



FEDERAL ENERGY REGULATORY COMMISSION



ANNUAL



REPORT



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ANNUAL REPORT

2005

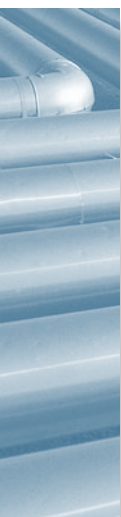
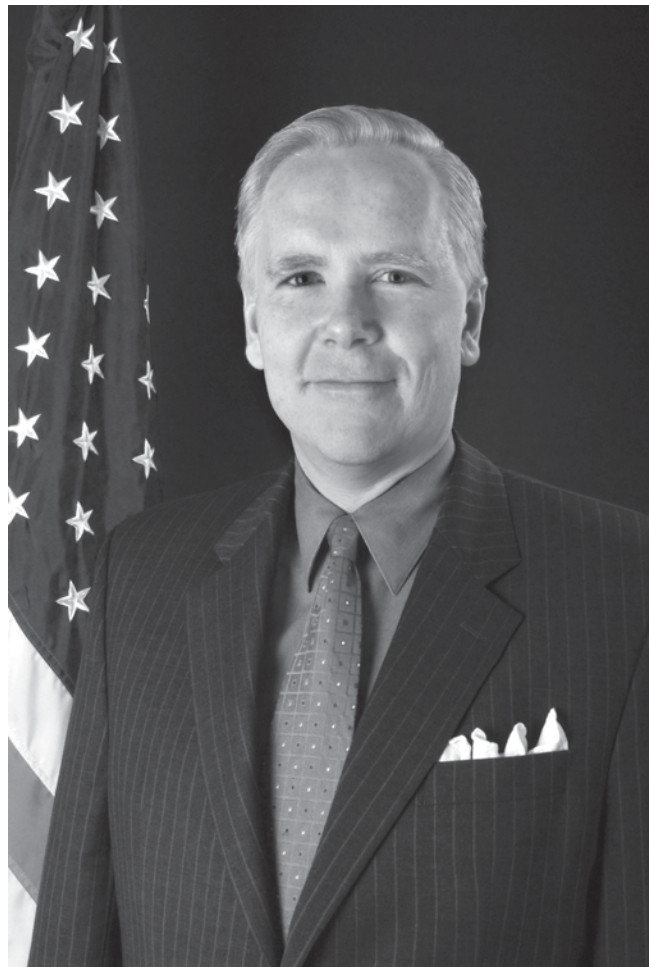


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FERC

A N N U A L R E P O R T



TO THE SENATE AND HOUSE OF REPRESENTATIVES:

I AM PLEASED TO SUBMIT TO THE CONGRESS THE FEDERAL ENERGY REGULATORY COMMISSION'S ANNUAL REPORT, COVERING THE FISCAL YEAR FROM OCTOBER 1, 2004, THROUGH SEPTEMBER 30, 2005.

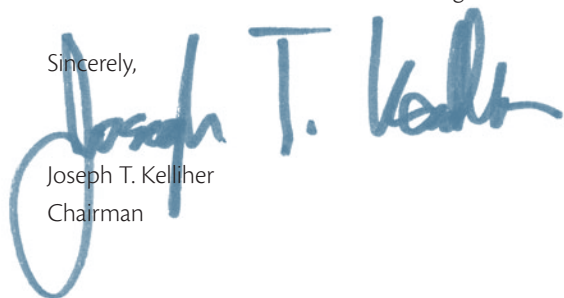
For fiscal year 2005, Congress appropriated \$210,000,000 to support Commission activities. Under the authority of the Omnibus Budget Reconciliation Act of 1986 and other laws, the Commission recovers all of its costs from regulated industries through fees and annual charges. Revenues generated from these sources completely offset congressional appropriations and results in a net cost of zero dollars to the treasury. Thus, the users and beneficiaries of the Commission's services pay its operating costs—not the general taxpayers.

This 85th Annual Report issued by the Commission and its predecessor, the Federal Power Commission, demonstrates that the Commission's overall duties remain the same: promoting safe and reliable energy supplies at just and reasonable rates, and preventing undue discrimination and preference. Those have been the same duties that have guided the Commission since 1935 and 1938, when the Federal Power Act and Natural Gas Act were enacted.

However, on August 8, 2005, the Energy Policy Act of 2005 (EPAAct) was enacted. EPAAct marked the most significant increase in Commission regulatory authority in 70 years. Among the most important of these tools is new authority to establish rules to prevent manipulation of electric and gas markets, with significant new penalty authority. These new regulatory tools also include authority to establish and enforce electric reliability standards, new tools to prevent the accumulation and exercise of generation market power by granting us authority to review acquisitions and transfers of generation facilities, and discretionary authority to provide greater price transparency in electric and gas markets.

This important new law gives the Commission the authority we need to prevent unjust and unreasonable rates in wholesale power sales, to prevent undue discrimination or preference in wholesale power sales and transmission service, and to encourage the development of a stronger energy infrastructure.

Sincerely,



Joseph T. Kelliher
Chairman

2005



VISION

Reliable, affordable energy through reliance on competition and effective regulation.

MISSION

The Federal Energy Regulatory Commission regulates and oversees energy industries in the economic, environmental, and safety interests of the American public.

SECTION 1

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Federal Energy Regulatory Commission (FERC or the Commission) is an independent agency that regulates the electric, natural gas, and oil pipeline industries. FERC also reviews proposals to build liquefied natural gas (LNG) terminals and interstate natural gas pipelines as well as licensing hydropower projects. The Energy Policy Act of 2005 (EPAct 2005) gave FERC additional responsibilities. With this expanded responsibility, the Commission:

- ◆ Regulates the transmission and sale of natural gas for resale in interstate commerce;
- ◆ Regulates the transmission of oil by pipeline in interstate commerce;
- ◆ Regulates the transmission and wholesale sales of electricity in interstate commerce;
- ◆ Reviews mergers, acquisitions, asset sales, and certain security transactions in the electricity industry;
- ◆ Licenses and inspects private, municipal, and state hydroelectric projects;
- ◆ Approves the siting of and abandonment of interstate natural gas facilities, including pipelines, storage and liquefied natural gas;
- ◆ Approves the siting of certain electric transmission facilities;
- ◆ Ensures the reliability of the bulk power transmission system;
- ◆ Monitors and investigates energy markets;
- ◆ Enforces compliance with FERC rules, through the use of civil penalties and other means;
- ◆ Oversees environmental matters related to natural gas and hydroelectricity projects; and
- ◆ Administers accounting and financial reporting regulations and conduct of regulated companies.

The Commission's vision, mission, regulatory authority, organizational structure and resources, goals, and information technology described in this section reinforce the efforts to achieve desired results and accomplish the new responsibilities in EPAct 2005.



REGULATORY AUTHORITY

The Commission was created through the Department of Energy Organization Act on October 1, 1977. At that time, the Federal Power Commission (FPC), the Commission's predecessor that was established in 1920, was abolished and the Commission inherited most of the FPC's regulatory mission.

Hydropower regulation, the oldest area of the Commission's jurisdiction, began with the Federal Water Power Commission's regulation of non-federal hydroelectric generation in 1920 and includes authorizing the construction of projects in interstate commerce and overseeing their operation and safety.

In 1935, the Commission's role was expanded to include certain electric industry activities by the Federal Power Act (FPA). Under FPA sections 205 and 206, the Commission oversees the rates, terms and conditions of sales for resale of electric energy and transmission service in interstate commerce by public utilities. The Commission must ensure that those rates, terms and conditions are just and reasonable, and not unduly discriminatory or preferential. Under FPA section 203, as amended by EAct 2005, the Commission reviews mergers and certain corporate transactions involving public utilities and public utility holding companies. Under FPA sections 203, 205 and 206, the Commission primarily regulates investor-owned utilities and independent power producers. Government-owned utilities (e.g., Tennessee Valley Authority, federal power marketing agencies, and state and municipal utilities) and generally, most cooperatively-owned utilities are not subject to Commission regulation (with certain exceptions).

The Commission may not regulate retail sales or local distribution of electricity, as the FPA leaves these matters to the states. In addition, the Commission does not have a role in authorizing the construction of new generation facilities (other than non-federal hydroelectric facilities) or transmission facilities, as these activities are the responsibility of state and local governments. However, under EAct 2005, the Commission now has, if certain conditions are met, the authority to permit the construction or modification of transmission facilities located in "national interest electric transmission corridors" that are designated by the Secretary of Energy. Pursuant to such a

permit, a permit holder may, through the exercise of eminent domain, acquire rights-of-way for just compensation.

The Commission's role regulating the natural gas industry is largely defined by the Natural Gas Act (NGA). Under the NGA, the Commission regulates the construction of new on-shore LNG import terminals, and natural gas pipelines and related facilities and oversees the rates, terms and conditions of sales for resale and transportation of natural gas in interstate commerce. The Commission's jurisdiction over wholesale sales of natural gas, however, is limited by the Natural Gas Policy Act of 1978 and the Natural Gas Wellhead Decontrol Act of 1989. Pipeline siting and construction is authorized by the Commission if found to be required by the public convenience and necessity. As with hydropower licensing, the Commission's actions on LNG and pipeline projects typically require consideration of factors set forth in the National Environmental Policy Act of 1969 (NEPA), the Endangered Species Act, the Coastal Zone Management Act and similar statutes. Currently, regulation of production and gathering of gas, as well as retail sales and local distribution of natural gas, are matters within the jurisdiction of the states.

Finally, the Interstate Commerce Act gives the Commission jurisdiction over the rates, terms and conditions of transportation services provided by interstate oil pipelines. The Commission has no authority over the construction of new oil pipelines, or over other aspects of the industry such as production, refining or wholesale or retail sales of oil.

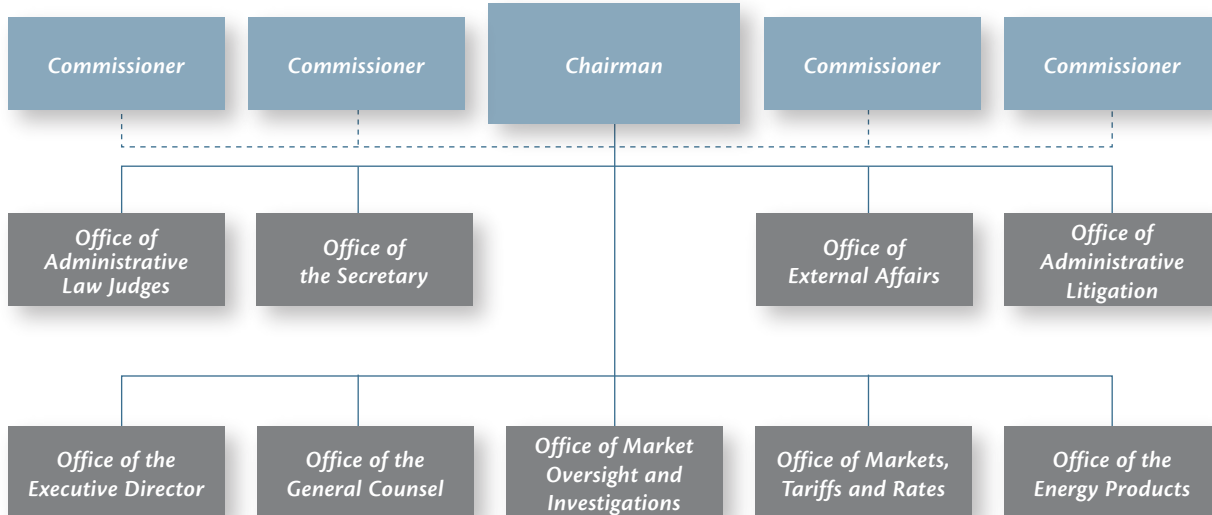
The Commission recovers the full cost of its operations through annual charges and filing fees assessed on the industries it regulates as authorized by the FPA and the Omnibus Budget Reconciliation Act of 1986. The Commission deposits this revenue into the Treasury as a direct offset to its appropriation, resulting in no net appropriations to the agency.

ORGANIZATIONAL STRUCTURE AND RESOURCES

The Commission is an independent regulatory agency within the U.S. Department of Energy (DOE) whose function is to oversee the Nation's electric, natural gas, hydroelectric, and oil pipeline industries. It is headed by a bi-partisan, five-member Commission, comprised of the Chairman and four Commissioners who are appointed by the President and confirmed by the Senate. The Chairman serves as the chief executive officer. In FY05, FERC was organized by nine functional offices (see table). The Commission's headquarters are in Washington, D.C., and it has five regional offices throughout the country.

In FY 2005, Congress appropriated \$210,000,000 to support Commission activities. As of September 30, 2005, the Commission had 1,236 staff, including 1,215 permanent staff and 21 temporary staff.

Federal Energy Regulatory Commission



<i>Offices/Organizations</i>	<i>Descriptions</i>
Office of Administrative Law Judges	Resolves contested cases as directed by the Commission effectively, efficiently and expeditiously, either through impartial hearing and decision or through negotiated settlement, ensuring that the rights of all parties are preserved.
Office of Administrative Litigation	Represents the public interest and seeks to litigate or settle cases set for hearing in a timely, efficient and equitable manner while ensuring the outcomes are consistent with Commission policy
Office of External Affairs	Handles all external communications with the public, Congress and the states for the Commission.
Office of the Executive Director	Provides administrative support services to the Commission including human resources, procurement, information technology, organizational management, financial, logistics and others.
Office of Energy Projects	Strengthens energy infrastructure through the approval and oversight of hydroelectric and natural gas energy projects that are in the public interest.
Office of the General Counsel	Provides legal services to the Commission. OGC represents the Commission before the courts and Congress, and is responsible for the legal phases of the Commission's activities.
Office of Market Oversight and Investigations	Ensures effective regulation and protects consumers through understanding markets and their regulation, timely identification and remediation of market problems, and assuring compliance with rules and regulations.
Office of Markets, Tariffs and Rates	Addresses markets, tariffs and rates relating to electric, natural gas, and oil pipeline facilities and services.
Office of the Secretary	Serves as the official focal point through which all filings are made for proceedings before the Commission, issues notices and Commission orders, records and preserves the minutes of all official actions taken by the vote of the members of the Commission.

GOALS

Energy Infrastructure: Serving the Nation's Needs

The Nation is best served by a secure and reliable energy infrastructure. The Commission seeks to encourage investment in the energy infrastructure by expediting the development of energy infrastructure projects while maintaining a high level of regulatory certainty in Commission policies. Project applications will be reviewed to ensure the reliability, security and safety of the energy infrastructure while ensuring that landowner and environmental concerns are addressed in a fair manner.

Competitive Markets: Benefiting the Consumer

Competition in wholesale power benefits consumers by supporting a strong, stable national economy. The Commission seeks to establish clear market rules to govern electric markets to prevent the exercise of market power, undue preference and self dealing, to provide regulatory certainty and to promote transparency of competitive electric and gas markets.

Enforcement and Oversight: Guarding the Consumer

The public is best served by the vigilant and effective oversight of energy markets. The Commission works to protect customers and market participants through vigilant and fair oversight of both traditionally regulated entities and transitioning energy markets. Monitoring of the markets, including identifying and remedying problems with market structure and operations, ensures long-term market development and the prevention of the exercise of market power.



SECTION 2

ENERGY INFRASTRUCTURE: SERVING THE NATION'S NEEDS

Competitive energy markets require robust infrastructure and the United States must encourage rapid, flexible infrastructure investment to meet market and operational demands. Adequate infrastructure helps make competitive markets work by:

- ◆ improving reliability;
- ◆ reducing barriers to entry;
- ◆ encouraging economically efficient markets;
- ◆ better matching of demand and supply;
- ◆ improving customer access to low-cost resources; and
- ◆ allowing customers to choose between multiple supply sources.

Healthy natural gas and electric markets require adequate infrastructure because both markets can experience rapid and large price fluctuations when demand and supply diverge, due to either insufficient supply or insufficient demand flexibility in response to those high prices. The Commission has to meet its goal of promoting development of a robust energy infrastructure:

- ◆ expedite development of energy infrastructure projects;
- ◆ encourage investment in energy infrastructure;
- ◆ address landowner and environmental concerns fairly; and
- ◆ affirm the reliability and safety of the energy infrastructure.

In August 2005, President George Bush signed EAct 2005 into law. The Act contains several new authorities to strengthen the Commission's ability to implement these objectives.

EXPEDITE DEVELOPMENT OF ENERGY INFRASTRUCTURE PROJECTS

Natural Gas and LNG: The Commission continues to strive to make decisions on project applications in a timely manner and to make improvements in its procedures.

During FY 2005, the Commission continued to refine its procedures to reduce the time that applications are before the Commission before final decisions are made, while ensuring the processes are consistent with statutory mandates and due process.

A significant step in improving the quality and timely review of LNG applications are the new pre-filing rules that have been proposed in accordance with the recently enacted EAct 2005. The new rules will establish mandatory pre-filing procedures for all applicants seeking to site, construct and operate new LNG terminals and related facilities, such as pipelines, that would transport the revaporized LNG to markets. The rules will require potential developers of new LNG terminals to initiate pre-filing procedures at least six months prior to filing a formal application. These improvements will help the Commission in its consideration of the LNG proposals before it. During FY 2005 the Commission authorized the construction of six new LNG import terminals. In addition, the Commission staff reviewed



proposals for 12 new import terminals and expansion of three recently approved terminals.

With respect to natural gas storage projects, the Commission took an average of seven months to issue final orders for gas storage projects in FY 2005. This included expansions of existing storage reservoirs to new solution mined salt cavern storage facilities. The fastest action, an expansion of an existing reservoir by Freebird Gas Storage, took only five months to complete.

In response to EPAAct 2005, the Commission also initiated action designed to promote the expansion of natural gas storage capacity to provide for mitigation of natural gas price volatility. The goal is to provide further incentives for the development of new natural gas storage capacity to ensure access to storage services at just and reasonable rates, while at the same time ensuring that adequate storage capacity will be available to meet anticipated market demand. During FY 2005, the Commission authorized 12 storage projects resulting in 4.4 Bcf of peak day deliverability as well as LNG projects resulting in 44.8 Bcf of storage capacity and 6.5 Bcf per day of peak day deliverability from LNG storage facilities. In FY 2005, there were 13 storage projects under analysis representing approximately 1.6 Bcf of peak day deliverability.

Since 1992, the Commission has actively promoted outreach through its industry training sessions. During FY 2005, Commission staff conducted four sessions of its Environmental Report Preparation Seminars and Post-Certificate Environmental Compliance Seminars. Further, staff revised its Third-Party Contracting Handbook to better address prospective applicants' questions on LNG projects and to incorporate the guidelines and goals of the Pre-Filing Process. Staff also worked with the Interstate Natural Gas Association of America to develop geographic information system standards in anticipation of the Commission's movement toward electronic filing of certificate applications. Staff in OEP and OEA worked jointly to develop *A Guide to LNG – What All Citizens Should Know*. The informative brochure serves as a much-needed source of accurate information that can be used by Commission staff to inform the public about the LNG industry and the Commission's regulations.

In Order No. 2005, the Commission reaffirmed and clarified its rules establishing requirements governing the conduct of

open seasons for potential shippers to compete for and acquire initial capacity and future expansion capacity on any potential Alaska pipeline.

In FY 2005, 28 major pipeline projects were certified, resulting in 14.5 Bcf per day of additional capacity, 147,000 horsepower of compression, and 935 miles of new pipeline.

Modernize and enforce power plant interconnection rules

Standardized interconnection procedures and agreements for electric generators encourage needed investment in generation and transmission infrastructure, as well as reduce opportunities for transmission owners to favor affiliated generation and encourage efficient generation and transmission siting decisions. The Commission issued several orders directed at small and intermittent resources, thus removing a major barrier to bringing generation to the national energy markets, where needed.

- ♦ In May 2005, the Commission issued a final rule (Order No. 2006) establishing standard procedures and agreements for the interconnection of small generators with a capacity up to 20 megawatts (large generator interconnection rules were issued in FY 2003). This rule will help preserve grid reliability, increase energy supply, lower wholesale electric costs for customers by increasing the number and types of new generators available in the electric market, and include the development of non-polluting alternative energy resources. The rule encourages standardization of interconnection practices across the nation, both at state and federal levels. It provides small generators reasonable certainty about the costs they will bear, the terms and conditions affecting their interconnection to the transmission system, and expedites the interconnection process.
- ♦ In June 2005, the Commission issued a final rule (Order No. 661) addressing the interconnection requirements for wind power facilities larger than 20 megawatts. The rule requires transmission providers to address technical and procedural requirements in their open access transmission tariffs (OATT) for integrating wind power facilities

into their transmission systems. The rule recognizes the unique characteristics of wind generating technology, and removes unnecessary obstacles to further development of wind generating resources while ensuring that reliability is protected.

During FY 2005, the Commission's infrastructure policy group participated in a number of conferences and presentations for senior Commission staff, commissioners, and the Chairman. In particular, the group prepared and delivered an overview of coal's contribution to the electric generation industry as part of a Commission technical conference in West Virginia. In addition, they took part in the analysis of electric transmission deficiencies in southwest Connecticut. Also, the group prepared and delivered the opening presentation on California's current electric infrastructure and supply and demand at a Commission technical conference in San Francisco before the California Public Utilities Commission and the California Energy Commission.

Improved Hydropower licensing through the integrated licensing and pre-filing processes and interagency agreements

The Commission continues to encourage early stakeholder involvement in the licensing process through the use of tools such as the hydropower licensing pre-filing process in the context of the Alternative Licensing Procedure (ALP) and the new Integrated Licensing Process (ILP). The environmental review process includes numerous opportunities for stakeholder involvement. The Commission has expanded those opportunities by: providing staff resources, providing all readily available project information and holding additional, issue-specific meetings in the project areas. In FY 2005, Commission staff actively participated in 21 projects that were using the pre-filing process to engage stakeholders in the identification and resolution of stakeholder concerns prior to the filing of a license application with the Commission. The staff's participation and initiative in these efforts will allow for the filing of better license applications enabling more efficient and expeditious licensing actions by the Commission.

Section 241 of EAct 2005 permits license applicants and others to request a trial-type hearing and to propose alternatives to mandatory section 4(e) conditions and section 18 fishway prescriptions issued by Interior, Commerce, or Agriculture. Commission staff has provided: guidance to the required Departments on the ILP process; methods to implement these EAct provisions; and comments on the Departments' joint rulemaking. This rulemaking was scheduled for issuance in November 2005.

The Commission has made great progress in implementing its new ILP. In FY 2005, the percentage of hydropower projects using the ILP increased by 450 percent. The Commission expanded the use of the ILP which, among other things, merges pre-filing consultation with the development of the environmental analysis document under NEPA. Throughout FY 2005, the Commission undertook numerous outreach efforts to educate the industry, resource agencies, Indian tribes, nongovernmental organizations, citizen groups and other stakeholder groups on the ILP. Staff made presentations and led discussions on the ILP at several national hydropower meetings. In addition, regional conferences and intensive project-specific meetings with multiple stakeholder groups were held to educate participants on the ILP.

The ILP is currently being used by the following ten projects: Morgan Falls (Georgia), Canaan (New Hampshire/Vermont), Smith Mountain (Virginia), Metro Hydro (Ohio), Coon Rapids (Minnesota), De Sabla (California), Tacoma-Ames (Colorado), Mystic Lake (Montana), Packwood Lake (Washington), and Allison Lake (Alaska). Licensees for all five relicenses that needed to select the preferred licensing process in FY 2005 opted for the ILP. In addition, three original license applicants opted to use the ILP in FY 2005.

One of the primary benefits of the ILP is the opportunity to resolve any study disputes early in the licensing process. An informal dispute resolution process is available to all participants and a formal dispute resolution process is available for mandatory conditioning agencies. Five projects have resolved study disputes through the informal process. One project, Morgan Falls, used the formal dispute resolution process. A technical

expert from the Commission unassociated with the project acted as the chair of the panel. The team reached consensus on recommendations within the prescribed time frame for the ILP.

In addition, the Commission undertook a three-pronged approach to monitor the extent the ILP achieves its goals of reducing processing time and costs while ensuring appropriate environmental protection. Furthermore, the Commission conducted multi-stakeholder teleconferences, followed by four regional workshops, and, finally, a technical conference in Washington DC. The Commission received positive feedback on the ILP as well as ideas for improving implementation.

Fifteen applications for hydropower relicensing of existing facilities were filed in FY 2005. There were also six exemption applications filed. These applications, along with others that will be filed over the next 10 years, represent over 38 projects with installed capacities in excess of 100 megawatts. Many of these applications are for regionally important cases that affect the

full spectrum of environmental concerns ranging from shoreline development (marinas vs. residential development vs. public access) to conflicting uses of instream flows for water supply, irrigation interests, white-water boating and endangered fish species. The expeditious processing of hydropower license and exemption applications, while ensuring that the concerns of those affected by hydropower projects are addressed, remains an ongoing goal for the Commission.

The Commission's practice of approving comprehensive settlements and incorporating in whole or in part the terms of the settlements recommended by stakeholder groups into the license has encouraged stakeholders to formulate such agreements. Through this practice, the Commission has empowered the various stakeholder groups to resolve, in large part, the issues during the licensing process through reaching consensus. Of the 27 licenses issued in FY 2005, seven contained measures contained in proposed settlement agreements.

Examples of licenses issued in FY 2005 that included some or all provisions of settlement agreements:

In January 2005, the Commission issued a license for the 380-megawatt Tapoco Hydroelectric Project located on the Little Tennessee and Cheoah Rivers in North Carolina and Tennessee. The license was issued a mere 11 days after the licensee completed a land exchange with the Great Smoky Mountains National Park authorized by P.L. 108-343. The Commission approved a settlement agreement signed by 20 stakeholder groups and included provisions in the project license that addressed fish and wildlife resources including fish passage, threatened and endangered species protection, land protection, whitewater boating, vegetation management, and contingencies for drought management. The license also authorized an additional 20 megawatts of installed capacity.

In June 2005, the Commission issued a license for the 367-megawatt Pelton Round Butte Hydroelectric Project located on the Deschutes River in Oregon. The Commission approved most of the provisions of a settlement agreement signed by more than 20 stakeholder groups and included a multitude of provisions in the project license for the protection and enhancement of fish, wildlife, and recreation in the project area. Such measures included fishway measures and habitat improvements for the reintroduction of salmon and steelhead in the Deschutes River basin upstream of the project.

In June 2005, the Commission issued a license for the 21-megawatt Lamoille Hydroelectric Project located on the Lamoille River in Vermont. The Commission approved a settlement agreement signed by the licensee and five state and local government agencies and nongovernmental organizations that included provisions for minimum instream flows and fish passage.

In July 2005, the Commission issued a license for the 44-megawatt Wallenpaupack Hydropower Project No. 487 located on the Wallenpaupack Creek and the Lackawaxen River in Pennsylvania. The license incorporates terms of a settlement agreement, signed by 28 agencies and nongovernmental organizations that provide fish and wildlife enhancements, recreational opportunities, and protection of historic properties.

In December 2004, the Commission sponsored the fourth in a series of workshops on long-running hydropower licensing proceedings. Interested stakeholders were invited to discuss, on a project-specific basis, procedural impediments that precluded the Commission from taking final action. Because of the actions spurred by the first three workshops, the number of five-year old cases and older dropped from 51 identified in the first workshop to 13 discussed at the December 2004 workshop. As a result of this decline the Commission was able to lower the threshold to three years and older for the December 2004 workshop where a total of 22 cases were discussed. As with the other workshops, this last workshop identified a key source of licensing delay as the applicants' receipt of necessary state certifications and permits.

In FY 2005, the Commission authorized 117 megawatts of additional capacity at existing licensed hydropower projects. The Commission also granted a large number of preliminary permits authorizing feasibility studies for 2,266 megawatts of capacity for new projects. The purpose of a preliminary permit is to maintain priority of application for a license for three years while the permit holder conducts investigations and secures data necessary to determine the feasibility of a new project and prepares an application to develop it.

During FY 2005, the Commission acted on a total of 30 hydropower applications which included a total of 24 applications to relicense, three original license applications and three, five-megawatt exemption applications. These applications represented an installed capacity of over 1,000 megawatts. The Commission also initiated the processing of 15 proposals to relicense, seven of which have an installed capacity in excess of 100 megawatts. Meanwhile, the Commission reduced the average processing time for hydropower relicensing by 5.5 percent.

During FY 2005, interest in non-conventional hydropower development has continued, but at a slower pace. The Commission had three preliminary permit applications—Golden Gate Energy's San Francisco Bay Project No. 12585, Verdant Power's Roosevelt Island Project No. 12611 and Tacoma Power's Tacoma Narrows Project No. 12612—for proposals to develop wave action and tidal action hydropower facilities.

There are currently three different proposals where applicants are proceeding with development of non-conventional hydropower projects. These proposals include:

- ♦ AquaEnergy Group Ltd.'s (AquaEnergy) preparation of a license application for the Makah Bay Wave Energy Project using the ALP. This is a pilot project designed to test the relatively new and developing wave energy technology off the coast of Washington State which, according to the proposal, would consist of up to four, 250-kW units.
- ♦ Verdant Power is proposing to install what can best be described as underwater windmills, capable of producing 16 kW of energy, in the East River in New York City. It has been estimated that the total expansion potential of this site could range from five to ten megawatts.
- ♦ Energetech proposes to build a 500 kW wave action facility off the coast of Rhode Island.

The overall staff workload in the hydropower compliance and administration area is increasing. The issuance of 220 new hydropower licenses between FY 2000 and 2010 will add about 2,200 more license articles, requiring numerous compliance filings and amendment applications. In addition, the annual workload in this area has become increasingly complex as agencies and the public participate more fully and vigorously in setting license requirements and negotiating settlements and agreements that are incorporated as conditions of the license. As a result, average annual workload is expected to increase about 15 percent each year.

ENCOURAGE INVESTMENT IN ENERGY INFRASTRUCTURE

Maintain high level of regulatory certainty in Commission policies through guidance, and policy statements

Without assurance that the Commission's policies will be consistently applied, investors would bear greater risks and

require higher returns on their investments, thereby increasing customer costs, and industry participants would find it harder to obtain financing to build much needed infrastructure, and invest in fewer projects.

The Commission is committed to providing such assurances and has issued policy statements to that effect. For example, in May 2005, the Commission issued a policy statement to permit cost-of-service rates to reflect actual or potential income tax liability for all public utility assets, regardless of the form of ownership (e.g., corporations or partnerships). Under the policy, all entities or individuals owning public utility assets would be permitted income tax allowances on the income from those assets, provided they have an actual or potential income tax liability on that income. Other examples include:

- ◆ In April 2005, the Commission issued a guidance order providing a structure in which flaws in regional transmission organization (RTO) and independent system operator (ISO) tariffs can be fixed promptly through an expedited tariff revision process;
- ◆ In June 2005, the Commission issued a guidance order on how jurisdictional natural gas companies should account for costs associated with implementing new pipeline integrity management requirements of the U.S. Department of Transportation's Office of Pipeline Safety;
- ◆ In June 2005, the Commission issued a guidance order on its ratemaking policy with respect to the American Jobs Creation Act of 2004 tax deduction for manufacturing activities, which provided a tax deduction for income attributable to, among other things, sales of electricity and natural gas produced in the United States.

The Commission also has used its declaratory order process to provide clear cost recovery processes to energy industry stakeholders. In March 2005, the Commission approved a cost recovery methodology to allow the restart and reconfiguration of an idle pipeline system that permits the delivery of much needed crude oil supplies from Canadian sources to refineries in Oklahoma, Kansas, and Texas. The Spearhead Pipeline Project,

proposed by Enbridge Energy Company, will be used to transport 125,000 barrels of crude oil per day and will offer a more varied grade mix of crude oil to meet the needs of the U.S. petroleum market. By reversing the flow, the project will offer more domestic refiners access to crude oil that will be extracted from Canada's western tar sand reserves using new technology. Additionally, the conversion of an idle system benefits the environment because the project will use the same route, thus reducing adverse impact that would result from the construction of a new pipeline.

Using orders to establish pricing policies that encourage investment in electric generation and transmission

In FY 2005, the Commission approved several rate proposals providing rate flexibility or incentives needed for infrastructure additions. Specifically, in June 2005, in an effort to remove barriers to the formation of independent transmission companies, the Commission clarified its policy on passive ownership of independent transmission companies by signaling a more flexible approach to passive equity ownership of independent transmission companies by market participants. This policy statement is a step toward policies that will encourage development of a more reliable transmission grid for the nation's consumers.

EPAAct 2005 directed the Commission to develop incentive-based rate treatments for transmission of electric energy in interstate commerce, to provide regulatory certainty, and to support expanded and improved transmission infrastructure while ensuring that transmission rates remain just and reasonable. The Commission's goal is to establish a proposal for transmission pricing reforms designed to promote needed investment in energy infrastructure.

In FY 2005, the Commission approved various rate proposals that facilitate development of infrastructure by ensuring that revenue levels and rate designs for regulated company services are just and reasonable and support long-term competitive markets:

Proposals by the Southwest Power Pool (SPP) to implement a regional cost allocation plan; an experimental program where transmission customers who frequently use short-term

transmission service can, on a voluntary basis, prepay for service thus providing a means of funding transmission expansion for the provision of additional short-term service; and an aggregate transmission study process and cost allocation that allows SPP to review transmission service requests over a four month period for the purpose of determining the aggregate required upgrades and cost allocation.

- ◆ A methodology established by PJM Interconnection (PJM) and the PJM transmission owners for the recovery of costs incurred under PJM's Regional Transmission Expansion Plan (RTEP) that provided transmission owners with the ability to fully recover all reasonably incurred costs under the RTEP, thus removing disincentives for transmission owners to build regional transmission upgrades quickly.
- ◆ ITC Holdings Corporation's revised business model to allow passive ownership, thus attracting new interest and capital as an encouragement to independent transmission companies to build needed transmission infrastructure and to operate their transmission facilities in a non-discriminatory and efficient manner.

In FY 2005, the Commission also accepted or approved several rate proposals by electric utilities that spurred development of badly needed new transmission capacity on the West Coast. For example, the Commission:

- ◆ Acted on TransElect's Path 15 expansion in California;
- ◆ Facilitated development of new transmission to serve the capacity constrained areas of San Francisco (Trans Bay Cable between Pittsburg, CA, and San Francisco);
- ◆ Approved the Olympic peninsula in Washington state, the Sea Breeze's cable between Vancouver, BC, and Port Angeles, WA; and
- ◆ Accepted Southern California Edison's proposal to construct and roll-in to its rate base the costs of a new trunk line designed to serve wind power generators (approved in part).

ADDRESS LANDOWNER AND ENVIRONMENTAL CONCERNS FAIRLY

Encourage potential applicants for licenses or certificates to utilize the Commission's collaborative pre-filing process

Addressing Environmental Concerns Fairly

The Commission continues its efforts to incorporate reasonable environmental conditions into permits, licenses and certificates and regulate compliance with conditions, while avoiding unnecessary delay in developing environmental impact statements (EISs).

During FY 2005, the Commission staff completed the environmental review of 465 gas pipeline and LNG filings, including 52 environmental assessments (EAs) and ten EISs. Concurrently, the Commission staff continued work on 17 additional EAs and 20 additional EISs, primarily for new LNG import terminals, both onshore and offshore. Because of the effective use of the Commission's pre-filing process, the average time for the staff's completion of the ten EISs was about 10 months. The EIS for the Ingleside LNG project was completed in less than seven months.

The Commission staff also completed the environmental review of 31 hydroelectric license and exemption applications, including 27 EAs and four EISs. Concurrently, the Commission staff continued work on eight draft EAs and five draft EISs.

The Commission also worked with parties to ensure that appropriate environmental conditions were placed on hydroelectric licenses. These conditions require licensees to prepare and file plans or reports with the Commission that may deal with project operation, recreation, fisheries, water quality, wildlife, wetlands and others. In FY 2005, the Commission completed reviews of about 1,000 of these applications. For example, the Commission required the development of a protection plan for populations of a threatened plant species related to dam rehabilitation at the Catawba-Wateree Project in North Carolina. These measures were in addition to procedures included in the biological opinion for this species that occurs in the work area.

The protection plan was implemented to ensure the plant's protection during the rehabilitation work.

Also, additional water quality protection measures were approved by the Commission during this fiscal year at the Castaic pumped storage powerhouse of the California Aqueduct Project. A Commission environmental inspection found secondary containment to be insufficient at some of the large transformers at the project and required the development of plans for retrofitting the structures and continuously monitoring the sites. The approved measures for secondary containment were needed to prevent oil pollution of nearby water resources should a spill from failure of the transformers occurs. Improved secondary containment is now in place to prevent the horizontal migration of oil should a discharge occur at the site.

The Commission required the licensees for the Burnham Project and Benton Falls Project, both in Maine, to assist the state for its expense in passing fish upstream. Because of the delay in constructing fish passage facilities, the state had to pass fish upstream by trapping and then trucking the fish upstream in order to meet the state's fish management objectives. The Commission also required the licensees to undertake an aggressive schedule to install the facilities for use during next year's fish migration season.

The Commission approved provisions of the Penobscot River Basin Settlement Agreement, which is the first step towards the restoration of approximately 500 miles of river for migration in Maine. The projects involved are PPL Maine's Veazie Project, Milford Project, Medway Project, Stillwater Project, and Bangor-Pacific Hydro's West Enfield Project.

The Commission approved construction of fish passage facilities for the Fiske Mill Project, on the Ashuelot River in New Hampshire, which will open approximately 10 miles of the Ashuelot River upstream of the Fiske Mill Project to spawning for American shad and river herring.

The Commission requires environmental measures in certificates, inspects natural gas facilities for adherence to prescribed environmental mitigation measures, and demonstrates its commitment to expedited project reviews and addressing landowner concerns when performing NEPA reviews. For example,

in August 2005 in the Entrega pipeline project, the Commission issued an order eleven months after filing. The order imposed 48 environmental mitigation conditions on the project, which will reduce the impact on bald eagles, cultural resources, and water bodies along the route, establish a landowner hotline for complaints, and require two route variations, among other things.

In the Capacity Restoration Project proposed by Northwest Pipeline to address needed integrity management repairs on their system, the Commission issued a September 2005 order that included 27 environmental mitigation conditions. These conditions addressed landowner concerns in residential subdivisions crossed by the Northwest system, cultural resources, Coastal Zone Management Act consistency, erosion control and other resource issues.

The Commission continued to offer training sessions on compliance with Commission regulations and certificate conditions. In addition to helping certificate applicants, the well-attended sessions are also valuable to Commission staff. The comments and questions from the sessions help us monitor the clarity and effectiveness of certificate conditions.

PROTECT THE RELIABILITY, SECURITY AND SAFETY OF THE ENERGY INFRASTRUCTURE

Oversee the development and enforcement of mandatory grid-reliability standards to protect the bulk power supply

Reliability is essential to ensuring adequate energy infrastructure that serves the nation's needs. With this goal in mind, the Commission's Reliability Division became fully operational in October 2004. On February 8, 2005, the North American Electric Reliability Council (NERC) Board of Trustees approved Version 0 Reliability Standards, which have the goal of restating existing standards in a manner that is unambiguous and measurable. These standards replace NERC's operating policies, planning standards and compliance requirements to ensure that clear and unambiguous standards are set as to "what needs to be done and who needs to do it" to achieve reliable grid operations. The next day, the Commission issued a policy statement

that supplemented an earlier reliability policy by making clear that the term “Good Utility Practice,” as that term is used in the *pro forma* OATT, includes compliance with NERC’s Version 0 Reliability Standards.

On September 1, 2005, three weeks after EAct 2005 was signed into law, the Commission issued proposed rules to implement the reliability provisions of the bill. The proposal established criteria for an Electric Reliability Organization (ERO) that will propose and will enforce reliability standards under the regulatory review and oversight of the Commission. These new rules will, for the first time, make compliance with electric reliability standards mandatory and enforceable. In addition to ERO criteria, the proposal includes:

- ◆ Procedures governing enforcement actions by the ERO and the Commission;
- ◆ Procedures under which the ERO may delegate authority to a regional entity to enforce reliability standards;
- ◆ Procedures for the establishment of regional advisory bodies that may advise the Commission, the ERO, or a regional entity on governance and reliability standards, and propose fees within a region, or undertake other responsibilities designated by the Commission;
- ◆ Regulations for issuing periodic reports by the ERO on reliability assessment and adequacy; and
- ◆ Regulations on funding the ERO.

By serving as the lead Federal agency on siting and authorization, FERC assures the safety of hydropower projects, energy projects and LNG import facilities licensed by the Commission

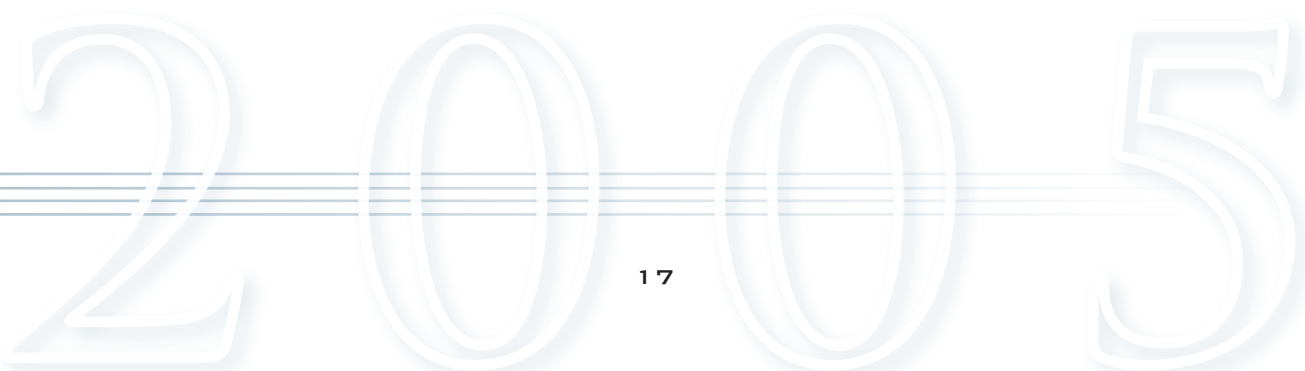
The Commission has adopted a policy statement on development of consolidated federal administrative records for judicial review of proceedings involving authorization of interstate natural gas pipelines and LNG facilities. The policy statement provides interim guidance pending a future rulemaking to implement provisions of EAct 2005. This new law re-

quires the Commission to implement a coordinated method for authorizing proposals to develop interstate natural gas pipelines and import terminals for LNG.

Hydropower Projects: The Commission’s dam safety program, through its many components, helps ensure dam safety, public safety, environmental resource protection, and reliability in the electric industry. Inspections verify the structural integrity of dams and compliance with engineering, environmental, and public safety conditions and regulations. They also identify necessary maintenance and remedial modifications. The Commission is responsible for inspecting about 2,600 dams and related water retention structures. It conducts periodic inspections starting from the receipt of an application for a proposed jurisdictional project, throughout the term of a license. Types of inspections are pre-license, construction, operation, instrumentation, exemption, and special. The Commission’s Division of Dam Safety and Inspections with its five regional offices conducts the inspections.

During FY 2005, the Commission was actively resolving dam safety deficiencies at 43 projects and overseeing operation and maintenance repairs at 107 projects, totaling more than \$600 million in construction costs. Most notably the Commission worked with the licensee and independent engineering consultants on the remediation of the Saluda Dam in Columbia, South Carolina. Engineers determined that the dam would fail if subjected to a repeat of the 1886 Charleston earthquake, threatening over 120,000 downstream residents. To alleviate this potential hazard, a massive rock fill and concrete structure was constructed at the existing dam, which was completed in June 2005. Throughout the three-year and \$275 million project, the Commission worked with the licensee, engineering consultants, state and federal agencies and the public to fix the dam as quickly as possible, while minimizing the associated disruption to the local area.

Applying instrumentation to dams and related water-retaining structures to monitor otherwise-undetectable changes in these structures are critical component of the Commission’s dam safety program. By applying the correct technology and instrumentation to each unique situation for early detection and evaluation of deficiencies, serious problems are identified,



evaluated, and corrected before they fully develop. In FY 2005, the Commission entered its third year of implementation of an important aspect of its performance monitoring program called potential failure modes analysis. About 600 dams have now undergone a potential failure modes analysis, a comprehensive, rigorous study of each project, with emphasis on failure possibilities. This program helps safeguard important hydropower infrastructure, and provides cost-effective, targeted results.

LNG Import Facilities: In FY 2005, the Commission staff started the process of producing guidelines for its engineering and cryogenic review of LNG facilities, drafting guidelines on the content and level of engineering detail required for LNG applications. Final versions of the guidelines for the program are scheduled to be completed and fully implemented by May 2007, with guidance on all facets of the Commission's LNG program scheduled to be issued throughout FY 2006 and FY 2007.

The LNG Engineering Branch, created in 2004 in the Office of Energy Projects, continued its commitment to enhance the Commission's LNG expertise. Extensive training programs were developed and implemented for the four new LNG engineers hired last year, and two new positions were established for senior LNG modeling experts. As part of the staff's efforts to enhance and maintain the LNG program, a contract was issued to ioMosaic to conduct an independent review of the LNG engineering program. The final report was issued in September and the staff is in the process of implementing the recommendations. One of the recommendations was to establish standard engineering guidelines for LNG facility safety, and these are being created.

Throughout FY 2005, the staff worked closely with National Association of State Fire Marshals and the Department of Transportation to develop a training module on LNG for first responders that included a film. Under its continuing inspection program, Commission staff conducted 11 biennial inspections of jurisdictional LNG peak-shaving and import facilities, placing increased emphasis on plant security measures and improvements. In addition, the Commission staff conducted bi-monthly inspections of the three existing LNG terminals being expanded and of the three new terminals that are under construction. Regarding pipeline safety, the staff developed and issued guidance

to the industry on conducting emergency pipeline repairs required by the Pipeline Safety Integrity Act.

Other Energy Projects: Commission staff conducted 204 inspections of natural gas pipelines to ensure compliance with environmental regulations and certificate conditions. Of the 87 projects that were inspected, 15 involved environmental issues and affected populated areas and were inspected at least once every four weeks during construction, and at least once following the completion of construction.

Work with other agencies and industry to address and improve infrastructure security.

The Commission is an active member of the Interagency Committee on Dam Safety, the U.S. Society on Dams, the National Dam Safety Review Board, and the Association of State Dam Safety Officials, and shares its dam safety expertise internationally as well. During FY 2005, the Commission also provided dam inspection and evaluation services to the Nuclear Regulatory Commission and the Department of Energy, and assisted the Director of the Federal Emergency Management Agency in implementing the National Dam Safety Program.

The Commission places high importance of emergency management personnel working closely with dam owners to understand their Emergency Action Plan and ensure that it continues to be a point of emphasis and program development. The need for well-functioning Emergency Action Plans was highlighted by the aftermath of Hurricane Katrina. Beginning in 2004, dam owners were required to have annual coordination meetings with emergency management personnel to ensure all parties understand their roles and responsibilities. These are in addition to annual drills performed by the dam owners, and periodic tabletop and functional exercises. During FY 2005, the Commission focused closely on security issues and further developed the hydropower security program by:

- ◆ Conducting two workshops on dam site security and emergency action planning;
- ◆ Providing significant contributions to Department of Homeland Security (DHS) on dam security and criticality of dams;

- ◆ Continuing to work with DHS and the Federal Bureau of Investigation to coordinate a national security response at dams;
- ◆ Leading interagency coordination on federal infrastructure security at dams, including the creation of the Government Coordinating Council for Dams;
- ◆ Continuing coordination efforts between Commission-jurisdictional dam owners and law enforcement and emergency management agencies; and
- ◆ Reviewing the results of 1,050 required vulnerability and security assessments of dams and how licensees are implementing security upgrades.

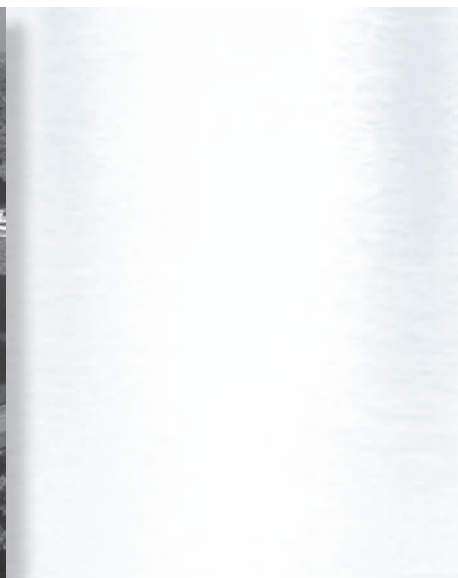
Staff assisted in drafting the National Protection Plan specific to dams and in the creation of the National “Top 100” Critical Dam List. DHS utilized Commission security guidance as the basis for their “Protective Measures Infrastructure Category: Dams” directive. The Commission continued security efforts with the FBI and DHS on several security incidents throughout the country. Staff participated in workgroups, including the Government Coordinating Council for Dams, the Interagency Forum on Infrastructure Protection, a Security Task Force of the National Dam Safety Review Board, and the FERC Hydro Security Task Force, comprised of FERC staff and licensee representatives, to assist in developing a unified and effective national response to security at dams. The Commission also held a three-day security workshop on responding to emergencies at dams: Unifying Dam Safety and Security.

In keeping with the Commission’s goal to strengthen relationships with other federal agencies, the staff developed a Memorandum of Understanding with the U.S. Army Corps of Engineers to better define the roles and responsibilities of each agency, and the necessary interaction related to the defining of project purpose and need and scope of alternatives discussed in EISs.

Allow prompt recovery of prudently-incurred expenses to safeguard and enhance the reliability, security and safety of the energy infrastructure

In FY 2005, the Commission timely processed all 14 oil pipeline and three gas pipeline proposals to recover prudently incurred costs to safeguard the security and safety of energy transportation and supply infrastructure. Specifically, the Commission approved surcharges to recover capital costs (including costs to enhance security) for two natural gas pipelines, a recovery of software costs to meet security requirements for an electric public utility, and security surcharge requests received from oil pipelines. The Commission also timely processed 313 proposals to recover prudently incurred costs to improve the reliability of the transmission grid. Through the timely processing of these filings, the Commission has aided the companies in promptly recovering their costs.

During the 2005 hurricane season, the Gulf of Mexico region endured two major hurricanes that caused major disruptions to the nation’s energy infrastructure. In anticipation of flooding and wind damage, gulf coast pipelines evacuated personnel and shut down their systems. The storms had direct and devastating effects. Energy production was shut-in, natural gas processing plants were closed and natural gas pipelines were seriously damaged. Safety inspections and damage assessments continue. Section 260.9 of the Commission’s regulations requires natural gas pipeline companies to report service interruptions to firm customers lasting three or more hours. However, in the occurrence of a major event, such as Hurricanes Katrina and Rita, FERC requested all regulated companies, as well as the various industry associations (American Gas Association, Interstate Natural Gas Association of America), to report all service interruptions and related infrastructure issues. For easy reporting FERC established a central e-mail address: pipeline.service.interruptions@ferc.gov.



SECTION 3

COMPETITIVE MARKETS: BENEFITING THE CONSUMER

One of the Commission's primary goals is to prevent the exercise of market power by wholesale power sellers, electric transmission companies, and natural gas and oil pipelines. This is accomplished by striking the right balance between competition and regulation. Achieving this balance has been particularly challenging for electricity where Congress has not deregulated the underlying commodity, as it did for natural gas, and where basic generation and transmission siting authority and retail regulation remain with the states. The Commission has been steadily reforming its electricity policies to find this balance in its regulation of wholesale power sales and transmission. The Commission will continue its generation policy reforms, as appropriate, and is undertaking reforms to transmission open access and pricing policies.



The Commission still believes competition is the right national policy for wholesale power markets – when combined with effective regulation. Meeting this goal includes two objectives:

- ◆ *Promoting Effective Competition in Electric Gas Markets.* Commission policies must recognize the differences in regional power markets, prevent the exercise of market power, and improve transparency. The Commission also needs to take steps to lower trade barriers among regions.
- ◆ *Establishing Clear Market Rules to Govern Electric Markets.* Reforming transmission open access policies to prevent undue discrimination and preference and providing regulatory certainty through our rules and case-specific decisions will provide the first line of customer protection in competitive wholesale energy markets.

In addition, the Commission continued to beef up its market monitoring capabilities, greatly augmented by EPAAct's new penalty authority.



PROMOTE EFFECTIVE COMPETITION IN ELECTRIC AND GAS MARKETS

Current Commission policy promotes the voluntary formation of RTOs and ISOs, as evidenced by the Commission's July 2005 order terminating the proposed Standard Market Design rule. The Commission is promoting the voluntary formation of RTOs to promote efficiency in wholesale electricity markets and the lowest price possible for reliable service.

The key to expansion of organized markets is whether the existing RTOs and ISOs prove to be a success and deliver on their promised benefits. During FY 2005, two RTOs became operational, bringing the number of RTOs that serve various regions of the country to six. These two applications were processed within six months of the filing. A number of existing RTOs expanded or adopted important market reforms. These include:

- ◆ Southwest Power Pool (SPP), covering Kansas and Oklahoma, and parts of Missouri, New Mexico, Texas, Louisiana and Arkansas, was granted full recognition as an RTO on October 1, 2004, subject to limited compliance issues.
- ◆ ISO New England (ISO-NE), serving the New England region, achieved RTO status on February 1, 2005.
- ◆ ISO-NE adopted revisions to implement a test program to address differences in market rules across regions, including changes to scheduling of energy transactions between the New England and New York control areas and allowing for the partial de-listing of capacity resources for sales to neighboring control areas.
- ◆ American Electric Power, with its facilities in Indiana, Kentucky, Michigan, Pennsylvania, Ohio and Virginia, was integrated into PJM on October 1, 2004; and Duquesne Light Company was integrated into PJM effective January 1, 2005.
- ◆ PJM added Virginia Electric Power Company as a transmission owner to form "PJM South" on May 1, 2005,

which extended the RTO's geographic scope throughout Virginia and into a portion of North Carolina.

- ◆ PJM adopted revisions to its OATT and restated its operating agreement to create a special membership category to reduce the cost of participation of smaller Curtailment Service Providers that wish to participate in PJM's real-time economic load response program.
- ◆ The Midwest Independent Transmission System Owner (MISO) formally launched its new competitive wholesale power market on April 1, 2005.
- ◆ The New York Independent System Operator (NYISO) adopted revisions to implement a comprehensive planning process for reliability, provisions to reduce the price volatility in NYISO's real-time market that is attributable to real-time forecasting uncertainties rather than to actual market conditions, and provisions that reduce the amount of collateral required by virtual transactions.

Additionally, the Commission gave preliminary positive guidance to new forms of regional entities in the Southeast and Northwest. While these entities are not seeking RTO or ISO status, they are proposed as independent entities that will oversee and/or provide regional transmission service, thereby providing an added assurance of nondiscriminatory treatment and greater customer access to low cost power in the region.

Encourage the reduction or elimination of seams between organized markets

Seams issues are trade barriers and inefficiencies resulting from equipment limitations and differences in market rules and designs, operating and scheduling protocols, and other control-area practices that inhibit or preclude the ability to transact capacity and energy sales between regions. Resolving seams differences between regions can lower the cost of transacting power sales between regions, permit dispatch of lower cost power, increase reliability and, ultimately, lower costs to customers. Actions taken during FY 2005 to eliminate seams issues at RTO and ISO boundaries include the following:

- ◆ The Commission accepted filings to eliminate through and out rates (transmission charges for power originating in one region and transmitted to another region) from the combined MISO and PJM regions. The new pricing structure will, after a transition period, eliminate “pancaking,” or multiple charges for transacting across multiple transmission systems, and promote more efficient interstate electricity flows between the two RTOs.
- ◆ MISO and PJM entered into a Joint Operating Agreement (JOA) which became effective April 1, 2005, consistent with MISO’s start-up of its energy markets. The JOA coordinates the market-to-market operations between the entities pending implementation of the joint and common market between MISO and PJM which is under development. MISO also entered into joint operating and/or coordination agreements to coordinate market-to-nonmarket seams resulting from the start of its energy markets with SPP, Mid-Continent Area Power Pool, Tennessee Valley Authority, and Manitoba-Hydro.
- ◆ In PJM and MISO, the Commission conditionally accepted a utility-to-utility interconnection agreement between Indiana Michigan Power Company, a PJM transmission owner, and Northern Indiana Public Service Company, a MISO transmission owner.
- ◆ The Commission accepted a transmission operating agreement between ISO–NE and Maine Electric Power Company, which granted ISO–NE authority to operate its 345 kV intertie between Central Maine Power Company and Bangor Hydro Electric Company, thus integrating Maine Electric Power Company into the New England Control Area.

Support the creation of regional state committees to advise RTOs and ISOs

The Commission has encouraged the establishment of regional state committees to ascertain views of states on the development of regional market rules. In FY 2005, the Commission

convened technical conferences for the Commission, state regulators, and industry officials to discuss regional market design issues. The Commission met in Dallas, Texas, with members of the Southwest Power Pool (SPP) and representatives of the states covered by the newly approved SPP RTO, and in New Orleans, Louisiana, and Jackson, Mississippi, with representatives from Entergy Corporation, its state regulators, and other electric industry market participants, to discuss Entergy’s ICT proposal.

Commission staff located at the MISO continued to work with the Midwest stakeholders on issues regarding pre-filing, tariff implementation, and market protocol implementation. They have met with state regulatory commissions and staffs to discuss seams issues, cost control, financial transmission right allocations, and the treatment of grandfathered agreements.

The Commission continues to have staff at the California Independent System Operator (CAISO), the Commission’s first regional outpost, established in October 2002 after the Western Energy Crisis. At the CAISO, Commission staff meets with state regulatory commission staffs and other state governmental entities on a variety of market design, reliability, and operational issues.

The Commission also encouraged the development of a regional state committee at the recently formed SPP RTO and deployed Commission staff at the SPP RTO offices to work with state regulators and regional stakeholders. The MISO and SPP regional state committees have both proved to be effective organizations.

Promote transparency of competitive electric and gas markets

In order to assure well-functioning competitive markets, the Commission took several steps to promote transparency. The Commission’s standards for internet-based Open Access Same-Time Information System (OASIS) were designed to provide transparency by making information about electric transmission capacity and requests for, and awards of, capacity available to utility customers and the public. The Commission continues to encourage industry’s improvement of OASIS and in May 2005 issued a Notice of Proposed Rule or NOPR to

address, among other things, ways for industry to make business easier through greater transparency and use of OASIS.

The Commission also proposed in May 2005 to update its Uniform System of Accounts and its quarterly and annual financial reporting requirements for public utilities and hydropower licensees, including RTOs and ISOs. The Commission proposed these changes to add visibility and uniformity to accounting and financial reporting for the cost of utility assets and the expenses utilities incur in providing services along with revenues collected from RTO members. The proposed revisions will allow the Commission and the public to better understand transactions and events that affect RTOs and ISOs, and their members.

Ensure that mergers and jurisdictional facility sales are consistent with the public interest

The Commission examines mergers under its jurisdiction and sales of jurisdictional facilities to ensure that they do not harm the overall competitive balance of the energy markets. In FY 2005, the Commission processed 125 corporate applications under section 203 of the FPA. Specifically, the Commission authorized the following:

- ◆ The merger of Exelon and PSEG, creating a combined company with nearly 40,000 megawatts of electricity generation capacity in the PJM and the MISO areas. The Commission based its decision to approve this merger on the applicants' commitment to divest 4,000 MW of intermediate and peaking generation facilities located in PJM, along with the long-term sale of energy from 2,600 MW of nuclear capacity, in order to address the potential harm to competition resulting from the increase in market concentration. This is the largest divestiture ever ordered by the Commission.
- ◆ The acquisition of TNP Enterprises, Inc. and Texas-New Mexico Power Company (TNMP) by PNM Resources. Approval was accepted on TNMP's commitment to continue to participate in regional transmission planning.

- ◆ The acquisition of UniSource Energy, Tucson Electric and UNS Electric by Saguaro Utility Group I Corp.

ESTABLISH CLEAR MARKET RULES TO GOVERN ELECTRIC MARKETS

Reform transmission open access policy to prevent undue discrimination and preference

The electric industry that existed when Order No. 888 was issued has changed considerably. It has evolved from an industry characterized by large, vertically integrated utilities to one with increasing wholesale trade and increasing numbers of independent buyers and sellers of wholesale power. Questions have arisen concerning the continued reasonableness of various non-rate terms and conditions of OATTs. To address these issues, the Commission issued a notice of inquiry in September 2005 to seek comments on what reforms are necessary to the Order No. 888 *pro forma* OATT and to the individual public utility OATTs. The inquiry asks commentators to focus on OATT reforms necessary to prevent undue discrimination and preference in the provision of transmission service.

In addition, the Commission recognized that there are areas where the transmission provider's obligation under Order No. 888 may not be sufficiently clear in some respects. This can be a source of uncertainty regarding the transmission provider's compliance obligation and ultimately makes it difficult to determine whether the terms and conditions of the OATT have been violated. The inquiry asks numerous questions to explore this issue. For example, it seeks comment on whether the OATT needs to better define how public utility transmission providers must respond to a request for transmission service. Similarly, the Commission seeks comment on whether more specific rules, standards, and business practices need to be incorporated into individual public utility tariffs. It is important that jurisdictional entities fully understand their compliance obligations under the OATT and the Commission's inquiry will help this to happen.

Reform market-based ratemaking policy to prevent exercise of market power and provide regulatory certainty

The Commission allows wholesale electric power sales at market-based rates if the seller and its affiliates do not have, or have adequately mitigated market power in generation and transmission and cannot erect other barriers to entry by other suppliers. The Commission also considers whether there is evidence of affiliate abuse or reciprocal dealing. As a condition of a company's authorization to sell power at market-based rates, the company must file an updated market power analysis every three years. These filings help the Commission ensure that market power is not being exercised in wholesale electricity markets. During FY 2005, the Commission handled 434 market-based ratemaking filings and reviewed 346 market-based rates triennial review cases.

In February 2005, the Commission finalized new rules to standardize market-based rate sellers' reporting requirement for changes in status and provide guidance as to the events that would trigger this reporting requirement. The rule benefits customers by ensuring compliance with market-based rates. It also eliminates the option to delay reporting changes in status until the submission of a market-based rate seller's triennial market power analysis. In addition, the Commission requires that the reporting requirement be incorporated into the market-based rate tariffs of each entity that is currently authorized to make sales at market-based rates, as well as that of all future applicants. In May 2005, the Commission issued an order directing companies which were delinquent in filing their market-based rate triennial review to demonstrate that they continue to qualify to charge market-based rates under the new indicative screening process.

Provide regulatory certainty through clear market rules and case specific decisions

Finding that the absence of clear rules governing the wholesale electric industry and other impediments were preventing markets from realizing their full potential, the Commission implemented power market rules designed to help prevent

market abuse, provide a more stable marketplace and create an environment that will attract needed investment capital in the electric and natural gas industries.

The need for clear market rules arose because of persistent and costly problems in the Nation's wholesale electric power markets. These include a decade of under-investment in needed transmission, which raises energy costs by billions of dollars across the grid and exacerbates reliability problems, complaints of unduly discriminatory behavior by transmission providers against independent generators, and deficient market rules in certain existing electricity markets that reduced efficiency of grid operations. Sound market rules and fair and open transmission access, as implemented under these rules, should cure many of these problems.

Proposed market rules evolved over many months as the result of extensive outreach efforts with interested parties. The Commission indicated in its RTO rulings that flexibility is needed to accommodate regional concerns. For example, in FY 2005, the CAISO filed tariff provisions to implement an oversight and investigations program. The CAISO's enforcement protocols provide for monitoring, investigating and enforcing the new rules of conduct included in the CAISO tariff. The Commission conditionally accepted the CAISO's behavioral rules.

Prevent undue preference and self dealing in affiliate transactions

In December 2004, the Commission held conferences to discuss transmission market power and barriers to entry, and additional conferences were held in January 2005 to discuss affiliate abuse and reciprocal dealing and generation market power. In addition, several publicly noticed technical conferences were held regarding market-based rate triennial review filings. In FY 2005, the Commission continued with its compliance efforts to assist the industry in addressing issues associated with undue preference and self dealing. For example, in May 2005 in Chicago, Illinois, the Commission hosted a technical conference to work with the industry to promote compliance. During the conference, Commissioners and Commission staff provided

informal guidance to industry participants regarding implementation of the Standards of Conduct and market-based rate rules.

Similar efforts are underway with regard to Order No. 889 OASIS requirements. In its initial compliance review of 190 transmission providers' internet and OASIS web sites, the Commission found that only 58 transmission providers posted all the required elements. That number has dramatically improved, as all of the companies have followed the mandate and come into compliance. In Phase 2 of its effort, the Commission began on-site operational audits of specific transmission providers to determine whether and how they are complying with the remainder of the requirements of the Standards of Conduct, including the independent-functioning requirement and the information-sharing prohibitions. The Commission completed four of these audits in FY 2005.

Encourage the development of business rules and practices that maximize market efficiency, ease market entry and reduce transactions costs, relying on NAESB, NERC and the RTO/ISOs where appropriate

The Commission has been working extensively with the North American Energy Standards Board's (NAESB) Wholesale Gas Quadrant. In May 2005, the Commission issued a final rule adopting the Wholesale Gas Quadrant's latest standards, which included their Version 1.7 standards, which implemented the Commission's Standards of Conduct, and standards implementing gas quality reporting requirements. The Wholesale Gas Quadrant's Version 1.7 standards include business practice standards dealing with creditworthiness. In June 2005, the Commission issued a policy statement on credit issues relating to transportation on natural gas pipelines.

The Commission is working with NAESB's Wholesale Electric and Wholesale Gas Quadrants on a joint effort to identify and develop business practice and communication standards needed to coordinate the scheduling of electric and gas transactions. In June 2005, NAESB filed a report outlining business practice standards to improve coordination between the two industries during times of weather related emergencies and

highlighting Commission action policy issues that may inhibit such coordination.

Following issuance of a report by the National Petroleum Council and a Commission conference on natural gas quality and interchangeability issues, the natural gas industry initiated an industry-wide collaborative effort to examine the need for, and the possible scope of, industry-wide consensus on these issues. The results of this collaborative effort; two white papers that addressed interchangeability and liquid hydrocarbon drop out, were filed with the Commission in February 2005. The Commission held a technical conference in May 2005 to discuss the white papers. The Natural Gas Supply Association, which participated in the collaborative effort, filed a petition for rulemaking to adopt national standards for gas quality and interchangeability. The Commission solicited comments on this proposal and considered the need for further action.

In addition, in the final rule adopting the Wholesale Gas Quadrant's latest standards, the Commission adopted several standards requiring posting of gas quality information. These standards require a pipeline company to provide a link on its informational posting web site to its gas quality tariff provisions, or a simple reference guide to such information. Furthermore, these companies are required to provide on their website, in a downloadable format, daily average gas quality information for prior day(s) to the extent available for location(s) that are representative of mainline gas flow for the most recent three-month period.

Promote development of policies that accommodate effective demand response programs

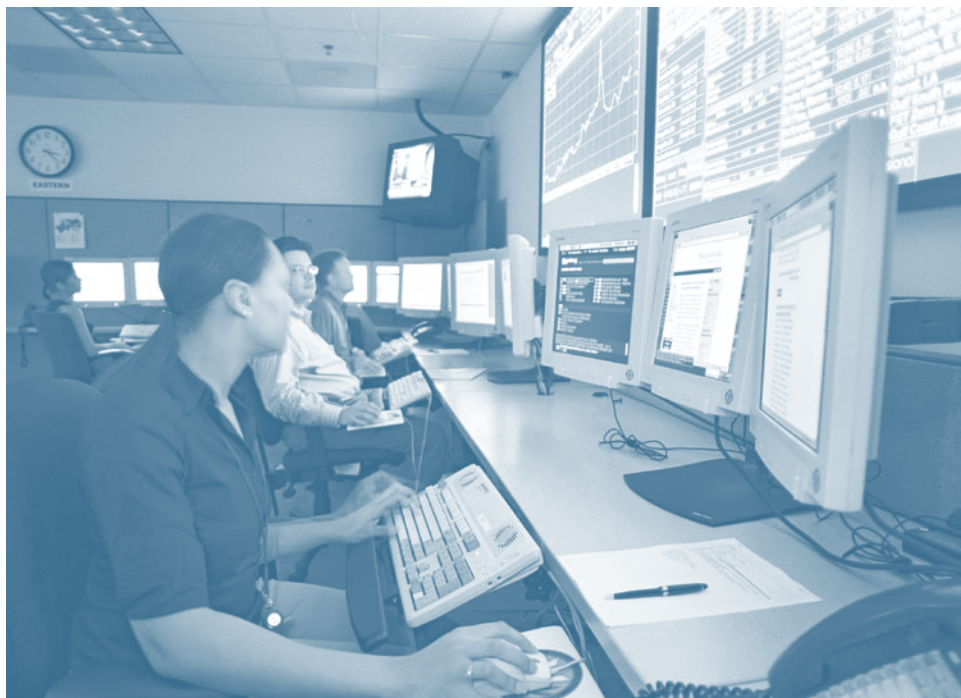
In June 2005, the Commission co-sponsored a National Town Meeting on Demand Response, which included state participation and live web casts to state commissions throughout the United States. In September 2005, the Commission conducted a demand response technical conference with California state officials. At the end of FY 2005, pursuant to EPCRA 2005 section 1252(e)(3), the Commission began preparing a report, by appropriate region, that assesses demand response resources, including those available from all consumer classes.

Remove unduly discriminatory barriers to entry affecting renewable energy

The Commission has conducted extensive outreach with the industry and public on wind energy issues and means to facilitate the renewable energy technology's integration into the nation's highly interconnected electric power grid.

In November 2004, the Commission issued a briefing paper, *Assessing the State of Wind Energy in Wholesale Electric Markets*, followed by a technical conference to discuss the issues associated with integrating wind energy in the energy market. In April 2005, the Commission issued proposed new rules designed to better accommodate an increased participation of wind energy in wholesale markets. The proposal, *Imbalance Provisions for Intermittent Resources*, would encourage the development of renewable resources by removing barriers that affect intermittent resources' access to the transmission grid.

The Commission also made available to the public during FY 2005 a report, entitled *Market Design Principles for Reactive Power*, which described the role of reactive power in establishing reliable power systems. Reactive power supports the voltages that must be controlled for system reliability. The report discussed regulatory policy and reactive power pricing and market design, and looked at the physical characteristics and costs of producing reactive power. A technical conference on principles for efficient and reliable reactive power supply was held on March 8, 2005, to discuss issues raised in the staff report.



SECTION 4

ENFORCEMENT AND OVERSIGHT: GUARDING THE CONSUMER

Competitive markets can only succeed when competition is combined with effective regulation. The Commission's two main objectives in meeting our goal of effective market oversight are:

- ◆ Vigilant and effective oversight of market operations; and
- ◆ Firm but fair enforcement of Commission rules.

The Commission has adjusted its regulatory policies to meet the dramatic changes that have occurred in both the natural gas and electricity industries. While the legal duties of the Commission have not changed – to guard against unjust and unreasonable rates and undue discrimination and preference – the means of discharging this duty have evolved over time. The Commission ordered the unbundling of natural gas sales and transportation in a series of landmark orders, which proved to be an unqualified success. In the wake of these orders, the Commission witnessed:

- ◆ A surge of activity by gas pipelines, as they sought to restructure the way they did business, and the way they interconnect to new markets;
- ◆ Market areas are now served by more pipelines;
- ◆ More competition for shippers' business, who themselves have seen their number of choices increase; and
- ◆ The cost of gas transportation has fallen while throughput has risen.



The Commission seeks to detect violations quickly, publicize misconduct where appropriate, and take prompt action to prevent future misconduct. The Commission can identify violations by many methods, including review of market information required to be filed by market participants, investigation of significant price or market anomalies, periodic audits of compliance with Commission tariffs, rules, and regulations, referrals from RTO and ISO market monitors, and tips and complaints from the public and market participants. It is important that the Commission understands market dynamics, detects problems or issues in energy markets early, prevents violations of its rules, and enforces compliance with the laws under its jurisdiction. Most importantly, the Commission needs to ensure that entities subject to its jurisdiction have effective internal monitoring and compliance programs in place to help assure that they are following established Commission rules and regulations. Commission oversight must then provide an independent and external check to ensure that the compliance programs of each jurisdictional entity are adequate, and to periodically audit compliance with the Commission's rules, regulations and statutory requirements.

VIGILANT AND EFFECTIVE OVERSIGHT OF MARKET OPERATIONS

Strengthen the Commission's ability to perform market monitoring

For trustworthy analyses based on strong empirical evidence to be used as a basis for fair and farsighted decisions, the Commission has strengthened its ability to monitor the markets. This requires access to relevant and timely information about electric and natural gas markets. To achieve this, data systems have been maintained, updated and expanded, largely consisting of the resources available through the Market Monitoring Center to all of Commission staff. One of the Commission's notable improvements to the timeliness and quality of Market Monitoring Center information is the establishment of 17 automated market alerts. These automated alerts notify staff when certain natural gas or electric prices fluctuate beyond a set parameter, and are extremely beneficial to analysts that

would normally need to sift through and analyze large quantities of raw data for price anomalies.

The Commission continued to supplement its data systems with access to RTOs and ISOs data, engaging states and other federal agencies in market oversight and reaching out to market participants. There has been a sustained drive to improve the accuracy of Electric Quarterly Report (EQR) filings. Entities subject to Commission jurisdiction provide summaries of all relevant contracts and identify, in detail, the characteristics of transactions under those contracts during a given quarter. During the fiscal year, the Commission began providing summaries of their submissions to companies that file, highlighting possible inconsistencies. Further, the Commission stepped up its efforts to correct instances of non-compliance with EQR reporting requirements. Also, the Commission initiated an effort to automate initial compliance screening, reviewing all submissions electronically for several key errors and notifying filers of those errors.

As markets have developed, there have been significant changes in the structure of some regulated companies. As part of ongoing oversight efforts, the Commission developed profiles of electric and gas corporations under the Commission's jurisdiction. The profiles provided an overview of corporate strategies, organizational structures, managements, lines of business, financial results and credit and conditions. In addition, the profiles explored company valuation, making comparisons with industry peers. The profiles also indicated if the company held market based rate authority and was applying to acquire or sell generation or transmission assets and if it was under non-public audits or investigations.

While the Commission has access to a large portion of energy and related market data through its Market Monitoring Center data systems, much crucial energy price development takes place in less transparent bilateral physical and derivatives markets. The commission is reviewing its efforts to gathering that information through increased industry interaction, oversight, audit and investigation activities is critical, absent major structural change in these markets.

The Commission developed a standard process to ensure the acquisition of comprehensive and timely market-related information to the Commission. Specific checklists of information sources were developed that market oversight analysts would examine on a regular schedule. This was followed by a specific process to collect, verify and follow up on key market insights that each analyst developed.

Included in the task of overseeing energy markets is analyzing apparent market anomalies such as high prices or abnormal volumes in unexpected places. Such anomalies can indicate problems with data, new patterns of market trading, or gaming of market rules. While information for these analyses largely comes from the Market Monitoring Center, the data is supplemented with information from industry contacts and by following up on audit and investigation results.

Encourage effective RTO and ISO market monitoring units, as permitted by law

Each established RTO and ISO has a Market Monitoring Unit, with six in place today. The May 2005 Policy Statement on Market Monitoring Units provided guidance on their critical roles in evaluating market rules and performance, recommending market improvements, and referring potential violations to the Commission.

In FY 2005, the Commission worked closely with the Market Monitoring Units through monthly conference calls and semi-annual conferences and Commission staff dedicated to specific regions communicated frequently with their Market Monitoring Unit contacts. In addition to RTO and ISO site visits and meetings with the Units, Commission staff directly monitored market development activities such as the start-up of the Midwest ISO and the rollout of NYISO's new real-time market software. Also, Commission staff worked with the RTO and ISO Market Monitoring Units to enhance performance metrics that will enable them to measure themselves against others, and to strengthen their market monitoring abilities.

Identify and remedy problems with market structure and operations, and periodically review market rules for consistency with long-term market development

An important task of guarding the consumer is to identify market problems as they develop, so that the Commission can rectify them quickly. The Commission continually observes market developments via the Market Monitoring Center, reports new issues that develop in various internal reports, and strives to anticipate responses to long periods of relatively high energy prices. Other activities during FY 2005 included:

- ◆ Pursuing follow-up efforts on price transparency;
- ◆ Calling attention to the illiquidity of certain gas price indices and promoting discussion or remedies;
- ◆ Investigating the communication of non-public storage inventory information in violation of the Commission's Standards of Conduct; and
- ◆ Improving working relationships with the Commodity Futures Trading Commission (CFTC), Department of Justice (DOJ), and states and federal agencies to encourage public discussion and resolution of energy industry problems such as capital availability for energy markets, credit issues, natural gas price formation, and price discovery and indices.
- ◆ Encouraging self-reporting of violations by regulated entities and improving the process for regulated entities to seek clarification of Commission rules.

An example of the Commission's market anomaly analysis is the investigation into the November 2004 natural gas storage reporting error by the Energy Information Administration (EIA). In one of its Weekly Natural Gas Storage Report, the EIA showed a net withdrawal much higher than anticipated by market observers. The higher than expected report caused prices for expiring New York Mercantile Exchange contracts to rise by more than \$1/MMBtu in December 2004 and January 2005. The Commission sent a data request to the ten largest storage operators to

determine if an error had been made in compiling data reported to the EIA. We determined that an erroneous report had been submitted by Dominion Transmission, causing the market prices to jump. Further investigation showed that the reporting error was inadvertent and that Dominion did not profit from it. Subsequent to this investigation, the EIA proposed and adopted changes to its Weekly Natural Gas Storage Report.

Assess market and infrastructure conditions and incorporate analysis into Commission decisions

The Commission has developed benchmarks and standardized graphics to monitor natural gas, electric, associated fuel, financial and equity market conditions and developments, to show systematically how well markets are operating. Specifically, the Commission has identified several key data requirements to analyze energy markets via its Market Monitoring Center.

Also, the Commission, worked closely with RTO and ISO Market Monitoring Units in developing a variety of measures to help assess and compare the performance of RTO and ISO markets. The measures show trends in prices, demand, trading, the climate for investment in supply, and market concentration. In spring 2005, RTO and ISO market monitors provided Commission staff the necessary market data for staff to compile and report on 13 annual "market metrics." The purpose of the report is to provide information to the Chairman and Commissioners on the health of RTO and ISO markets.

Staff reports systematically review data to help identify irregular behavior or patterns that reflect potential market manipulation. Staff analyses of market operations have been incorporated into Commission decisions, such as orders on tariffs for organized markets and actions taken to improve the accuracy, reliability, and transparency of wholesale price indices. Orders on the organization and operation of the CAISO, ISO-NE, PJM, and NYISO have been influenced by observations and information gleaned from staff oversight of these markets.

In addition to monitoring the markets and reporting, routinely, to the Chairman and Commissioners, the Commission generated reports on market developments throughout the year, some for internal use and some made available to

the public. These reports identified problems including EIA's storage reporting process, major weather disturbances (i.e. Hurricanes Katrina and Rita), and pre-summer market issues in California and the West. Overall, the reports identify key problems for the Commission to consider, present possible responses, and, in the case of apparent behavioral problems, lead to further investigations and audits. The reports are:

- ◆ Special Reports: developed during and after major market events, they provide updates and in-depth analysis.
- ◆ State of the Markets Report: a public document, which gave a comprehensive review of the preceding year and provides measures for energy market performance.
- ◆ Energy Market Surveillance Report: developed every three weeks for internal use, to provide information on new developments in energy markets and updates general energy market information.
- ◆ FY 2005 Seasonal Assessments: developed semi-annually to highlight key issues in the electric and natural gas industries prior to the heating and cooling seasons. The Commission issues the two assessments in public Commission meetings.
- ◆ Snapshot Reports: developed from the Commission's periodic staff reports, and offered to State Commissions and RTO Market Monitoring Units and currently delivered to 19 State Public Utility Commissions and five RTOs. For New England and the West, the Snapshot Reports are supplemented with periodic conference calls to discuss key issues raised in the reports.

FIRM BUT FAIR ENFORCEMENT OF COMMISSION RULES

Improve the Commission's enforcement capabilities

EPAAct 2005 gave the Commission substantial new enforcement responsibilities. First, the law provides for Commission enforcement of the express prohibition of manipulation of electricity and gas markets. The new law allows the Commission to issue rules to implement this provision, and enforcement will require making swift decisions on potentially manipulative practices.

The second enforcement responsibility under the new law is the Commission's authority to enforce reliability standards. Under the law, the Commission is responsible for reviewing preliminary enforcement actions taken by the ERO, a self-regulatory organization. While there were approximately 338 reliability standards violations in 2004, the first year the North American Electric Reliability Council began reporting this information, it is difficult to estimate how many enforcement actions the ERO will take, and how many would be reviewed by the Commission. In addition, the Commission is also authorized to initiate enforcement action on its own motion, which is a new enforcement responsibility for the Commission.

In FY 2005, the Commission's enforcement and audit staff received training in current forensic techniques and tools to assure that they are training in the latest investigations and auditing techniques.

Implement the market power and enforcement provisions of EPAAct 2005

With the passage of EPAAct 2005, the Commission was granted enhanced civil penalty authority and a clear mandate to prevent market manipulation. The Commission now has authority to impose civil penalties of up to \$1 million per day per violation for violations of rules, regulations, and orders under the NGA and all of Part II of the FPA, and up to \$1 million for any violation of the Natural Gas Policy Act of 1978.

Investigate statutory and rule violations, imposing penalties where appropriate and promptly terminating investigations when no violations are identified

In FY 2005, the Commission completed 16 operational audits, 18 financial audits and 29 investigations of energy companies and municipalities, including natural gas pipelines and electric utilities. These audits and investigations resulted in refunds, penalties and payments of more than \$67 million. The twenty-six operational audits the Commission completed focused on transmission market power, tariff compliance, affiliate abuse, standards of conduct and code of conduct compliance, and filing requirements. These operational audits resulted in stringent compliance plans containing 87 corrective actions involving organizational, procedural, and process remedies. In addition, the Commission ordered refunds of \$10.5 million to energy customers as a result of its operational audits.

The 18 financial audits the Commission completed during FY 2005 covered a wide range of financial accounting and reporting topics, including cash management compliance filings, data reported by gas pipelines in FERC Form No. 2 reports, RTO and ISO operations, and formula rate billings. Currently, audits are underway to examine EQR data submissions and compliance under the Commission's interlocking directorate rules for officers and directors of electric companies, operating expense data reported by electric companies in FERC Form No. 1 reports, and nuclear decommissioning trust fund accounting for a nuclear generating unit undergoing decommissioning.

The Commission's 29 investigations focused on possible instances of market power and manipulation, undue discrimination or affiliate abuses, violations of rules and tariffs and the Enron-related manipulation of short-term prices in the electric or natural gas markets or undue influence over wholesale prices during the western energy market crisis of 2000 and 2001. Additionally, the Commission has investigated the communication of nonpublic storage inventory information in violation of the Commission's Standards of Conduct rule. Many of the settlements also included strict compliance plans containing numerous process and procedural remedies. Some notable examples are:

- ◆ American Electric Power Company, Inc. (AEP), American Electric Power Service Corporation and AEP Energy Services, Inc. Commission staff investigated allegations that a wholly-owned pipeline provided transportation service on an unduly preferential basis to an affiliated marketer. The Commission approved a settlement in which the named companies agreed to pay a \$21 million civil penalty and to adhere to a detailed four-year compliance plan to settle. Commission staff coordinated its investigation with the CFTC and DOJ, each of which also assessed penalties in settlements.
- ◆ Commission staff conducted an audit of MidAmerican Energy's (MidAmerican) compliance with its OATT, Standards of Conduct, Codes of Conduct, OASIS, and Order No. 2004 information posting requirements. In response to findings of three major areas of noncompliance, MidAmerican agreed to build \$9.2 million in unplanned transmission system upgrades and to accelerate another \$14.7 million in planned transmission improvements. MidAmerican also agreed to implement a strict compliance plan to ensure future compliance with FERC regulations.
- ◆ Commission staff continued to achieve settlements in the California Refund Proceedings, which arose from the California energy crisis of 2000 and 2001, including settlements with Mirant (already approved by the Commission) and with Enron, Reliant, and Public Service Company of Colorado (with settlement approvals pending). These settlements will result in more than \$2.5 billion in refunds to consumers.

These cases and others show the Commission's increasing ability to audit and investigate market abuses and its continuing commitment to effectively police tariff and rule violations. This ability has recently been enhanced by EPCRA 2005 that has provided the Commission with even greater tools to enforce its statutes, orders and rules.

Encourage settlements to resolve disputes in an expeditious manner

The Commission encourages parties to use alternative dispute resolution (ADR) whenever appropriate to resolve conflicts. ADR supports the Commission's objective to be more citizen-centered, results-oriented, and market-driven. The Commission's experience with ADR demonstrates that it provides for effective public participation in government decisions, encourages respect for affected parties, averts future complaints that enable the Commission to direct more of its resources for critical matters, and avoids costs that would normally finance extensive litigation.

Overall, in FY 2005, the Commission specifically facilitated and accepted the following settlements:

- ◆ In December 2004, Duke Energy agreed to settle Western Energy Crisis issues with States and FERC.
- ◆ In January 2005, AEP Co. agreed to a settlement to resolve an investigation into the natural gas storage and transportation activities of two intrastate pipeline units formerly owned by the Columbus, Ohio-based utility holding company, and AEP-affiliated marketers.
- ◆ In June 2005, Williams Companies to pay \$7.6 million in refunds and civil penalty to settle a staff investigation into sharing of natural gas storage information.
- ◆ In July 2005, Staff facilitated Enron's proposed \$1.5 billion agreement to settle California energy refund and gaming issues.
- ◆ In August 2005, Reliant Energy agreed to pay \$460 million to settle Western Energy Crisis issues with States and FERC.

In FY 2005, the Commission's Dispute Resolution Service (DRS) continued to be a great resource for facilitation and mediation, and offers consultation and training in effective facilitation and negotiation skills to individuals and organizations that do business with the Commission, state agency personnel, and Commission staff. To help achieve the objective of increased use

of ADR, the DRS is implementing the Commission's Conflict Resolution Training Program, which emphasizes training staff in negotiation and facilitation skills, as well as conflict assessment, early neutral evaluation, and the design and maintenance of a successful collaborative process. This effort has further increased exposure for the Commission's DRS and consistently results in successful mediation of at least 75 percent of the cases referred to it.

Act swiftly on complaints, using administrative litigation as needed to determine factual issues

In FY 2005, the Commission made a concerted effort to provide timely resolution of third-party complaints. The Commission issued initial orders 50 percent of the time within 60 days of the filing of the complaint. In many cases, however, extension requests by the parties, complainant withdrawal of complaints, and deferral requests by the parties to pursue settlement made it difficult for the Commission to process these complaints in such an expeditious manner.

The Enforcement Hotline is also widely used by the public to informally resolve disputes in matters within the Commission's jurisdiction without litigation or other formal, lengthy proceedings. Hotline staff mediators resolve disputes, including landowner/pipeline disputes, tariff disputes, market disputes and disputes over procedural questions. In some cases, the complaints have been resolved at the initial stages while some complaints are processed through administrative litigation to determine contentious factual issues. In FY 2005, the Enforcement Hotline closed out 74 percent of the calls within two weeks of initial contact.

Encourage self-reporting of violations by regulated entities and improve processes to allow regulated entities to seek clarifications of Commission rules

It is incumbent upon the Commission to ensure that its market, reliability, and other regulatory rules are clear, enforceable and fully understood by the jurisdictional entities regulated. However, the obligation to comply with those regulations, rules and standards lies with the regulated entity. Therefore, it is important that regulated entities have a rigorous internal compliance program that provides them with the tools, processes, and high-level management support to identify problems or areas of noncompliance and to report such problems to the Commission. The Commission needs to work with entities it regulates to help them develop and maintain good compliance procedures such that any necessary enforcement actions by the Commission (including penalties or sanctions) are a regulatory tool of last resort – invoked only when the compliance process has failed.

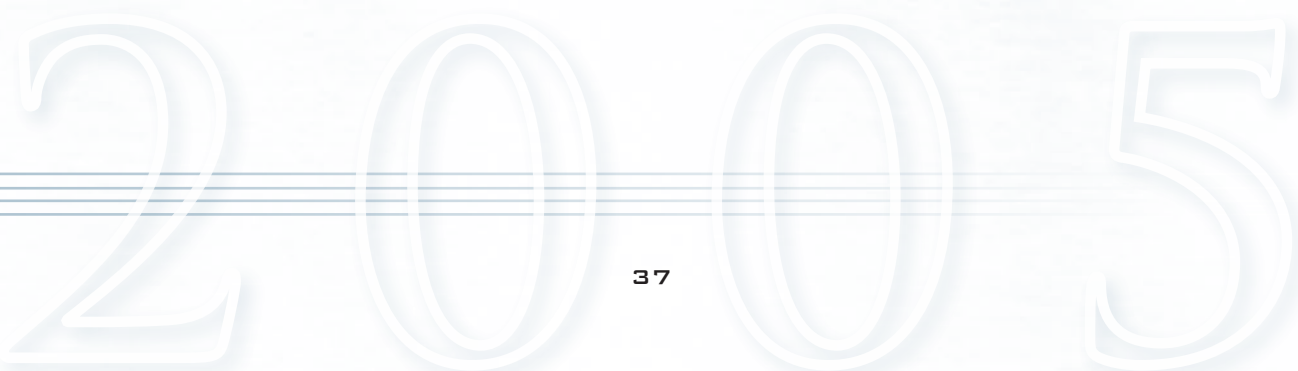


APPENDIX A

Hydroelectric Power Table

(Projects For Which Licenses Will Expire Between January 1, 2005 and December 31, 2010)

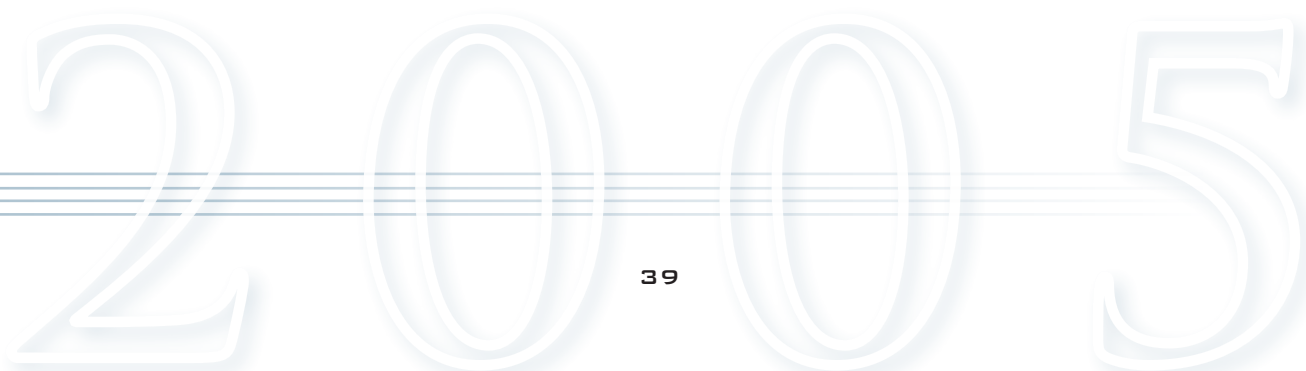
LICENSE EXPIRATION DATE	LICENSEE	FERC PROJECT No.	STATE	COUNTY	RIVER	INSTALLATION {KW}	PERIOD OF YEARS	FACILITIES UNDER LICENSE	SUBJ. FED.
2/28/2010	Energy Northwest	2244	VA	Lewis	Lake Cr	26125	50	DM PH	Y
3/31/2010	Appalachian Power Co	2210	ID	Campbell	Roanoke R	636000	50	DM PH	Y
4/10/2010	Consumers Energy Co	785	MI	Allegan	Kalamazoo R	2550	30	DM PH	Y
4/12/2010	Jacobson Eric R	733	CO	Ouray	Uncompahgre R	700	30	DM PH	N
4/30/2010	Willis Ken	1992	CA	Tehama	Fern Springs C	15	30	DM PH	N
6/30/2010	Public Service Co of CO	400	CO	Laplata	Animas R	11500	25	DM PH	Y
6/30/2010	Idaho Power Co	503	ID	Ada/Owyhee	Snake R	25000	40	DM PH	Y
8/11/2010	Kaukanuna	2677	WI	Outagamie	Fox R	8000	20	PH	Y
8/31/2010	South Carolina Elec & Gas	516	SC	Richland	Saluda R	207300	25	DM PH	Y
10/31/2010	Mackay Bar Corp	3041	ID	Idaho	Smith CR	12	30	DM PH	N
2/28/2005	Tapoco Inc	2169	NC	Blount	Tennessee	326500	50	DM PH	Y
2/28/2005	Southern Calif Edison Co	382	CA	Kern	Kern R	12000	30	DM PH	Y
3/31/2005	Northern States Power Co	2181	WI	Dunn	Red Cedar R	5400	50	DM PH	Y
3/31/2005	Northern States Power Co	2697	WI	Dunn	Red Cedar R	6000	20	DM PH	Y
3/31/2005	Southern Calif Edison Co	2174	CA	Fresno	Rancheria Cr	10800	50	DM PH	Y
4/30/2005	Alabama Electric Coop	2586	AL	Covington	Conecuh R	8250	25	DM PH	Y
4/30/2005	Pacific Gas & Electric Co	178	CA	Kern	Kern R	9540	30	DM PH	Y
5/31/2005	City of Marshall, Michigan	6514	MI	Calhoun	Kalamazoo R	319	20	DM PH	N
5/31/2005	Grand River Dam Auth	2183	OK	Mayes	Neosho R	100000	50	DM PH	N
6/30/2005	N. E. W. Hydro Inc Et Al	7264	WI	Outagamie	Fox R	1390	20	DM PH	N
6/30/2005	FPL Energy Maine Hydro	2194	ME	York	Saco R	4000	50	DM PH	Y
7/1/2005	Pacificorp	2630	OR	Jackson	N Fk Rogue R	36760	25	DM PH	Y
7/31/2005	Duke Power	2603	NC	Macon	Little Tennessee	1040	25	DM PH	N
7/31/2005	Duke Power	2602	NC	Jackson	Tuckasegee R	225	25	DM PH	N
7/31/2005	Duke Power	2601	NC	Swain	Oconaluftee R	980	25	DM PH	N
7/31/2005	Idaho Power Co	1971	ID	Adams	Snake R	1166900	50	DM PH	Y
8/1/2005	Duke Power	2619	NC	Cherokee	Hiwassee R	1800	25	DM PH	Y
10/4/2005	Norquest Seafoods, Inc.	620	AK	Aleutian Div	Indian Cr	60	30	DM PH	N



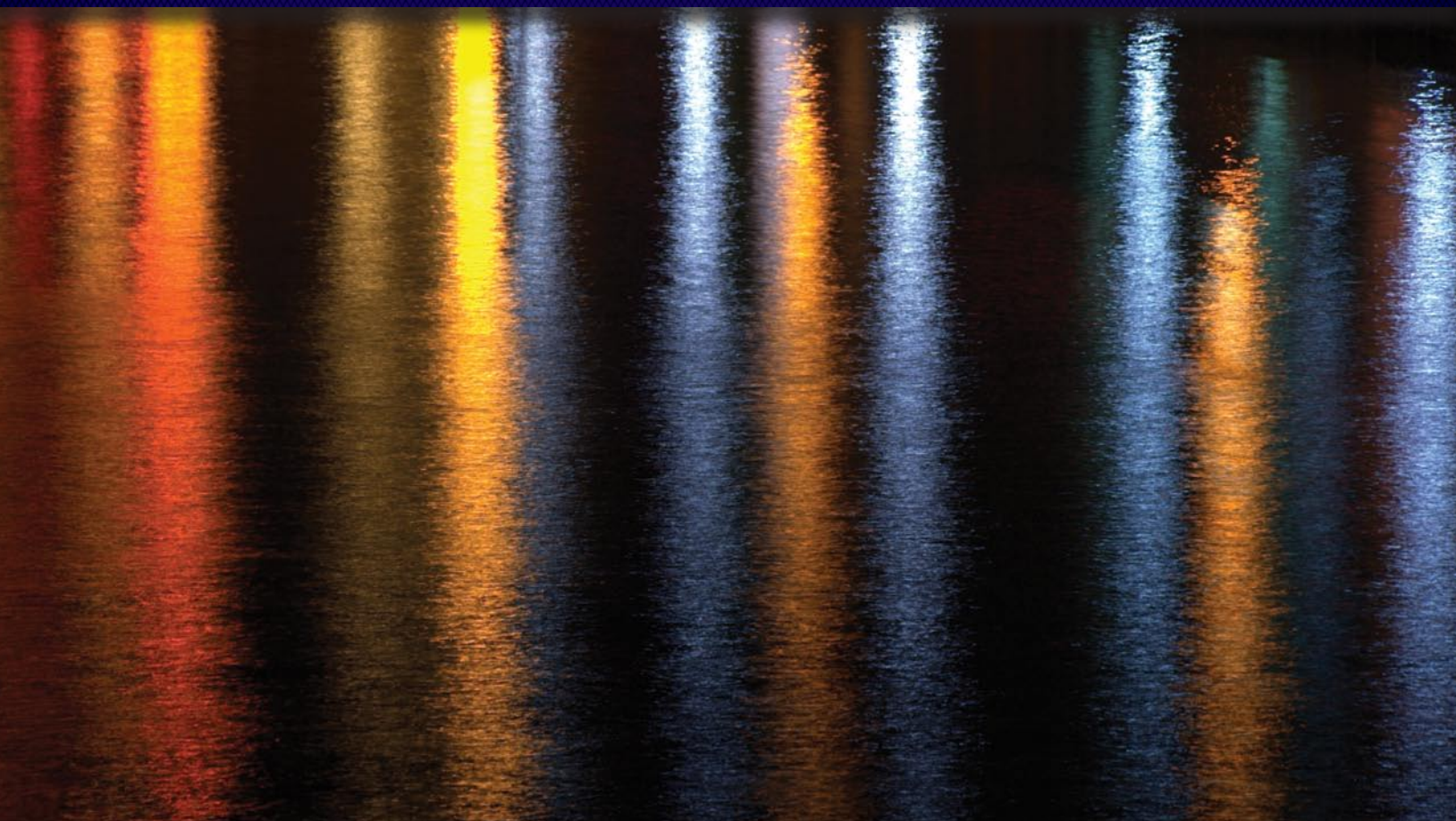
LICENSE EXPIRATION DATE	LICENSEE	FERC PROJECT No.	STATE	COUNTY	RIVER	INSTALLATION {KW}	PERIOD OF YEARS	FACILITIES UNDER LICENSE	SUBJ. FED.
10/31/2005	Erie Boulevard Hydropower	7387	NY	St Lawrence	Raquette R	2700	20	DM PH	Y
10/31/2005	Grant CTY PUD 2	2114	WA	Grant	Columbia R	1755000	50	DM PH	N
11/10/2005	Louisville Gas And El Co	289	KY	Jefferson	Ohio R	80320	30	DM PH	Y
12/31/2005	Public Service Co of NH	1893	NH	Merrimack	Merrimack R	29700	25	DM PH	Y
1/31/2006	Duke Power	2686	NC	Jackson	Tuckasegee R	24600	25	DM PH	N
1/31/2006	Duke Power	2698	NC	Jackson	Tuckasegee	26175	25	DM PH	N
2/14/2006	Monroe City Corporation	632	UT	Sevier	Monroe Cr	250	28	DM PH	N
2/28/2006	Duke Power	2692	NC	Macon	Nantahala R	43200	25	DM PH	Y
2/28/2006	Pacificorp	2082	OR	Klamath	Klamath R	151000	50	DM PH	Y
2/28/2006	Union Electric Co	459	MO	Miller	Osage R	176200	25	DM PH	Y
3/31/2006	SC Public Service Authority	199	SC	Berkeley	Santee R	134520	27	DM PH	Y
4/12/2006	N Y St Elec & Gas Corp	2738	NY	Clinton	Saranac R	38950	26	DM PH	Y
4/30/2006	Cowlitz Co PUD No 1	2213	WA	Skamania	Lewis R	70000	50	DM PH	N
4/30/2006	Puget Sound Pwr and Lt Co	2150	WA	Whatcom	Baker R	162400	50	DM PH	Y
4/30/2006	Pacificorp	2111	WA	Skamania	Lewis R	240000	50	DM PH	Y
4/30/2006	Pacificorp	935	WA	Clark	Lewis R	136000	23	DM PH	Y
6/30/2006	Chelan Co PUD No 1	2145	WA	Douglas	Columbia R	1237400	50	DM PH	N
8/31/2006	Portland General Elec Co	2195	OR	Clackamas	Clackamas R	136600	50	DM PH	Y
11/30/2006	Erie Boulevard Hydropower	7321	NY	Franklin	Salmon R	1000	20	DM PH	N
12/31/2006	City & County of Denver	2204	CO	Grand	Williams Fk R	3000	50	DM PH	N
1/31/2007	CA Dept of Water Res	2100	CA	Butte	Feather R	762850	50	DM PH	N
2/28/2007	Holyoke City of MA	7758	MA	Hampden	Holyoke Cnl	760	20	PH	N
3/27/2007	Pacific Gas & Electric Co	606	CA	Shasta	Cow Cr	4440	30	DM PH	Y
3/31/2007	Flambeau Hydro, LLC	9185	WI	Burnett	Clam R	1200	20	DM PH	N
4/30/2007	Garkane Power Assoc, Inc.	2219	UT	Garfield	W Fk Boulder	4300	50	DM PH	Y
4/30/2007	Chugach Elec Assn ,Inc	2170	AK	Seward Div	Cooper Cr	15000	50	DM PH	Y
6/9/2007	Flambeau Hydro, LLC	9184	WI	Burnett	Yellow R	1076	20	DM PH	N
7/31/2007	Pacific Gas & Electric Co	2155	CA	El Dorado	S Fk American R	7000	45	DM PH	Y
7/31/2007	Alabama Power Co	618	AL	Elmore	Coosa R	100000	27	DM PH	Y
7/31/2007	Alabama Power Co	82	AL	Chilton	Coosa R	170000	32	DM PH	Y
7/31/2007	Sacramento M U D	2101	CA	Placer	Gerle Cr	640950	50	DM PH	N
7/31/2007	Alabama Power Co	2146	AL	Elmore	Coosa R	690900	50	DM PH	Y
8/1/2007	Avista Corp	2545	ID	Spokane	Spokane R	1366000	35	DM PH	Y
8/29/2007	Alaska Power & Tel Co	1051	AK	Skagway-Yak	Dewey Cr	943	30	DM PH	N
8/31/2007	Alabama Power Co	2165	AL	Tuscaloosa	Black Warrior	203250	50	DM PH	Y
8/31/2007	South Carolina Elec & Gas	516	SC	Newberry	Saluda R	207300	23	DM PH	Y
8/31/2007	New York Power Authority	2216	NY	Niagara	Niagara R	2755500	50	DM PH	Y
11/30/2007	Wolverine Power Corp	2785	MI	Midland	Tittabawassee	3300	20	DM PH	Y
11/30/2007	Southern Calif Edison Co	2085	CA	Fresno	San Joaquin R	150938	50	DM PH	Y

LICENSE EXPIRATION DATE	LICENSEE	FERC PROJECT No.	STATE	COUNTY	RIVER	INSTALLATION {KW}	PERIOD OF YEARS	FACILITIES UNDER LICENSE	SUBJ. FED.
12/31/2007	Montana Power, L.L.C.	2543	MT	Missoula	Clark Fk R	3200	40	DM PH	Y
3/31/2008	Sitka City of & Borough AK	2230	AK	Sitka Division	Medvetcha R	7540	50	DM PH	N
4/30/2008	Hyrum City Corp Utah	946	UT	Cache	Blacksmith Fk	400	27	DM PH	N
4/30/2008	Ottumwa City of Iowa	925	IA	Wapello	Des Moines R	3250	26	DM PH	N
4/30/2008	Progress Energy Carolinas	2206	NC	Stanly	Pee Dee R	108600	50	DM PH	Y
4/30/2008	Alcoa Generating	2197	NC	Davidson	Yadkin R	209520	50	DM PH	Y
6/15/2008	Virginia Elec & Pwr Co	906	VA	Amherst	James R	7500	30	DM PH	Y
8/9/2008	Crisp County Power Comm	659	GA	Worth	Flint R	15200	30	DM PH	N
8/31/2008	Duke Power	2232	NC	Alexander	Catawba R	804940	50	DM PH	Y
9/30/2008	Pend Oreille Cty PUD 1	2225	WA	Pend Oreille	Sullivan Cr	0	50	DM PH	N
11/30/2008	Eugene City of OR	2242	OR	Linn	Mckenzie R	124500	50	DM PH	N
2/28/2009	Georgia Power Co	2237	GA	Fulton	Chattahoochee	16800	50	DM PH	Y
2/28/2009	Eagle & Phenix Hydro Co	2655	AL	Muscogee	Chattahoochee	27660	50	DM PH	Y
2/28/2009	Southern Calif Edison Co	2175	CA	Fresno	Big Cr	150150	50	DM PH	Y
2/28/2009	Southern Calif Edison Co	120	CA	Fresno	San Joaquin R	165675	32	DM PH	Y
2/28/2009	Southern Calif Edison Co	67	CA	Fresno	Big Cr	373320	38	DM PH	Y
3/31/2009	Oroville-Wyandotte Dist	2088	CA	Butte	S Fk Feather R	104100	50	DM PH	N
5/31/2009	Augusta Canal Authority	9988	GA	Richmond	Augusta Cnl	2050	20	DM PH	Y
7/31/2009	Public Service Co of NH	7528	NH	Coos	Connecticut R	1100	25	DM PH	N
8/31/2009	Boulder, City of	1005	CO	Boulder	Boulder Cr	20000	28	DM PH	Y
10/11/2009	Pacific Gas & Electric Co	803	CA	Butte	Butte Cr	26650	30	DM PH	Y
10/31/2009	Littleville Power Co Inc	2801	MA	Berkshire	Housatonic R	1140	30	DM PH	N
12/31/2009	Moss, Richard	6885	CA	Mono	Middle Cr/Birch Cr	175	50	DM PH	N
12/31/2009	PP&L Montana, L.L.C.	2301	MT	Stillwater	W Rosebud Cr	10000	33	DM PH	Y
2/28/2010	Energy Northwest	2244	VA	Lewis	Lake Cr	26125	50	DM PH	
3/31/2010	Appalachian Power Co	2210	ID	Campbell	Roanoke R	636000	50	DM PH	
4/10/2010	Consumers Energy Co	785	MI	Allegan	kalamazoo R	2550	30	DM PH	
4/12/2010	Jacobson Eric R	733	CO	Ouray	Uncompahgre R	700	30	DM PH	
4/30/2010	Willis Ken	1992	CA	Tehama	Fern Springs C	15	30	DM PH	
6/30/2010	Public Service Co of CO	400	CO	Laplata	Animas R	11500	25	DM PH	
6/30/2010	Idaho Power Co	503	ID	Ada/Owyhee	Snake R	25000	40	DM PH	
8/11/2010	Kaukanuna	2677	WI	Outagamie	Fox R	8000	20	PH	
8/31/2010	South Carolina Elec & Gas	516	SC	Richland	Saluda R	207300	25	DM PH	
10/31/2010	Mackay Bar Corp	3041	ID	Idaho	Smith CR	12	30	DM PH	

*Includes types of facilities at each project, but not total number of each type (e.g. A project may consist of multiple powerhouses of dams). DM Dam, RS Reservoir, CL Canal, TU Tunnel, FM Flume, PL Pipeline, PK Penstock, PH Powerhouse, TR Turbine, GN Generator(s), TC Tailrace, TL Transmission Line or connection thereto.







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