000 megawatts, which is a 47
14 percent drop from the 32,000 megawatts that were projected
15 to come on line over the next five years.

16 This graph also shows projects that are at
17 various stages of development. While it is probable that
18 projects in the advance development stage will transition to
19 construction, it is very possible that projects in the early
20 development phase may not materialize. Next slide, please.

21 (Slide.)

22 MR. HARRINGTON: This map provides the location
23 of projects that are under development, construction and
24 that have been canceled or tabled in California. The
25 project names you see written on the map represent tabled

1 and canceled projects only, most of which are concentrated
2 around San Francisco and Los Angeles. Although this map may
3 appear busy, we wanted to highlight the significance of
4 megawatts that will not be available to California in the
5 future. Next slide, please.

6 (Slide.)

7 MR. HARRINGTON: For any given year,
8 hydroelectric generation accounts for approximately 20 to 40
9 percent of the total generation in California and represents
10 the majority of imports that come from the Northwest into
11 Northern California. For the next several years, hydro will
12 play a major supply role for California. They will continue
13 to be heavily dependent upon hydro generation until
14 substantial investment is made in new generation, and
15 reserve margins will continue to fluctuate as hydro
16 conditions change.

17 As you will see in the next slide, hydro supplies
18 are dependent upon yearly snowpack conditions. Next slide.

19 (Slide.)

20 MR. HARRINGTON: The maps presented here show
21 snowpack conditions in the West. The graph on the left
22 shows the average snowpack conditions in the spring of last
23 year, while the graph on the right shows the current
24 snowpack conditions. Red highlights indicate less than
25 average snowpack, which you see a lot on the left side

1 graph, while the green and blue indicate greater than
2 average snowpack, which you see in the current graph to the
3 right.

4 Currently, snowpack in the Northwest exceeds the
5 30-year average, with snowpacks throughout Oregon, Nevada
6 and California greater than 130 percent of the historical
7 average. This compares favorably to snowpack conditions
8 last year, which were at 64 percent of the historical
9 average. Next slide.

10 (Slide.)

11 MR. HARRINGTON: This graph illustrates how gas
12 fired generation reacts to hydro conditions. From 2000
13 through early 2001, the Northwest experienced drier than
14 normal years, which resulted in low supplies of hydro. This
15 in turn led to higher demand for gas fired generation and
16 the urgency to build more of it. It also contributed to a
17 20 percent decline in hydro generation and a 25 percent rise
18 in gas fired generation.

19 As the graph shows, when there's more dependence
20 on hydro, you put more pressure on other resources, in
21 particular in California, natural gas fired generation.
22 Next slide.

23 (Slide.)

24 MR. HARRINGTON: Path 15, a transmission
25 chokepoint in the central part of California, has surplus

1 electricity available to it in the southern part of the
2 state, but not enough line capacity to move power up north
3 during peak times. In the past 11 months, significant
4 milestones have been achieved to resolve this problem. In
5 May of 2001, President Bush's national energy plan
6 recommended that DOE take action to relieve these
7 constraints on Path 15.

8 In October of the same year, PG&E, the Western
9 Area Power Administration and six other parties signed a
10 memorandum of understanding to build a third transmission
11 line and upgrade the existing transmission lines and
12 substations for Path 15. Just last month the U.S.
13 Bankruptcy Court gave PG&E the go ahead to begin
14 construction on Path 15.

15 Currently, the Commission Staff is working with
16 parties and DOE to facilitate the completion of the project
17 as it relates to matters within the Commission's
18 jurisdiction. Today Path 15 has the ability to transmit
19 3,000 megawatts and provide power to 3.9 million households.
20 When finished, Path 15 will be able to carry 5,400 megawatts
21 and serve 5.4 million households. Path 15 construction and
22 upgrades are anticipated to be done in the summer of 2004.

23 David Langenfelder will now continue with natural
24 gas.

25 MR. LANGENFELDER: Thank you, Brian. Next slide,

1 please.

2 (Slide.)

3 MR. LANGENFELDER: This map highlights the
4 sources of California's natural gas supply along with
5 natural gas transmission pipelines throughout the West. The
6 shaded ovals represent gas supply basins, and the colored
7 lines indicate interstate pipelines used to deliver gas to
8 California markets.

9 California produces 15 percent of the natural gas
10 required to meet the state's needs. The remaining 85
11 percent is imported. Of this gas, 47 percent comes from the
12 Southwest, 28 percent from Canada, and 10 percent from the
13 Rocky Mountains. Currently, California's concern that as
14 its growth in upstream demand from California increases such
15 as in Arizona, Nevada and Oregon, that the flow of available
16 gas to California may decline. That is, upstream users may
17 displace and bid away capacity for California. We've heard
18 some of that in the prior presentation.

19 Next slide, please.

20 (Slide.)

21 MR. LANGENFELDER: This slide lists the
22 interstate pipelines that serve California markets.
23 Interstate pipelines are pipelines outside of California and
24 supply natural gas to the border of California. From the
25 border, PG&E and SoCal Gas, the intrastate pipelines within

1 California, take receipt of the gas.

2 The first column of numbers show the existing
3 interstate transmission capacity as of 2001. The second
4 column of numbers show projected capacity additions. These
5 are projects that have met all requisite regulatory
6 approvals and should be fully operational by the end of this
7 year.

8 As you can see, total delivery capacity into
9 California, including projected additions, is approximately
10 7,666 Mm cfd. California's current take-away capacity is
11 shown on the next line down, is projected to be 7,415 Mm
12 cfd. This includes capacity additions as well.

13 Currently industrial customers and electric
14 generators and other noncore customers in California cannot
15 obtain firm capacity rights on SoCal Gas's backbone
16 transmission system. However, recently, the CPUC has
17 approved a settlement allowing these customers access to
18 firm capacity rights effective in July of 2002. This ruling
19 will give in-state generators the needed tools to more
20 efficiently arrange for long-term gas supplies and create
21 valuable economic signals indicating where to build
22 additional transmission facilities. Next slide, please.

23 (Slide.)

24 MR. LANGENFELDER: This slide illustrates the
25 various scenarios that weather can have on gas demand and

1 supply and the resulting projected slack capacity through
2 2006 as projected by the California Public Utilities
3 Commission. The table shows that even under adverse
4 conditions, California should have adequate natural gas
5 transmission capacity to serve increased demand. Average
6 statewide slack capacity is projected to be 27 percent. And
7 this coincides with what the California Energy Commission is
8 predicting, a slack capacity of 23 percent for the next five
9 years.

10 The CPUC projects that demand from gas-fired
11 electric generation should decline in the next five years,
12 and this is due to several factors that they are factoring
13 into their assumptions. And that is that a substantial
14 number of new, efficient gas-fired generation plants will
15 come on line and displace older, inefficient plants, that
16 there will be a return to normal hydro conditions, and that
17 new power plants under construction in neighboring states
18 will sell power into California.

19 Due to the hydro sensitivities previously
20 discussed by Brian, maintaining slack capacity is important
21 for serving any increases in gas-fired generation in the
22 event that hydro conditions deteriorate.

23 Next slide, please.

24 (Slide.)

25 MR. LANGENFELDER: For the immediate outlook,

1 currently spot prices for natural gas and electricity
2 throughout the West and California are at five-year lows.
3 Spot prices for electricity throughout the West last week
4 strengthened a little bit over the past six months, trading
5 between \$30 and \$35 per megawatt hour. Natural gas was
6 trading in the \$2.30 to \$2.50 per Mm Btu range, and last
7 week in some areas hit \$3.00.

8 Demand for electricity and natural gas is down as
9 a result of the slowing economy, mild weather and
10 conservation holdover. Hydro conditions appear strong and
11 should lead to hopefully healthy production in 2002.
12 Natural gas prices are expected to remain soft this summer
13 as hydro levels in the Pacific Northwest return to normal
14 levels.

15 Next slide, please.

16 (Slide.)

17 MR. LANGENFELDER: In terms of energy
18 conservation, Californians consumed 8.9 percent less
19 electricity in 2001 versus 2000. With electricity and gas
20 prices at five-year lows, consumers may become less
21 interested in conserving energy, and this is something that
22 we have to bear in mind as we move forward.

23 Traditionally, the California ISO had
24 approximately 2,800 megawatts available in its interruptible
25 load program that it could count on. Participation in this

1 program recently has declined to 1,600 megawatts. And this
2 is due to the heavy utilization of the program during the
3 past two years. Many subscribers in the program have
4 canceled their participation in the program as a result of
5 it.

6 Also, California's recent budget cuts discontinue
7 significant portions of their energy conservation programs
8 and renewable programs. These cuts have led to
9 discontinuing programs such as the 20/20 program in
10 California, which was established to give consumers a 20
11 percent rebate on their utility bills for a 20 percent
12 reduction in demand. And also what's been eliminated is the
13 power plant construction bonus program.

14 Next slide, please.

15 (Slide.)

16 MR. LANGENFELDER: The capacity outlook
17 conditions for California has changed as well, as Brian had
18 mentioned earlier. In October of 2001, the California
19 Energy Commission was forecasting that 27,000 megawatts of
20 additional capacity would be on line in California.

21 Currently, lower demand and market prices have
22 many companies reevaluating the projects they had planned.
23 Merchant generating companies are shoring up their balance
24 sheets and cutting capital expenditures, some hastened by
25 the recent bond rating downgrades. This reduction in

1 capital expenditures is evidenced by the increase in
2 canceled and tabled projects as previously presented in the
3 generation status section.

4 And then recently, the California Energy
5 Commission reported that only 9,900 megawatts of additional
6 capacity would be on line in 2004.

7 Next slide, please.

8 (Slide.)

9 MR. LANGENFELDER: And towards the end here, what
10 does all this mean? fortunately, since many supplies in
11 California will be secured under long-term contracts,
12 exposure to short-term price volatility should be limited.
13 However, the supply and demand situation could change if a
14 number of factors come true. And those are if economic
15 growth outpaces current projections; if California
16 experiences another bad hydro year; plant cancellations
17 continue; energy conservation declines. If energy demand
18 throughout the rest of the region increases, this would
19 limit import availability to California, and if the planned
20 transmission expansions that we had discussed here this
21 afternoon are delayed.

22 In closing, I would like to stress that today
23 California is feeling some recessionary effects and that
24 short-term supply may be adequate even with the
25 cancellations of plants, lower demand may keep electricity

1 shortages at bay. However, we have to remain aware that
2 adequate resources must be in place if the supply and demand
3 situation in California changes in the long term.

4 This concludes our presentation, and I thank you
5 for your time.

6 COMMISSIONER BREATHITT: Thank you for that very
7 comprehensive report.

8 COMMISSIONER BROWNELL: I just have a couple of
9 questions. On the Path 15 project, I know you said that
10 we're working on whatever we need to do to get any approvals
11 done. Has the state completed their approval process?

12 MR. HARRINGTON: Currently I don't know the
13 answer for that. I can check into that for you.

14 COMMISSIONER BROWNELL: That would be terrific.
15 And do we have a breakout, a couple of breakouts, in terms
16 of the age of the fleet in California? There aren't any
17 assumptions here that say they'll all be able to sustain the
18 use that they've had, and I know that there's been some
19 concerns about that.

20 And the other thing that I'd love to see is a
21 breakout of the plants that are still planned in terms of
22 the type of plant, whether it's baseload or a peaker or
23 whatever.

24 The other question I have is I'm looking at the
25 CPUC estimates a decrease in gas demand from gas-fired

1 electric generators due to the substantial number of new
2 gas-fired power plants. And then we have the cancellations
3 that you've estimated in the changed report from CEC. Is
4 CPUC basing their estimates on the old projections or the
5 new projections?

6 MR. LANGENFELDER: We had spoken to somebody from
7 the CEC, and they said that the CPUC includes everything in
8 their forecast. So anything that has a slight chance of
9 getting in there, they've put it in there. Because we were
10 looking at their winter assessment, which was done in I
11 think October, and it showed about 37,000 megawatts in new
12 capacity which was much, much higher than the CEC.

13 COMMISSIONER BROWNELL: Thank you. California's
14 budget cuts, you mentioned a specific program, the power
15 plant construction bonus. Could you tell me what that was
16 and how much money that was putting into the construction
17 efforts?

18 MR. LANGENFELDER: That program was established
19 by the governor to get power plants on line by the end of
20 the summer of 2001. Around September of 2001, they extended
21 the program until November. In terms of how many plants
22 actually took advantage of the program, I'm not quite clear
23 on that. Does that answer your question?

24 COMMISSIONER BROWNELL: It does. Thank you very
25 much. So I guess what we take away from this is in fact

1 we're relying on two very unpredictable aspects of the
2 market, hydropower and cool weather. We're assuming the
3 recession in California lasts perhaps longer than is now
4 estimated by economic forecasters, and we're hoping that the
5 transmission project gets through expeditiously. Wow.

6 (Laughter.)

7 COMMISSIONER MASSEY: And our mitigation program
8 expires in September, as I recall. And I know your
9 presentation is on the infrastructure issues, but I think I
10 know the answer to this, but I wanted to ask any Staff that
11 can answer the question. What progress has California made
12 in reforming its market design? That's another key aspect
13 of having just and reasonable prices out there.

14 MR. LARCAMP: I think it's a bit subjective about
15 the progress they've made. I think it depends on the eye of
16 the beholder. I do know that they have asked as late I
17 believe as their comments on the audit report to basically
18 defer making major changes in market design pending
19 completion of the SMD process that the Commission is
20 undertaking.

21 And we have had requests within the last week
22 from the ISO staff to talk with staff about those issues.

23 COMMISSIONER MASSEY: So we do not have before us
24 a major revamping of the market rules for the California
25 ISO?

1 MR. CANNON: I know that they are considering a
2 revamping of those rules. I'm not sure whether they've
3 actually made a filing with us yet. But my understanding is
4 that a lot of what's under consideration at this point in
5 time comports pretty much with what the Staff paper that you
6 all discussed as E-1.

7 MR. BARDEE: Commissioner, I don't believe there
8 is a filing here on that yet. They have put on their Web
9 page a proposal and revised the proposal and that's out for
10 discussion among other parties. But I don't believe that's
11 been sent to us yet.

12 COMMISSIONER MASSEY: Yes. I had read about that
13 in the trade press. But we don't have it before us now.
14 Because when I look at the question of just and reasonable
15 prices in California, there's many aspects to it, but one is
16 the infrastructure question, and that's what you've reported
17 to us on, and Nora has I think succinctly summarized in a
18 sentence what we're facing here in terms of uncertainties.
19 And you provide a lot of good information that I found very
20 useful. Thank you very much.

21 So there's the infrastructure question. And as I
22 recall, California has an absolute import capability limit
23 for electricity. It's around 12,400 megawatts. Am I right
24 about that?

25 MR. LANGENFELDER: That sounds like a good

1 ballpark figure.

2 COMMISSIONER MASSEY: There aren't any proposals
3 within California to change that absolute limit, are there?
4 The Path 15 change doesn't deal with that question, does it?

5 MR. LANGENFELDER: No it doesn't.

6 COMMISSIONER MASSEY: It's how power is
7 distributed within the state, whether it's distributed
8 efficiently. That's a good project. It has my complete
9 support. But is there any work being done to increase the
10 import capability?

11 MR. LANGENFELDER: In our last presentation where
12 we did the Western market, we discussed some of the other
13 transmission upgrades that are going on throughout the West.
14 As far as we know, those projects are still online and
15 going. In terms of what's being done for import capability
16 into California, I'm not aware of that anything has changed
17 since then.

18 COMMISSIONER MASSEY: Okay. So there's the
19 infrastructure question, which looks iffy. There's the
20 market design, market rules, which we know because we said
21 in numerous orders that the California market design had to
22 be revamped in order to have just and reasonable prices long
23 term.

24 And so I would welcome a proposal from California
25 to move in the direction of our working paper that we are

1 responding to the fact when you were talking with
2 Commissioner Massey, I wanted to ask specifically, we had
3 asked that they -- well, every ISO needs to file to become
4 an RTO. And I just wanted to be clear that your reply to
5 Bill was that they had not made their filing to become an
6 RTO.

7 MR. BARDEE: No. What I was addressing was a
8 filing that they have been working on for some time, but I
9 don't know when they will make it, to redesign their market,
10 as opposed to a filing on their RTO status. I thought we
11 had such a filing and have not yet --

12 MS. MARLETTE: I think they made that filing last
13 summer.

14 MR. LARCAMP: Commissioner, I believe that the
15 Commission has directed them to make these filings and that
16 they're not yet at that deadline. It's fast approaching,
17 but they're not there yet. And the Commission has on
18 various aspects been encouraging those filings for several
19 years.

20 MR. CUPINA: Meanwhile, Commissioner, let me add
21 on the pipeline infrastructure, we have pending the major
22 Kearn River expansion that you issued the preliminary
23 determination on at the last meeting. And there's a smaller
24 PG&E expansion coming down from the north. So on those
25 projects, we're moving ahead. And their contracts and

1 preliminary agreements are still intact as far as their
2 customers.

3 COMMISSIONER BREATHITT: Anything else? Are
4 there any other items?

5 SECRETARY SALAS: One more, Commissioner. The
6 next item in your discussion agenda is A-4, Northeast RTO
7 Update, with a presentation by Steve Rogers from our Staff,
8 Richard Grossi, Chairman of the Board of Directors of the
9 New York ISO, Gordon van Welie, CEO of ISO New England,
10 William Museler, CEO of New York ISO, David Goulding, CEO of
11 the Ontario Independent Market Operator.

12 MR. GROSSI: Thank you. Good afternoon or good
13 morning. Still good morning. Chairman, Commissioners, my
14 name is Richard Grossi. I am chairman of the New York ISO.
15 Here with me today is Gordon van Welie, who is the CEO of
16 ISO New England, and to my right is Bill Museler, who is the
17 CEO of the New York ISO.

18 Also with us today is David Goulding, the CEO of
19 Ontario IMO. As you know, the ISO New England and the New
20 York have entered into an agreement. And the essence of the
21 agreement is to move ahead with studies and efforts to in
22 fact standardize our markets. That effort is underway, and
23 today you will hear from Dave Goulding, who will describe
24 the efforts in detail, and Bill Museler is here also to help
25 with that effort. I will sort of sit back and listen to

1 those presentations.

2 But in any case, I do want to indicate to this
3 Commission that both boards are very much committed to this
4 effort. And it's our expectation that we'll be in a
5 position to make a filing with this Commission by no later
6 than June 30th of this year. So that's our commitment to
7 this effort, and I fully expect that we'll be able to make
8 that.

9 I should also indicate that clearly in this
10 effort, we will be involving the Canadians so that we could
11 hopefully get an effort which will really make them part of
12 this process. So in essence, when you look at this, what
13 we're talking about is addressing what we refer to as the
14 MPCC area. And that we feel is a natural market that
15 exists, and it's a market that we should be addressing at
16 this point.

17 So with that, what I would like to do is ask
18 Gordon to take us through this presentation, go through some
19 of the details, and it won't be very long. And then
20 certainly we're all available for any questions that you may
21 have. So with that, Gordon?

22 MR. VAN WELIE: Thank you, Dick. Good morning.
23 Considerable progress has been made since we informed you of
24 our January 28th agreement, and what I'd like to do is
25 highlight and summarize some of that progress. There's a

1 presentation pack that you have, and you can follow along in
2 the presentation. There's a lot of supporting material in
3 the pack that we don't intend to go into in any detail but
4 obviously be happy to answer questions.

5 The first topic I'd like to address is the one
6 that Dick has already briefly addressed, which is the
7 boards. Let me just reemphasize that the boards of both
8 ISOs fully support this RTO effort. They formed a committee
9 called the Joint Oversight Committee as provided in the
10 January 28th agreement. This Committee consists of three
11 directors from each board, with the directors already having
12 been chosen by the respective boards. The Committee has
13 already met, and it will continue to supervise and drive the
14 process going forward.

15 The next thing I'd like to just summarize is the
16 stakeholder process, what we're doing in terms of making
17 sure that stakeholders have an opportunity to give input
18 into this process going forward. We recognize that the
19 success of our efforts depends in part on achieving a
20 reasonable degree of consensus amongst market participants
21 and regulators, and we've already begun that process.

22 The stakeholders of both New York and New
23 England, working together with ISOs, have developed an
24 initial protocol for providing input, and we are currently
25 operating under that protocol. What's happened is that the

1 stakeholders have agreed on seven working groups, which
2 include market design and system implementation, market
3 monitoring and mitigation, economic and reliability
4 evaluation and assessment of RTO size and scope, governance,
5 transmission planning, ITCs and tariffs, operations and
6 facilities, and transmission owner ISO issues.

7 These stakeholder working groups are meeting.
8 There have been several meetings actually just this week
9 already, and they will continue to do so over the next two
10 to three months. There's also the concept of a plenary
11 session where all the working groups report back to a joint
12 meeting of all the stakeholders. And so the plan here is
13 that several plenary sessions will be held going forward.
14 Representatives from both ISO boards will be attending those
15 plenary sessions.

16 We have set up a Web site, nerto.com, in order to
17 facilitate this collaborative effort. And what happens is
18 the ISO taskforces prepare straw proposals -- we're kind of
19 taking a leaf out of the mediation process last year -- for
20 discussion in the working groups. They're also then
21 published on this Web site. So everyone has equal access to
22 all the information.

23 Representatives of the relevant Canadian
24 provinces we invited to participate in the working groups,
25 and so far the IMO and Trans Energie have accepted. The ISO

1 staffs have met with transmission owners to discuss the
2 formation of ITCs and how they could fit into the RTO
3 structure, and we will continue to work with the TOs to
4 develop the ITC proposal.

5 As provided in the January 28th agreement, all
6 efforts will be made to accommodate the proposal once it is
7 developed.

8 What we'd like to do now is just highlight
9 developments in three substantive areas, firstly in the area
10 of the economic evaluation. In response to suggestions from
11 state regulators and many market participants, we are
12 undertaking an economic evaluation of the Northeast RTO
13 proposal. We have preliminarily identified basic
14 assumptions for the evaluation, and we are now reviewing
15 them with stakeholders and regulators. We expect that the
16 Commission's own evaluation will be helpful in this respect.

17 We would like to publish the first results of
18 that evaluation in early May and we'll release them as soon
19 as they are available. We believe that this evaluation will
20 enable all parties to assess the value of a Canadian-New
21 England-New York structure.

22 The second thing I'd like to just update you on
23 is market implementation. New York and New England spent a
24 lot of time in the latter half of last year working on a
25 market design for a Northeast RTO, which is based on the

1 standard market design. The ISOs plan to adopt a single
2 market design for the two areas which would become the
3 market design for the single Northeast RTO. We've already
4 completed a draft design which would be consistent with the
5 Commission's forthcoming standard market design. A summary
6 is contained in the package that we've left with you.

7 We expect to have all aspects of the market in
8 place consistent with the planning horizon discussion option
9 1-M during the mediation, which is roughly a three-year
10 timeframe. And meanwhile we continue to work together with
11 neighboring control areas, including PJM, to fix existing
12 seams.

13 The third area that I'd like to highlight is in
14 the area of transmission planning. Our efforts to develop a
15 unified transmission planning process appear very promising.
16 Our focus is on a process that clearly identifies grid
17 shortcomings and provides competitive opportunity for
18 generation demand side and transmission solutions to fix any
19 shortcomings which we identify.

20 On the international front, considerable trading
21 is already occurring in the New York, New England and
22 adjacent Canadian regions. We believe that the proposed RTO
23 will further enhance that trading, and we intend to focus
24 attention on the needs of the provinces. As I mentioned
25 early on, the IMO and Trans Energie have accepted our

1 invitation to participate in taskforce and working group
2 meetings.

3 New Brunswick has said it's interested in
4 participating at some level. I think they're still deciding
5 where they want to be with respect to markets. And they've
6 asked for information, and we are exploring with the IMO the
7 benefits of increased coordination and collaboration in the
8 areas of transmission planning, coordinated congestion
9 management across our borders, and identical standardized
10 market rules and products such as operating reserves.

11 Where is this all leading us? We are leading up
12 to a filing. The plan is for a filing by June 30th. In
13 June the ISOs intend to present the RTO plan reached through
14 this consensus-building process that I described to you
15 early on, to New York and New England regulators and
16 stakeholders, and the boards will meet mid-June, and then we
17 would file the plan by the end of June, assuming of course
18 that the economic evaluation doesn't dictate some other
19 course.

20 Every effort will be made to achieve as much of a
21 consensus as possible among state regulators and market
22 participants by that time. We are working with all of our
23 regions' transmission owners with the object that they will
24 join us in the filing.

25 The filing will also include a market

1 implementation plan. The filing will of course address the
2 functions and characteristics set forth in the Commission's
3 Order 2000 and will address shortcomings identified by the
4 Commission in the previous RTO applications of each ISO.

5 The handout includes further details, and we
6 appreciate the opportunity to report to you on this very
7 important matter to us both, and we stand ready to answer
8 your questions.

9 COMMISSIONER BREATHITT: Thank you very much. Do
10 you have any questions?

11 COMMISSIONER BROWNELL: You indicated in your
12 remarks that New York, New England and Canada create a
13 natural market or are a natural market. Could you explain a
14 little bit more what you mean by a natural market? And have
15 you submitted anything to us, or do you intend to submit
16 information to us and your stakeholders that would show some
17 of the trading patterns that would support that and also
18 other options that you might have considered in your early
19 discussions with PJM?

20 You've talked a lot about trading patterns when
21 you've talked about it to me, but I've never seen anything
22 submitted that would help me in that.

23 MR. GROSSI: Bill?

24 MR. MUSELER: Commissioner, at the request of
25 your staff, we did provide some megawatt flows for the past

1 two years between the NPCC region and MAC and also within
2 the NPCC region. So we did supply that information. It's
3 not an exhaustive analysis. We believe the data is
4 accurate. But shows the amount of commerce that we have
5 with PJM and the amount of commerce we have between Ontario,
6 Hydro Quebec, the Maritimes, New York and New England.

7 MR. LARCAMP: Commissioner, the information has
8 been provided informally to Staff. To my knowledge, it's
9 not been publicly filed so someone could comment on it.
10 Staff has asked ISO New England, New York ISO as well as PJM
11 to provide the interchange information to us for I think
12 it's the last three years, '99, 2000 and 2001.

13 COMMISSIONER BROWNELL: I think it would be
14 helpful perhaps if you continue to work with our staff to
15 make sure that information is accurate and complete. And I
16 think we need to find a way to make it public so that we can
17 have some discussion about what that looks like. It would
18 be helpful to me.

19 MR. GROSSI: We'll certainly follow up on that.
20 Thank you.

21 COMMISSIONER BROWNELL: I just have another
22 question in terms of your stakeholder involvement. We read
23 in the trade press, and I'm not sure that we ever got
24 anything officially, I can't remember, that some of your
25 stakeholders were not as positive as the boards are,

1 including, I'm not sure, but I think there were some state
2 commissioners who had some concerns as well. Don't know how
3 the Canadian regulators are feeling about this, but maybe
4 you could give us an update on where you are with those
5 discussions.

6 MR. VAN WELIE: Let me give you the New England
7 perspective. We've been spending a lot of time with NECPUC
8 keeping the staffers and the commissioners up to speed.
9 Obviously you have six states, and they're each going to
10 have their own different view. I would summarize the view
11 within NECPUC as cautious at this point.

12 MR. GROSSI: Dave?

13 MR. GOULDING: Regarding Ontario, and I'm always
14 -- experience has told me to be a little careful in making
15 commitments on behalf of the regulator, but I have met
16 absolutely no objections from participants at this point in
17 time, none from the government and none from the regulator.
18 And my strong belief in consistent rules across a wide
19 region in the marketplaces is well known, so I probably
20 wouldn't be sitting here today if there had been any
21 resistance.

22 MR. GROSSI: Let me just say that certainly there
23 are concerns. I think there should be concerns. This is
24 going to be a major, major step. I basically believe that
25 if you keep people informed, stay in touch with them, hear

1 what their concerns might be, I feel we can get through
2 that. So essentially from my point of view, I have
3 maintained an ongoing personal contact, for instance with
4 the New York Commission Chair, Maureen Halber, and I intend
5 to do that throughout this process.

6 So, yes, you're right. There are some concerns,
7 but I think under the circumstances, those concerns are
8 justified. But I do feel they can be addressed.

9 COMMISSIONER BROWNELL: Thank you.

10 COMMISSIONER MASSEY: From the Ontario
11 perspective, are you saying that there's a possibility that
12 you can actually be a part of a new RTO that is formed in
13 the Northeast and fold your operation into it? Or are you
14 simply talking about a common market design?

15 MR. GOULDING: Well, first of all, nothing is off
16 the table at this point in time. But at the very least,
17 what I'm talking about is a market design that is consistent
18 with most of the features being consistent and probably most
19 of the features being identical across the whole region. In
20 that context, I think there will always be a requirement for
21 some more local variations.

22 But just a point I should mention is that we're
23 in the final run up to actually opening our wholesale and
24 retail markets on the May the 1st of this year when, by the
25 way, we will have over 200 participants in the wholesale

1 markets and we already have close to a million customers
2 signed up for the retail market.

3 So we have a set of market rules in place. Those
4 market rules in many instances are pretty much identical to
5 the direction that New York and New England are heading in.
6 And I think my main objective at this point in time is to
7 keep looking out and skate to where the puck is going. And
8 in that context, for me it's consistent rules on a very
9 broad basis that I'm interested in, not just across the
10 Northeast by the way. We're also connected in through
11 Michigan, through Manitoba, through Minnesota to MISO. And
12 so as they get up and running, we'll be wanting to look at
13 that too.

14 COMMISSIONER MASSEY: So from your perspective,
15 the movement to a standard market design in the United
16 States sounds good?

17 MR. GOULDING: I strongly encourage it. We're
18 strong supporters. You'll see that in all of our filings or
19 our responses that we make to FERC initiatives, yes.

20 MR. MUSELER: Commission Massey, about a year and
21 a half ago, New England and New York and the IMO conducted a
22 joint study of the possibility of forming a single day ahead
23 market and that study we think demonstrated that such a
24 market is possible, even with a separate control area.
25 We're going to look at that as part of this effort we are

1 going forward to, with no preconceived decisions. But
2 that's the kind of thing that we think is on the table.

3 COMMISSIONER MASSEY: But New York and New
4 England are exploring an actual merger to create a single
5 organization with a single board of directors?

6 MR. GROSSI: That is correct.

7 COMMISSIONER MASSEY: And you're hoping to entice
8 the Canadians in as well? Is that right.

9 MR. GROSSI: Not as formally as the structure
10 that is contemplated for New England and New York. But,
11 clearly, yes, that is the intent.

12 COMMISSIONER MASSEY: And if this were as broad
13 as you're conceiving it now, what would be let's say the
14 peak load for the whole area?

15 MR. MUSELER: The peak load in the entire NPCC
16 area is approximately 110,000 megawatts.

17 COMMISSIONER MASSEY: I see. And from your
18 perspective, Gordon or Dick, what is -- or Bill -- what's
19 the toughest work in proceeding? Because with respect to
20 market design, I would think if you know which way the
21 Commission is headed and, you know, New York is most of the
22 way there already, it seems to me. But if you know which
23 way we're headed, then that issue looms as less and less of
24 a conflict I would think. So what do you see as the bumps
25 in the road here? And don't tell me there are none. What

1 do you see as the potential bumps that you've got to work
2 through?

3 MR. GROSSI: Certainly listening to the
4 presentation your staff gave you today as far as the paper
5 that they're coming out with, and again, I don't want to
6 speak -- the detail, you know, has to be looked at, but
7 certainly just listening to it in a broad sense, I see
8 nothing there that is inconsistent with what we would be
9 proposing. In fact, if anything, it's very similar. So
10 you're absolutely right. I don't see any problem there that
11 is significant.

12 The issue is a typical issue of getting people to
13 -- all the stakeholders to essentially embrace change, and
14 that's what we're talking about. So that becomes an effort
15 of sitting down and listening to the concerns, the same
16 issue the Commission has I'm sure, and trying to address
17 those issues as best you can. And then hopefully in the
18 final analysis come up with a plan that can be mutually
19 accepted by all parties.

20 Now that doesn't mean that we may not be making a
21 filing, even absent total consensus. All I'm saying is that
22 the real desirable conclusion here is to end up with a
23 solution that everyone can endorse. But that, to answer
24 your question, is the major concern I see.

25 MR. VAN WELIE: From my perspective, I'd echo the

1 market design discussion. In fact, that was one of the
2 working groups that met earlier this week, and I heard that
3 it went very well. So I think there's general agreement.
4 Everybody, to use Dave's terminology, is following the puck
5 at this point, and we should be fine in market design.

6 I think the issue of governance is potentially
7 controversial. And somehow linked into that is going to be
8 the fact that in order to be successful at this, we're going
9 to have to have pretty broad agreement with the transmission
10 owners. And that all is in the end somehow wrapped up with
11 governance as well. So I think that's going to be a fairly
12 controversial discussion.

13 COMMISSIONER MASSEY: Go ahead.

14 COMMISSIONER BROWNELL: When you say governance,
15 are you talking about the actual board or how the
16 stakeholder process works? And maybe you could explain to
17 us how your boards -- I know there was a search firm that
18 selected the original group. How are they elected now? Do
19 they elect themselves? Do stakeholders elect them? How
20 does that work?

21 MR. GROSSI: It's a self-perpetuating board.

22 COMMISSIONER BROWNELL: It is a self-perpetuating
23 board? And is that one of the issues that is of concern to
24 the stakeholders.

25 MR. VAN WELIE: Probably yes. In both boards, in

1 both ISOs, the stakeholders elected the initial boards. But
2 I think one of the concerns that I've heard expressed by
3 certain market participants is the fact that there is no
4 stakeholder involvement going forward in terms of reelection
5 of directors. So I think that's going to be one of the
6 discussion points.

7 COMMISSIONER BROWNELL: And the boards, the joint
8 oversight board is actively considering some of those
9 governance and bylaws issues?

10 MR. VAN WELIE: Yes. Actually, the oversight
11 committee of the two boards is reaching out to both the
12 public utility commissioners as well as the stakeholders to
13 get input on this matter. So what we'd like to do is get
14 people's views and try and synthesize those views before
15 coming out with a straw proposal.

16 So this is a topic of discussion I know, because
17 just recently we attended an oversight committee, and
18 there's a lot of debate about how we go forward on this one.

19 What we would like to do is obviously get
20 something that works and get something that is generally
21 acceptable to most of the people.

22 MR. MUSELER: The other issue, Commissioner, that
23 is not universally agreed to is the issue of the advisory
24 nature of the stakeholder process. I think the Commission
25 has made your requirements clear in that regard, and I think

1 that's the direction that New York and New England intend to
2 go, but that will be controversial. The 205 rights
3 responsibility.

4 COMMISSIONER MASSEY: And Gordon, you
5 characterized the New England commissioners' views on this
6 as cautious. Can you -- cautious why?

7 MR. VAN WELIE: Well, I think if you spoke to
8 them, most of them would agree and support the notion of
9 standardized markets. And many of them have said, well, you
10 know, that's something that ought to happen and we support
11 that. But not many of them are convinced that there are a
12 lot of additional benefits to them in terms of a larger RTO
13 footprint.

14 So I think they are at this point it's fair to
15 say they're probably watching, waiting and talking to us,
16 engaging, but they haven't taken a firm position on whether
17 they're going to support this or not yet.

18 COMMISSIONER MASSEY: So in other words, they
19 like what they have now, and if they change it, they want to
20 make sure that they get a lot of bang for their buck?

21 MR. VAN WELIE: Yes. And I would say I think
22 what's very positive, NECPAC, we've got a good relationship
23 with them. And I think what's been very good is the fact
24 that there's been no major outcry against this to say this
25 is really a dumb idea. Don't even go and explore it. So I

1 think they're allowing us to go through this process of due
2 diligence, and they obviously just, like yourselves, want to
3 be convinced, and our boards want to be convinced this is
4 the right solution.

5 So I think that will take some months of
6 discussion and effort before we can put those facts on the
7 table.

8 COMMISSIONER BREATHITT: Gordon, has there been
9 much discussion of the cost benefit analysis that the
10 Commission recently completed and issued done by ICF that
11 had a regional emphasis that included the Northeast? That
12 might be something that -- I know the state commissioners
13 are going to be involved in conference calls on that. And
14 to the extent that any of that can --

15 MR. VAN WELIE: I think that's going to act as a
16 catalyst for the discussion. So that's going to be helpful.
17 What I'm finding is that 80 percent of the challenge is to
18 get everybody up onto the same page and the same level of
19 understanding in terms of what we're talking about, and then
20 you can have a sensible debate about drawing conclusions
21 out.

22 My observation is that I don't think we're going
23 to get any black-and-white answers. So there's going to be
24 some judgment required. And there's probably more than one
25 factor. It's not just going to be economics, it's going to

1 be, you know, alignment between organizations, reliability,
2 the continued efficiency of the existing markets, all of
3 those things are going to be what the boards look at, and I
4 think no doubt probably the state commissioners as well.

5 COMMISSIONER BREATHITT: When you mentioned in
6 the presentation that Quebec and New Brunswick were
7 interested in the progress of this and might even have some
8 participation, was the Trans Energie, was that the Quebec
9 part of that? They're a subsidiary of Hydro One, aren't
10 they?

11 MR. MUSELER: Actually I believe Trans Energie is
12 the old utility, and Hydro Quebec USA is the marketing arm.

13 COMMISSIONER BREATHITT: Okay.

14 MR. GOULDING: Just for clarification, Hydro One
15 is the transmitter in Ontario that's currently up for
16 privatization.

17 COMMISSIONER BREATHITT: Just one final question
18 for me. The June 30th filing, do you intend that to be as
19 complete in terms of governance, and hopefully that will be
20 the target date for getting as much of the stakeholder
21 involvement put to bed as you can?

22 MR. VAN WELIE: Yes. There was some debate about
23 how long we should make this process. And I suspect it
24 could fill up as much time as we give it. So our intent
25 here is to go to put enough substance into this so that the

1 Commission can give us a clear decision one way or another.
2 And that means, hopefully to answer your question, we want
3 to have all the aspects covered in this RTO filing.

4 MR. GROSSI: I should add that this is a very
5 tight schedule. There's a great deal of work that has to be
6 done. The board recognized it was tight schedule when it
7 was put together. But, as Gordon said, unless you keep the
8 foot to the pedal, things don't work. So we are certainly
9 going to do everything possible to make that schedule.

10 If you don't mind, I'd like to make one comment
11 with respect to the emphasis that's being placed on the
12 economic studies, and clearly they are important. But there
13 are some philosophical issues I think that we have to keep
14 in mind here. And that is just the inherent benefits you
15 get when you go to a larger region, the issues of
16 reliability and things of that nature and how those become
17 wrapped into this overall analysis I think is very
18 important. And as we heard today, times change. And we
19 can't very well predict the future.

20 So I think we have to keep that in mind. So I
21 think these decisions have to be somehow considered in a
22 more philosophical type of framework. So, for that reason,
23 the boards here certainly at this point believe this is the
24 right direction to go. Now unless the economic studies
25 demonstrate that this is really a dumb, dumb exercise, you

1 know, and I don't think they will show that.

2 MR. ROGERS: Madam Chairman, I had just a couple
3 of questions if I could. I was wondering if you could tell
4 us whether it would help what you're doing or hinder what
5 you're doing for the Commission to issue an order in the
6 near future addressing the recommendations that were made by
7 the judge in the Northeast RTO mediation report.

8 MR. VAN WELIE: My answer is I don't know. I
9 need to go back and consider that. But thank you very much
10 for that question. If you would give us some to consider
11 that, we'd like to come back to you with an answer.

12 MR. ROGERS: Okay. I was also wondering if you
13 could give us an idea of how confident you are of making the
14 June 30th date. Do you think it's a 50-50 shot? Do you
15 think there's 90 percent certainty that you can make that
16 or?

17 MR. GROSSI: You guys are doing the work.

18 MR. VAN WELIE: I think there's a better than 50
19 percent probability. I was pleased that we have made as
20 rapid progress as we have on the market design area. Some
21 of the really tough discussions haven't started yet. So
22 going back to my questions about where are the potholes in
23 the road, are we going to be encountering those in the next
24 month or two, hopefully we can negotiate those. And we're
25 firmly committed from a staff point of view in terms of

1 making this happen by June 30th.

2 Obviously, we have to be sensitive to the fact
3 that people want to have input. So it's not going to help
4 us to pursue a June 30th goal at all costs. And I think our
5 board is going to be very sensitive to that and they've got
6 feelers out, boards on both sides, into the various
7 stakeholders to make sure that they're getting a true sense
8 of what the level of support is for this.

9 MR. GROSSI: If I may add, as far as the boards,
10 we do get schedules from the teams that are working on this.
11 Those schedules reported to us. So the boards are engaged
12 directly as well as through the oversight committees. We
13 will remain on top of this, certainly continue to help them
14 with their efforts. If they need more resources, we'll do
15 what we can. But as I indicated earlier, it is a tight
16 schedule.

17 MR. VAN WELIE: You just triggered me to think of
18 something else, which is we've got a very formalized
19 tracking and project control mechanism in place. So this is
20 not just something that's being administered on an ad hoc
21 basis. We've got laid out for the next three to four months
22 board meetings, oversight committee meetings. Bill and I
23 get together once a week with our taskforces and we get a
24 status report on where we are and what the issues are.

25 And the whole model we've set up here is that the

1 ISo taskforces work together to put the straw proposals in
2 place. They then manage the interaction with the
3 stakeholders. And then Bill and I are there to try and
4 break any deadlocks that may or may not occur between the
5 two ISOs. And of course, the oversight committee is in
6 place there if Bill and I should fail to reach agreement.
7 So I think the structure that we've put in actually allows
8 us the best possible chance at actually making this thing
9 happen by June 30th.

10 COMMISSIONER BREATHITT: Thank you very much.

11 MR. LARCAMP: Could I just make sure Staff
12 understands our assignment? We'll go out to each of the
13 three ISOs probably in the mediation docket, ask for their
14 interchange information last three years looking at sort of
15 the annual summaries. I think it would be helpful if we
16 could get that by month if you have no objection to that.

17 COMMISSIONER BROWNELL: No, that would be great.
18 And I think we ought to get it into the hands of the
19 stakeholders who have raised some of the same issues we've
20 raised.

21 MR. LARCAMP: We'll just make sure that they
22 publicly file it in the mediation docket presumably.

23 COMMISSIONER BREATHITT: Thank you. That
24 concludes our meeting.

25 (Whereupon, at 12:25 p.m. on Wednesday, March 13,

1 2002, the meeting was adjourned.)

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