

TRANSITION ADVISORY COMMITTEE

October 4, 2001

Original Minutes with Attachments

Please note: These are summary minutes. Testimony and discussion are paraphrased and condensed. Committee tapes and Exhibits are on file at the offices of the Legislative Services Division.

COMMITTEE MEMBERS PRESENT

Sen. Fred Thomas	Larry Nordell (for Art Compton)
Sen. Emily Stonington	Gary Wiens (for Dave Wheelihan)
Rep. Stanley Fisher	Gene Leuwer
Rep. Jim Keane	Bob Nelson
	Russ Ritter
Rep. Alan Olson	Kathie Roos
Sen. Alvin Ellis	Gary Willis (for Pat Corcoran)
Sen. Walter McNutt	Matt Brainard
Sen. Linda Nelson	Jerry Driscoll
Rep. Roy Brown	Dave Kinnard
	Kathy Rice

COMMITTEE MEMBERS EXCUSED

Sen. Don Ryan
Rep. Steve Gallus
Rep. Tom Dell
Jerry Driscoll
Stephen Bradley

STAFF MEMBERS PRESENT

Jeff Martin, Legislative Research Analyst
Todd Everts, Legislative Attorney

I DISCUSSION AND REVIEW OF MEETING GOALS AND STRUCTURE

SEN. THOMAS said that the reason this meeting is being held in Big Sky is to get away from the politics of this issue. Today's purpose is to learn as much as possible about energy issues. It is designed to start from the most elementary to the most complex. The Committee is encouraged to ask

questions and otherwise interact with the presenters. Everybody has something to learn.

II SITUATION ANALYSIS: HOW DID WE GET WHERE WE ARE?

- ***History and Review of Why Many States Began the Move Towards Retail Electric Restructuring***

Matthew Brown, NCSL, said that NCSL (National Conference of State Legislatures) is a nonpartisan organization. They are not here as a proponent of any particular view, they are here to provide an educational forum. He said he would be discussing the Federal Power Act (FPA), which is underlying a lot of what the states are trying to do; talk about the Public Utility Regulatory Policies Act (PURPA), which is a 1978 federal law, which also underlies a lot of what the states are trying to do; and the Federal Energy Regulatory Commission (FERC) orders.

The FPA was one of a series of federal laws that were enacted in the mid 1930s dealing with how the federal government was going to regulate the electric power industry. It was to make sure that there would not be unregulated monopolies and predatory pricing. Over the last 50 to 60 years the FPA has been interpreted again and again through a series of court cases. In essence the FPA defined jurisdiction over the electric power industry.

In the electric power industry there are 3 parts: the distribution end, which is the low voltage power system that serves retail customers, which is and will be under state control; the transmission system, which is often the high voltage power lines that feed into the distribution system. The transmission system is a subject of changing jurisdiction. Depending on how it is structured it could be under state or federal jurisdiction. Generation is the final component of the electric power industry. Generation has been under state regulation, but this is what people are talking about when they are talking about competition in the power markets.

The utility system grew up from essentially a very small system within a municipality for instance, where there was one company originally owning a small generator and power lines that went into a house. This has grown up and expanded geographically since then. The electric utility system hasn't always been the most well thought-out, well planned expansion. In many cases it has been a haphazard growth in the power system. One company, until recently, owned generation, the transmission, the distribution as a vertically integrated business. The company charged one bundled rate for power. A bundled rate means that the rate includes all parts of the electric industry. Transmission has been sold as part of this bundled product.

As we move toward deregulation, utilities across the country are selling generation as a separate product through a variety of structures. The rate has become unbundled. Under this billing there might be three separate products sold separately under different kinds of regulation. That unbundling triggers federal jurisdiction.

SEN. STONINGTON asked whether under a state regulated monopoly, could the Montana Power

Co. (MPC) have sold its generation assets without being deregulated by the state. **Mr. Brown** said that it could have, but it would have been subject to approval by the utilities commission and potentially by federal entities as well. **SEN. STONINGTON** said that MPC would have had to be permitted to do so. **Mr. Brown** said that was correct.

Matthew Brown continued by asking once those assets are sold, what happens to the proceeds of that sale? If the proceeds of that sale exceed to a significant degree the price that was put on the book, what happens to the excess? Does it go to the ratepayers, shareholders, or others? That is something that the Commission would decide.

SEN. ELLIS asked if it was sold under a regulated basis, would the price have been less.

Mr. Brown said that it gets into speculation. When utilities made this transition from a regulated to a differently regulated marketplace, the utilities had made a lot of investments and were recovering those investments through the rates. The idea was that those power plants would be worth a great deal less in a competitive marketplace than they previously had been. There had been speculation that there could be stranded costs in excess of tens of billions of dollars for the nation. What actually happened was that the first power plants to be sold were sold at twice or three times what anybody had thought.

Matthew Brown discussed federal jurisdiction over the electric industry. The electric business started out with small municipalities building their own generation systems and then gradually getting connections from different power plants. Eventually those power lines started to cross state lines. The power system is fundamentally an interstate system. You can't physically tell if power from a certain plant is crossing state lines or not. Power generated from separate power plants will have a physical interaction which will push power over whatever transmission line has the most available capacity. Power will flow to the point of least resistance. That is why there is federal jurisdiction over wholesale power markets.

One of the early court cases was a Connecticut Light and Power case. This went before the Supreme Court which said that the utility will maintain jurisdiction over transmission, distribution, generation, over all the transactions within their state, and the federal government has no control. That argument was put aside. The idea was that all the transactions that you could see were taking place within the state of Connecticut; there was one integrated power system so it could not be demonstrated that power generated from the power plant in Connecticut didn't affect the transmission system throughout the rest of New England. It could be demonstrated that it did affect the power system through the rest of the grid. Fundamentally, from a jurisdictional perspective, the power system is a multi-state system.

Matthew Brown went on to explain why Montana is actually split. There are several primary grids within the country. Except for a few small ties, power generated within the western half of the United States stays within the western half of the United States. Within that, there is a transmission system which is constrained in certain areas. There is a limited ability to get power out of Montana and to the west. Montana has no ability to get power east. This is because of the way the current transmission

system is structured. This makes it hard for many states to get power to California.

REP. KEANE asked if states could get into the transmission business. **Mr. Brown** replied that states can get in the transmission business; however, it is not an easy business to be in. Alaska is the only state that he knows of that has made investments in the transmission system.

REP. KEANE asked what Wyoming is proposing. **Mr. Brown** said that they haven't come up with a specific proposal yet, but Wyoming has talked about making a state investment, setting up some kind of state authority to build a transmission system going out of the state. It is expensive and he doubts that it will happen soon. Wyoming has set up a commission to investigate what the options are. It only makes sense to build the transmission out of Wyoming if there is a market for the power. The market now is not as hospitable to that type of thing as it was six months ago.

SEN. THOMAS said those power plants probably aren't going to be built without a contract to sell that power somewhere. **Mr. Brown** agreed with that.

SEN. THOMAS asked if when the generation was sold, all the issues with that stay with the Public Service Commission's authority; is that common in every state? **COMMISSIONER BRAINARD** said that the PSC didn't approve the sale of the generation assets in the sense that it is an approval. It was more just saying that it was a good thing. The PSC was asked to approve, granting the exemption for wholesale generation status, and that was a condition of the sale. That, in essence, gave approval.

Robin McCue, PSC, commented that the PSC didn't have anything to do with the actual sale of the generation. The agreement of PPL to purchase the generation was contingent upon the PSC agreeing to PPL's exempt wholesale generator status.

Matthew Brown said that one of the keys with any commission is what happens to the money after the sale. That is where the Commission's power really lies; what goes back to the ratepayers, what goes back to the shareholders, et cetera.

Matthew Brown said that FERC can confer market-based authority. This is an authority for a power generator to sell power on the market at market-based rates. FERC looks at a market in which generators are operating and determines whether that market is competitive. They then say that the generator may sell at that market-based rate. What happened in California in the past year was that power prices went way up. There has been the argument that some of the generators exceeded their authority to sell at a market-based rate. FERC has gone back and said that the generators will need to justify the rates that they charge based on what the market will bear. One thing that happens is that you move from state jurisdiction and state regulation over rates for generation to a market-based regulation, but that market-based regulation is overseen by FERC. A lot of people have suggested that FERC should have been exercising stronger authority over the rates that were being charged.

SEN. MCNUTT asked, in the situation where there is not a competitive market, can FERC set a rate.

Mr. Brown replied that, in the situation where there is not a competitive market, FERC can set a rate. **SEN. MCNUTT** asked if there is a threshold regarding competition. **Mr. Brown** said that it is not as clear as FERC would like it to be.

Matthew Brown said that generators need to consistently review their market-based authority. One of the arguments a few months ago was that FERC should revoke that authority for these generators because the market wasn't competitive. Exempt wholesale generators (EWG) is the category of generators who are selling at the market-based rate. That category didn't exist before the Energy Policy Act of 1992. This act also underlies a lot of the changes that have happened in the last few years.

Matthew Brown said that Public Utility Regulatory Policies Act (PURPA) passed in 1978. This came about at a time when the US was very concerned about its dependence on foreign oil, the oil prices are rising and the US is trying to figure out how to integrate non-traditional fuels into the power system. PURPA required utilities to buy power from a new kind of company, a non-utility, independent generator. Often what happened was that these facilities sold power to the utility under a long-term contract. A lot of those contracts were set up to be front loaded, paying a lot in the beginning and less in the later years of the contract. Most were long-term contracts specifying fixed prices. California and New York had standardized contracts. This tended to raise electricity rates. PURPA also initiated a shift in who was building power plants and owning generation. Without that, there would be no discussion about how to restructure the utility industry.

Gary Willis, MPC, asked if the retail rates that were paid to the utilities are always set by the PSCs in all the states. **Mr. Brown** said that Nebraska is an exception to this because they are an entire public utility state. The retail rates for investor-owned utilities were set by the PSC.

Matthew Brown said there has been a fundamental shift that led to wholesale restructuring of the industry. In wholesale restructuring we are talking about a relationship between an investor-owned utility and another utility-related entity. For example, before 1992, an investor-owned utility is selling power at 4 cents per kilowatt hour over transmission lines for 2 cents per kilowatt hour for a total price of 6 cents per kilowatt hour. That relationship is very common. Now we move to a situation where there is an independent power producer coming in with a newer, more efficient energy station, who wants to sell power at 3 cents per kilowatt hour. It is impractical to build a transmission line to get the power from the independent producer to the customer. So what happens is that they connect to the existing transmission system, which is owned by the investor-owned utility. The Federal Energy Policy Act required that the independent utility would have access to this transmission system, but the question was, at what price. The investor-owned utility used to sell power for 6 cents, but is now being undercut so that the total price would be 5 cents. The investor-owned company allows the independent supplier to use the transmission system for 4 cents per kilowatt hour. What the FERC said is that the investor-owned utility has to charge what it would charge itself for the use of the transmission system. This was FERC Order 888. This is all on the federal level. This order was meant to open the

transmission system.

SEN. STONINGTON asked if the large industrial customers, when Order 888 was passed, could leave the system, and was one of the driving forces behind deregulation was that they would leave the system and leave the rest of the consumers to pay the stranded costs. **Mr. Brown** replied that, in general, the answer is no. Retail restructuring was authorized by state law. The Federal Energy Policy Act specifically did not say that retail customers, industrial or residential, could switch providers. There are a couple of exceptions. One is in Georgia, where, at that point, Georgia had allowed large accounts to switch. There are a lot of creative ways to get around this. One way is that large industrial customers, not dealing with the transmission system, say that they are going to build an on-site power system. There is the Montana situation with Flathead Electrical Cooperative (FEC) buying power from Bonneville Power Administration (BPA). **Paul Cartwright**, DEQ, said that FEC picked up about half of the load from Enron, starting in 1997.

John Malowney, Enron, said that this has been an ongoing battle. A lot of industrials said that, if they had to, they would form their own utility. **Matthew Brown** said that on the one hand it is clearly defined under state law, authorization is needed to change retail providers.

SEN. STONINGTON said that the argument had to do with the definition of retail. The large industrials were saying that they would become a wholesale distributor and therefore be eligible to use the common carrier and the industrials were approaching providers other than MPC. That was the threat that was used to justify the impetus.

Gary Willis, MPC, said that if an industrial, after Federal Energy Policy Act passed, built its own transmission system tied into the wholesale transmission system, there was nothing to keep the industrials from doing that. Once the transmission systems were deregulated, the industrials could tie to them. **Matthew Brown** said that is true. He would argue that it is difficult and expensive, and not many companies wanted to do that, but it did become a viable threat.

Todd Everts, Staff, said that was part of the debate for the restructuring bill. One of the elements of the restructuring bill was a transition charge for someone going off the system. That was granting the right for retail, but the arguments came up in the debate and the large industrials were saying that, under Order 888, they were going to attempt to go off the system. MPC was making that argument as well. **Matthew Brown** thinks that it didn't end up happening that way.

REP. FISHER asked if it was an oversimplification to say that Order 888 made the investor-owned transmission lines a common carrier. **Mr. Brown** said that was the idea. FERC didn't think that happened, even though that was the goal. That is why FERC has more recently tried to create the regional transmission organizations to deal with the transmission issues on a regional basis.

SEN. THOMAS asked if each state has a separate law dealing with the right or obligation to serve a

customer in an entity's jurisdiction. **Mr. Brown** said that was correct. **SEN. THOMAS** said that Montana's law gives the utility the right to serve that customer, but it doesn't say that the customer has to buy from the specific utility. The element of monopoly is what it came down to. **Mr. Brown** said that those laws vary from state to state.

Kevin Higgins, Energy Strategies, added that, from FERC's point of view, in implementing Order 888, it was not making that service available to retail customers unless it was a voluntary arrangement that the utility was permitting or there was a state direct access program which was being implemented, which FERC would then accommodate through Order 888. FERC tried to be clear that this did not mean that retail access is being granted by the federal government, rather it was deferring to the states' programs.

SEN. STONINGTON asked if Order 888 was in response to growth from the private, independent providers and what did FERC anticipate would happen. **Mr. Brown** said that the official thinking was that FERC was not pushing states towards retail competition, but many would argue that at the time many states were looking at competition and FERC saw that, in order to have competition, a transmission system was needed. Officially it wasn't one of FERC's goals, unofficially FERC was trying to move the wholesale market into a more competitive retail market.

COMM. BRAINARD asked if there was anything in the FERC order or Energy Policy Act that clearly defined who could buy at a wholesale rate and is there anything regarding a wholesale contract from a large industrial in one state buying power from a generator in another state.

Mr. Brown replied that within the combination the Federal Power Act and the Energy Policy Act there was nothing that would define that a large retail customer could go to a wholesale customer. **Kevin Higgins** said that Order 888 required the utilities under FERC's jurisdiction file pro forma tariffs, these are the open access transmission tariffs. These tariffs look very much the same from state to state and utility to utility. Within the tariffs there are definitions of eligible customers. The definition means if you are a retail customer you are not an eligible transmission customer unless your state has a retail access program or your utility has voluntarily allowed retail customers access to the transmission system.

SEN. STONINGTON asked how Enron can come into Montana and bid against PPL, when PPL has power generation in the state and Enron doesn't; how can Enron be competitive?

Mr. Brown said that when we are talking about the transmission system, we are talking about the integrated grid; state boundaries don't matter much. What does matter is the transmission lines, the ability of the transmission lines to shift power from place to place, and the price structure that is set up by the regional transmission organizations (RTO), which are set up to essentially define how much it costs to shift power from point A to point B.

Mr. Brown described how an unbundled bill would look. There is the electric energy charge, which is the competitive piece of the bill, and the transmission charge, which is under federal jurisdiction; there is the distribution charge, which is state jurisdiction. The deregulated part of the business is one part of a

much bigger bill. One of the things that a lot of states did, including Montana, was take a bundled bill and put out all the different pieces.

REP. KEANE asked, if there was a bottleneck in the transmission and the state decided to build a new line, the old transmission cost for the old line is 2 cents, but the new transmission line can only make money at 4 cents, is a federal agency able to say that only 2 cents can be charged on that new line. **Mr. Brown** said that if a state entity built a transmission line, there is a very good argument that the lines would not be subject to federal regulation. **REP. KEANE** asked if the state would be able to recover the higher cost of the transmission line. **Mr. Brown** said that it all goes to the way that the rates will be structured by the RTO. The investments are large enough that unless it is clearly defined how these companies are going to make money by building transmission, there will be no transmission built.

LARRY NORDELL, DEQ, said that historically the cost of building a transmission line would be rolled into the rate base and the cost would be recovered through the wholesale transmission rates. The idea behind the RTO is that when there is congestion that is blocking generators, it will be in their benefit to expand the transmission capacity because by doing so they will save money on their congestion costs.

Someone added that in the early 1980s, the Montana Legislature looked specifically at building transmission facilities. One of the things that was looked at was how to recoup the costs of these facilities. The way that a company recoups the cost is either from the ratepayers or the taxpayers. **Paul Cartwright, DEQ**, asked if there would not be any transmission lines built until there was certainty that the costs would be recouped. **Mr. Brown** said that was correct. The same thing happened with generation. **Mr. Cartwright** asked if there would only be new generation built in places where there is excess capacity on the transmission lines. **Mr. Brown** said that is one of the key factors of whether or not new generation is built. The best place to build new power plants is close to a transmission line or a gas pipeline. The company needs to know that, as a generator, they will have firm access to the transmission system. A lot of generation is getting built on the existing transmission system. The siting of transmission might be done on a federal level rather than on a state level.

Jerome Anderson asked for information on the open access to transmission lines. **Mr. Brown** said that if a private company builds a transmission line, it is subject to the open access provisions that FERC ordered and subject to federal jurisdiction. If it is a state or municipal entity building it, then it is not.

SEN. THOMAS asked who it is regulated by and how much; couldn't the private company say that they have the whole thing in use? **Mr. Brown** replied that is one of the reasons that many people will argue that FERC Order 888 wasn't working.

III POWER MARKETING BASICS: HOW ARE WHOLESALE MARKET PRICES

SET?

John Malowney, Enron, said that Enron is one of the world's largest natural gas marketers. Today the company is called Enron North America. Mr. Malowney primarily handles Oregon, Washington, Idaho, Montana and northern California. (EXHIBIT #2)

Mr. Malowney expressed how important it was for people to become informed about the energy issue. He reviewed what deregulation means. Essentially today there is one component of deregulation: generation. Transmission is regulated by FERC; distribution is regulated by the state. In a deregulated environment, it is ideal to have one too many generators. This will offer better prices, different ways to bundle it, and different ways to look at it. When deregulation is reached, there will be pricing opportunities for the consumer that have never been available before. When someone is dealing with a power generator or power marketer, they are buying a take-or-pay, which means that the consumer will have an obligation to take a certain amount of power within a certain time.

There are three distinct markets: real-time, which is hour to hour; prescheduled, also known as the Index; and a term market, which can be anything longer than a month. If a company were to call Enron because the company's generator was down, Enron would be able to provide energy for the next hour using the real-time market. In the real-time market, you are a price taker, whether buying or selling, because there is no time to negotiate. You either are long and need to get rid of the excess energy or you are short and need to buy it. The prices on this market are very volatile. The prescheduled market involves the Dow Jones. The Dow Jones will call major utilities to find out what has been done for the following day, hoping to get an average. A company can buy off of this index. The prices are all relative to the region within the Western System Coordinating Council (WSCC). A company can buy power off of the Index, but it leaves the company exposed in the market place. As was seen last year, when the prices on the Index went up, the companies that were buying power there started to struggle.

Paul Cartwright asked how much of the sales in the northwest are represented by the transactions that go through the Mid-Columbia. **Mr. Malowney** said, on a prescheduled basis, all of them. For example, MPC buys term energy, they are then exempt from the Mid-Columbia because it is not the market that they are participating in. The Index market does seem appealing when the market is lower than what can be reached on a fixed-price contract, however, it does have the associated volatility. As of the last two or three months, there has been very little volatility.

SEN. THOMAS asked if someone in California could buy power on the Mid-Columbia Index. **Mr. Malowney** said that they could.

REP. BROWN asked why someone would buy the Index price. **Mr. Malowney** said that this is relative volatility. If you are buying Index power it is double edged, leaving the buyer naked in the market place. It can go from \$18 to \$200, which has the potential to bankrupt a company. **REP. BROWN** asked for more clarification on the chart. **Mr. Malowney** said that the volumes that are

listed are what market participants created. **REP. BROWN** asked, if loads were reduce 5 to 10 percent, would that help the volatility of the market. **Mr. Malowney** didn't agree with that specifically.

SEN. THOMAS asked how long the Mid-Columbia Index and other Indexes of the same nature have been in effect. **Mr. Malowney** said that they are relatively new, the Mid-Columbia was one of the first to come online. **SEN. THOMAS** asked, for a utility in 1990, if one of their generators went down and they needed 100 megawatts, what did that utility do. **Mr. Malowney** said that years ago, if company was long or short they would swap with another company. When price volatility started, the companies were saying that they didn't want to swap for energy, they wanted the money that was represented by that energy. At this point, the industry changed from a physical industry to a financial one. There is now a master sales and purchase agreement that is often used. It includes ideas such as a reasonable effort to replace the power for a like cost.

Mr. Malowney said that the final market is the term market. A term transaction can be from a month to 10 years. There is less volatility because there is lots of time to spread the price out.

Mr. Malowney said that what separates Enron from other generators is the fundamental balances, the knowledge of what is BPA going to be doing, what is the weather going to do, et cetera. He takes that and uses it to predict what he thinks energy will do. The company will then give him a certain amount of value at risk (VAR). This amount of VAR is the amount of money for that person to buy power. Prices are set through the day as the term traders negotiate. Tremendous volumes of energy are moved by these traders who are out there every day trying to make money on this energy.

SEN. STONINGTON asked if she were trying to buy power, would she likely go to several brokers to see who is going to get the better deal for her for a term contract.

Mr. Malowney said that a relationship develops between the buyer and the trader because they become comfortable with each other. The trader has to gain the trust and confidence of the buyer, proving that they can deliver the best deal.

SEN. FISHER asked if it would be in the best interest of the default provider to look at the Mid-Columbia Index to see if this is the right time for long-term contracts. **Mr. Malowney** said that the Index has an influence and correlation to the term contracts, however, it doesn't set them. Another option is to buy chunks of energy off of the Index and develop a portfolio.

Mr. Malowney said that there are a few people buying 18 months or greater, the closer it gets to the date the energy is needed, the more the excitement picks up because the power is needed more immediately. There are some options in how to buy energy. One option is a fixed price for a long-term. Another is off of the Index, setting both a high and low price limit as to what they will pay. A combination of these is also possible. Some companies may be able to swap energy with other companies. Historically, northwest energy was worth more the farther south it went.

The question was asked if the basis of Mid-Columbia versus California-Oregon Border (COB) roughly equivalent to transmission costs. **Mr. Malowney** said that the costs of the transmission losses of getting energy to California are factored in. It is to the seller's benefit to settle that financially. There are times of the year when the energy on COB is worth more than the energy on the Mid-Columbia or the other way around.

REP. KEANE asked if PPL wanted to take a generator down, could they buy term power to cover the power lost. **Mr. Malowney** said that they could, but it would be more likely that PPL would call Enron.

REP. FISHER asked when prices would get down to the point where the Columbia Falls Aluminum plant could get back into production. **Mr. Malowney** replied that the aluminum industry is in a rough spot. At the present time Bonneville Power Administration (BPA) is offering power at about \$30. The aluminum industry has to deal with many other factors such as environmental laws. The market has to shake out in the aluminum industry in addition to lower prices in the energy market. **REP. FISHER** asked if because of the instability of the aluminum prices the plant may have to stay closed. **Mr. Malowney** said that was correct.

SEN. THOMAS asked for information on the term "caller." **Mr. Malowney** referred to a chart that showed the price of energy rising over time. If a person is saying that they don't want to pay over a certain price for energy, they will have to have price insurance. If the person doesn't want to pay the premiums for the price insurance, then the trader will say that the person won't ever pay over the given price, but they also won't pay under a certain price; that is the caller. With this the benefit of down side participation is lost.

SEN. THOMAS asked what the most common contract is that Mr. Malowney arranges for Montana industrials. **Mr. Malowney** said that 80 to 90 percent are saying that they want a fixed contract.

SEN. THOMAS asked if part of that is a reaction to the period of time when the industrials paid a huge penalty for being on the Index. **Mr. Malowney** said that is where the relationship with the trader comes in. He personally doesn't like companies to go on the Index because he doesn't like to see them get beat up.

MR. WILLIS asked about the premium. **Mr. Malowney** said that he doesn't charge a premium.

Mr. Malowney talked about the term aggregation, saying that there are advantages and disadvantages to it. There are both volumes and load factor concerns with it. An example would be a summer resort and a ski resort coming together to bring it up to a flat line demand year round.

He commented that Enron prides itself in being innovative and creative. They will come up with any pricing structure that a company could demand. This goes back to getting involved in the industry and knowing what is going on. Energy is fluid, it is coming and going. A trader won't take unknown risks.

The more constraints that there are, the less responsive the market is going to be.

SEN. STONINGTON asked if, considering that PPL generates energy in the state so there aren't significant transmission costs, can Enron be competitive. **Mr. Malowney** said that they could. He could buy energy at less than the cost of in-state generation or swap energy for in-state generation.

SEN. STONINGTON asked if Enron's creativity is their competitive advantage. **Mr. Malowney** said that it is, especially considering that they have very little generation of their own. **SEN.**

STONINGTON asked if PPL's competitive disadvantage was that they have certain facilities where there may be unit contingent problems. **Mr. Malowney** said that for a competitive market there needs to be a variety of power marketers and power generators.

SEN. ELLIS asked if federal power was promised and therefore not on the market.

Mr. Malowney said that some of the direct service industries that have federal power have some marketing rights.

The comment was made that roughly 75% of electrons generated in Montana are not PPL. There are plenty of players to make deals with in the state of Montana.

IV WHOLESALE POWER MARKETS CONTINUED

Matthew Brown, NCSL, introduced Kevin Higgins, Energy Strategies. Mr. Higgins' firm works on the kinds of transactions that Mr. Malowney was just speaking of. Mr. Higgins is going to offer his perspective on wholesale markets and the RTOs that emanated from FERC Order 2000.

Kevin Higgins, Energy Strategies, (EXHIBIT #3) said that he is a consultant and working with a firm out of Salt Lake City. Their clients are retail customers ranging from grocery stores to copper mines. Mr. Higgins' background is in economics.

There are several services that have to be provided to get power to the consumer, such as generation, transmission and distribution. Ancillary services are also very important; they are services that help support the transmission transaction. Wholesale transactions are sales for resale. The transmission service is necessary to deliver a wholesale product. There are rules when using a transmission system. Those rules typically deal with two basic categories: liability and calls from market participants. If you try to change the way the transmission system is used, you end up with a very intensive discussion about these criteria.

The wholesale market participants are usually generators, traditional utilities, federal projects, qualifying facilities under PURPA, and exempt wholesale generators (EWG). He pointed out that EWGs are not exempt from regulation, they are under FERC jurisdiction. Another participant might be power marketers, which are certified by FERC. To a limited extent there are also state power authorities participating in the wholesale market. Then there are the purchasers, who would be the utilities, those

providing competitive retail service, and now the state of California has started purchasing wholesale power.

There are a couple types of wholesale markets. There are some markets that are centralized power markets, which are governed by formal bidding rules that lead to market clearing prices. An example of that is the now defunct California Power Exchange. This exchange was set up to be a formal market place that had bids coming from buyers and sellers and there would be a price that emerged from those bids. There are still some of these centralized power markets operating back east. Another type of wholesale market deals with trading, which Mr. Malowney discussed. Those markets are places where there are bilateral transactions, two parties making a deal for a delivery to a specific location on the grid. Some of these markets have futures contracts available. Futures contracts are the one place that you can get publically available information on forward prices, however, they are thinly traded.

The question was asked if Mr. Higgins had any involvement in the market place with value-added energy. **Mr. Higgins** replied that he had not personally been involved in creating such a product. It did occur to him that a product that someone should come up with was certifying green power. He is not aware of anyone who is doing that.

The question was asked where the North Path and south Path are. **Mr. Higgins** said that they are in California. In terms of the buying paths, the one with the most trading on it is Palo Verde. The next largest in terms of volume is the South Path 15. Both South and North Path 15 have emerged as replacements for the California Power Exchange. After that, in terms of volumes, there is the Mid-Columbia, which is in Washington; and the California/Oregon border. There are also certain specialty markets, for example, the California Independent System Off Link.

Mr. Higgins showed that wholesale prices are now starting to approach where they were in 1999, where during the year 2000 the prices were off the map.

Mr. Higgins talked about FERC Orders 888 and 889, which were landmark policies that made non-discriminatory open access transmission service and required that the transmission providers separate their transmission and generation. FERC realized that there can be competition for generation, but not for transmission. Order 889 created something called OASIS, which is open access same time information system. OASIS is an Internet based access to conduct transactions. The purpose of this is to level the playing field for everyone who wants to use the transmission system.

In December 1999, there was FERC Order 2000, which is driving the formation of the RTOs. In the northwest there is RTO West. Its participants are from Washington and Utah. There is also Desert Star, which is the southwest. This RTO involves the southwestern states reaching up into Wyoming and Colorado. Desert Star is planning to make a filing at the end of October. The utilities in Desert Star have also been discussing forming a transmission company. The idea would be to operate transmission for profit. The third entity is the California ISO, which has been operational since 1998. FERC has

been telling the RTOs in the west to form one RTO to cover the entire west. FERC issued that message on July 12, 2001. Right now it is an open question as to what this statement really means.

Larry Nordell, DEQ, added that there is the feeling that it is a lot easier for three RTOs to negotiate than it would be to take the all of the participants in each of the three RTOs and merge them into a single group of industries. **Mr. Higgins** said that it is hard enough for those in the southwest trying to work things through, he can only imagine what it would be like to try to work out all the details with one giant group. It seems that it would be a step backward in terms of the time frame.

Mr. Higgins continued, FERC has offered some guidelines, identifying four basic characteristics and eight functions, within those guidelines FERC allowed for people to be creative and develop their own basic solutions. The first characteristic is that the RTO has to be independent of any market participant, that means that the transmission providers can't control policy decisions of the RTO. What they were trying to avoid is the situation where people who own both transmission and generation were making the policy decisions for how the new transmission entity was going to operate. The second characteristic is scope and configuration. Another characteristic is operational authority. What that means is the RTO has to be the entity that calls the shots on how things operate. Today that is the transmission provider's job; in the future that will be the RTO's job.

One of the functions that FERC set out is that the RTO will be the party that offers a tariff. Today, if someone wanted to conduct a transaction across a number of different providers territories, they would pay "pancake" rates, which are like a toll that has to be paid every time a border between transmission providers is crossed. One of FERC's objectives is that in order to have viable competition on the wholesale side, they need to be able to move power around without having to pay the tolls, but at the same time, the transmission providers have to recover their costs. One way to do this is with "postage stamp" rates, which would mean that it would cost the same amount to move power anywhere within the RTO. Another idea is the license plate approach, which says that there will be access charges that recover the fixed costs in a local access region and there is no additional charge to move power to different access regions. There are down sides to both of these approaches.

Another thing that has to be dealt with is congestion management, which is the challenge that occurs when more people want to schedule more transmission through a certain place than the lines can carry. FERC has told the RTOs to figure this out and that the ways that they do it should encourage market efficiency and market solutions to the construction of new transmission and generation. One of the ideas to come out of this is the idea of firm transmission lines (FTR). FTRs will be the repackaged property right; they are going to be what people need to have to schedule through congested interfaces. How these things will get applied is a key question with a lot of important ramifications.

The RTO also has to manage parallel path flows, which has to do with the fact that power doesn't always go where you want it to go. The RTO also has to be the provider of last resort. FERC wants to see markets provide ancillary services to the extent possible, but that people should provide their

own ancillary services. Ancillary services are things like operating reserves and frequency response, which means that you have to match load and generation every second.

SEN. STONINGTON commented that as the market place opens up and becomes more of a level playing field, Montana, which has had low energy prices as a competitive advantage, will lose that advantage, and FTRs may be the one remaining competitive advantage that Montana may have if they are established as first in time, first in right. **Mr. Higgins** thinks that if Montana is able to produce power more inexpensively than other places, that competitive advantage would stay with Montana, but the energy would have to be delivered. He does believe that who gets the FTRs is a key public policy issue, primarily in terms of the retail customers. The FTRs need to follow the loads that are impacted by congestion on the customer side. In terms of how they would effect Montana as an export entity, if there is a cost advantage on one side of the constraint and a higher costs on the other side of the constraint, that will bid up the value of the FTRs. **SEN. STONINGTON** said that if MPC is the beneficiary of the FTR on the transmission lines that they own, then presumably if transmission and distribution remain regulated, the PSC can pass that through to the retail customers. **Mr. Higgins** said that is correct.

MR. RITTER asked, if the state of Montana produces another thousand megawatts that can be sold inside or outside, why would Montana lose a competitive advantage. **Mr. Higgins** replied that he didn't think that it would, to the extent that Montana can produce electricity more cheaply than a competitor.

Mr. Higgins continued that regulation and frequency response basically matches flow to resource. Energy balancing is very important. In the market place people schedule their generation and transmission. That can be refined as the actual hour gets close, but at some point it is inevitable that there is going to be a mismatch between the amount of energy that was scheduled and the amount of resource that was provided, the difference is an energy imbalance and someone has to provide that balance. The RTO will have the responsibility of making sure that the system is in balance. This will involve knowing what capacity is available and the available transfer capability that is available.

SEN. STONINGTON asked, if the RTO calculates the capacity available, who decides who gets that capacity. **Mr. Higgins** said that in the models that are being developed for the west, the available transmission capability (ATC) will become obsolete because today there is no FTR. ATC is zero in places where there is congestion. In the future, under the RTO models, a person will be able to schedule from point A to point B. The time that you run into a problem is when there is congestion, this is when FTRs are needed.

Mr. Higgins continued, RTOs are supposed to come up with a solution or proposal to monitor markets. There is a lot of debate as to whether that monitoring should be part of the RTO or whether it should be independent of the RTO. So far FERC has kept the door open on this issue.

Another function of the RTO is transmission planning and expansion. Obviously we want a world in which there is efficient price signals for constructing new generation and new transmission. There is a lot of debate happening right now as to how strong the RTO's role is going to be versus the transmission provider. FERC is saying that it is the RTO's job, but the transmission providers are keeping as much involvement in this as they can.

Mr. Higgins said that there is significant new generation coming online, although not as much as had been identified. The RTO formation is taking place, although there is no consensus yet as to how the west will comply with FERC directive for one RTO. California is pulling back for direct access, but Oregon, Arizona and Montana continue toward direct access.

SEN. STONINGTON said that it seems that FERC is really pushing the RTO concept, while the transmission providers are trying to retain their own roles. How does the state and federal jurisdiction fit into that conflict? **Mr. Higgins** said that from FERC's point of view, this issue is front jurisdictional. The transmission is their business. While FERC will not attempt to regulate transmission rates that are sold as a bundled product, they are still very adamant about their jurisdiction over transmission as soon as products are unbundled. The state regulators frequently intervene in the FERC proceedings and make recommendations when the filings are made.

SEN. ELLIS said that 90% of the new generation that is coming online is gas, the WSCC is served by three different gas markets. The volatility in those gas markets varies greatly. Can total competition in the electric energy market really be reached if there isn't a free flow of gas?

Mr. Higgins said that one of the constraints on how well electric competition will work is how well the gas competition works. You want to have a situation where there is quick responsiveness to gas demand requirements.

John Malowney added that today Enron is taking care of the ancillary services. They are helping settle energy imbalances.

V GENESIS OF RESTRUCTURING IN MONTANA

JEFF MARTIN, TAC staff, encouraged committee members and others who are interested to look at the committee web site. He also said that a report by Peter Navarro¹ discusses a lot of the information presented today.

MR. MARTIN referred to the *Comprehensive Review of the Northwest Energy System*, which was a report that was prepared in 1996. (EXHIBIT #4) The idea behind talking about this report is to emphasize that restructuring in Montana was developed, in part, from coherent policy analysis. The

¹Peter Navarro, *A Guidebook and Research Agenda for Restructuring the Electricity Industry*, Energy Law Journal, Vol. 16, No. 2, (U. of Tulsa College of Law, 1996) pp. 347-418.

governors of Idaho, Montana, Oregon and Washington wanted to do an energy policy analysis of the Pacific Northwest, so they created a study committee to do that. The committee recognized that the electricity industry is changing and the report was an effort to shape that change to the extent that shaping is possible, to ensure the potential benefits of competition are achieved and equitably shared. The report analyzed the Columbia River system governance, conservation, renewable resources, low income energy assistance, consumer access to competitive markets, and open access to transmission. The goals of this study were to make recommendations on retail markets and customer choice, to encourage a more efficient power system, lower electricity costs, provide for increased product choice, and greater product innovation for all consumers. The study committee recommended that by July 1, 1999, open access be provided to all customers who want it. This was looking at what was happening in the wholesale market, especially with large industrial customers having the opportunity to choose their energy supplier. They wanted to encourage the development of meaningful market access for all consumer classes, to prevent unwarranted cost shifts between consumer classes.

The policy conclusions recommended licensing of new electricity service providers, consumer protection laws, complaint procedures, consumer information programs, ensuring that there is a provider of last resort, and providing utilities a fair opportunity to recover stranded costs. The committee also talked about the unbundling of billing, the separation of transmission and generation and providing open access to transmission. Many of these issues were addressed in SB 390 and HB 474.

VI FEDERAL PROPOSALS FOR REVAMPING THE TRANSMISSION AND POWER MARKETS

Eileen Doherty, NCSL, said that she is the committee director for the Energy Transportation Committee in Washington D.C. She offered some background of what has been happening with the energy issue on the federal level. In July, the Senate Energy and Natural Resources Committee held hearings on a range of energy issues. August 1 and 2, the committee held their preliminary markups on programs aimed at increasing energy efficiency and renewable energy, natural gas technologies and more, but there has been no significant outcome from those markups.

The primary energy bills that are being considered right now in the Senate is SB 597, which promotes energy efficiency and increasing domestic production. SB 352 is focused primarily on social energy programs, such as state energy programs. SB 389 promotes increasing domestic energy production and energy efficiency.

The recent developments in the Senate energy debate have been the transmission siting jurisdiction issue. Senator Bingaman, who initially opposed eminent domain for the siting of transmission lines, published a paper on July 20 that proposed to preempt state authority over the siting of transmission lines. In September, Sen. Bingaman introduced an amendment to SB 597 which talks about a whole host of different electricity issues, and specifically transmission siting jurisdiction.

Essentially, there are two consolidated cases before the Supreme Court, *New York vs. FERC* and *Enron vs. FERC*. These cases are to determine whether bundled retail transmission services are the jurisdiction of state or the federal government. Oral arguments were to start yesterday and a decision is likely between the end of this year and June 2002. That will provide who has jurisdiction over transmission siting and service.

At the National Governors' Association annual meeting, Secretary Abraham spoke, saying that the federal government needs to perform an analysis of the nation's grid structure to ensure that there is adequate infrastructure and transmission capabilities to meet the nation's increasing demand for energy. If there are areas identified where bottlenecks can be expected to create problems in meeting a regions' needs, then action is needed. Abraham said that siting ought to first be dealt with by the state or community, but if they refuse to take action and there is a national need, then federal authority should exist to do the siting.

From the federal perspective, Congress is hearing a lot of testimony indicating that there is a significant need for federal control over transmission siting to reduce constraint problems. NCSL and other organizations don't feel that there has been sufficient analysis to determine what constraint problems exist and where the problem areas are.

The amendment to SB 597 places a whole host of different state authorities in the hands of FERC and other federal agencies. This amendment has a very broad scope. Currently NCSL is in collaboration with a coalition of state and local organizations, including the National Governors' Association, National Association of Counties, National State Association of Energy Officials, and are working with Sen. Bingaman's staff in an attempt to make sure that the state authority isn't completely undermined.

HR 4 combined several energy bills, including a tax incentive bill. The tax bill provided \$33.5 billion in tax incentives for energy production, conservation and infrastructure improvement. HR 4 was passed by the House in August. HR 4 retained the \$33.5 billion in tax breaks and incentives, it provided a modest increase in fuel efficiency standards, increased weatherization assistance programs, and state energy programs.

The latest action in the House was September 21. Congressman Barton, who is the chair of the Energy and Air Quality Subcommittee, circulated a draft bill titled the Electricity Supply Transmission Act. This bill is less preemptive than Bingaman's, but would propose to preempt state authority in a few areas. It would direct FERC to establish uniform interconnection standards for both distribution and transmission facilities, it would force states and non-regulated utilities to implement that metering program meeting minimum federal standards. NCSL argues that states should be able to adopt those standards on a voluntary basis. The legislation also seeks proposals in dealing with jurisdiction over the transmission component of bundled rates. Bundled rates have always been under state authority. It permits FERC to extend eminent domain authority for transmission siting only if states have not responded within 12 months or if they have rejected a proposal for public interest.

The terrorist attack on September 11 has changed all congressional schedules and plans. The feeling is that if comprehensive energy legislation fails to be passed this legislative year, it is uncertain and unlikely to pass in the near future. The issue of energy has never been more important, but NCSL is uncertain of the proposals that they are seeing now. It has been said that Congress will be in session in one form or another until the end of the year in order to deal with different issues. The Senate Energy Committee has said that it is prepared to send a markup of energy legislation, including electricity issues, during the week of October 15. The administration was happy to hear that because they were wanting to see an energy bill by the end of the year.

SEN. STONINGTON asked what Ms. Doherty had sensed in the mood towards preemption of state authority and why it is occurring. **Ms. Doherty** replied that as far as Sen. Bingaman is concerned, originally, when he was in the minority, he had said that he was against eminent domain. When he became chair, he shifted quite dramatically to where he now is interested in seeing eminent domain and FERC having much more authority. Also, a member of Sen. Bingaman's staff used to work with FERC and is probably very federal friendly. She also thought that the industry is interested in seeing federal siting of transmission lines because it would benefit their delivery of power across the country.

VII RURAL ELECTRIC COOPERATIVES

GARY WIENS, MECA, said that the electric cooperatives are non-profit businesses. The first coops were formed in 1936 in rural areas. The cooperatives are locally owned and controlled by the customers. Each coop is overseen by a Board of Investors. There are 26 electric distribution coops in Montana, with a total payroll of 34 million dollars and more than 700 employees. Their goal is to supply their customers with reliable electricity, delivered to them at cost. With the exception of 2 small hydro plants, the coops own virtually none of their generation. Most coops are on long-term, fixed-price contracts.

SB 390 created the option for cooperatives to participate in customer choice, opening their systems up to competition, but it did not create a mandate for them. Today, 24 of the 26 have opted out. SB 390 also reaffirmed the cooperatives' historical role as the default supplier. It also contained separate provisions from the investor-owned utilities, these provisions recognized that cooperatives should have local control and decision making authority on the quality aspects of opening their system to choice. The law gives the coops decision making authority over development of transition plans, customer education, recovery of stranded costs, and more. Another provision of SB 390 allowed the coops and investor-owned utilities to reach territorial agreements so that the coops could continue to own their poles and wires. SB 390 also mandated the Universal Systems Benefit Program (USBP).

As the cooperatives look at supply issues they will be deciding whether to pursue long-term or short-term contracts. Most coops will continue to pursue long-term contracts.

Under federal law, all public power utilities, including cooperatives, are entitled to first rights of refusal for federal power. They are also guaranteed that the price for that power will be based on the cost of production. Right now those rights are being threatened by environmental issues. States in the northeast parts of the country don't have access to this low cost federal power. In Montana this power is being threatened by urban state law makers that would like to see a reallocation of the federal power. MECA feels that Montana would be the loser if this reallocation were to occur because they lack the votes in Congress and do not have the competition.

As cooperatives have to deal with new supply, they will have to deal with the question of whether they want to continue to rent their power supplies, purchase it on the market, or to begin to own their own facilities. That is what the central Montana coops are dealing with right now. The decision from these coops is expected in the next year.

The issue of delivery is an issue that is more critical for them than supply. The coops would like to see the development of an interstate transmission system. The current bottlenecks are a factor in what the cooperatives decide to do for their supply. There are both in-state and out-of-state transmission problems. They feel that the federal government must take a leadership role. The current lack of action is affecting investment in the expansion of transmission.

Another challenge that the cooperatives are dealing with is the issue of new technology. Cooperatives are working to offer technology that will give their customers options. This includes fuel cells, heat pumps, wind power, et cetera. There are some cooperatives that are also looking at propane for various reasons. They are also working aggressively to address net metering issues. They are doing that by coming together to form uniform policies and standards on how they are going to be able to interconnect the surplus power produced by customers who have these types of new technologies and how they are going to be able to interconnect that into the utility grid system.

Another challenge that the cooperatives face is that of conservation. The cooperatives believe that conservation will always be a very important part of any utility's operation. If you reduce the demand, expensive surcharges can be avoided. Also, if demand is reduced, the wear and tear on the utility system is reduced. As part of conservation programs there are grants and rebates. Last year the cooperatives provided \$250,000 of grants and rebates for the purchase of highly efficient hot water heaters.

Competition is also a challenge that the cooperatives face. If there is robust competition, the price will be lower. The cooperatives think that the arrival of competition is something that is going to take time. Until the market matures and settles down, there won't be many cooperatives jumping into competition. They were greatly encouraged in the last legislative session by the passage of bipartisan legislation that provided significant property tax benefits for the development of new generation if some of that generation is sold at cost-based rates.

VIII REVIEW OF THE RESULTS OF RETAIL RESTRUCTURING

Matthew Brown, NCSL, said that there are 24 states that have passed retail restructuring laws. Oregon has never allowed competition for any of the smaller customers, who were going to buy from a selection of regulated products. Nevada is also not going to allow competition for smaller customers. Oklahoma and West Virginia had said that they were going to move forward, but after California they decided to wait.

A big barrier of restructuring is that wholesale markets weren't working as they should. Retail competition won't happen if the wholesale markets aren't working. There are several problems in the wholesale market. One of them is, starting in the mid 1990's, companies couldn't figure out how they were going to earn a return on building new generation or transmission, therefore, nobody was building new generation or transmission. That was fine because up until that point there was a decent energy surplus. There was a steady growth of demand that was eating up the reserve margins. At the same time there was a reduction in the investments in energy efficiency and natural gas prices were spiking upwards. This coincidence of many factors conspired to push wholesale power market prices very high. At this time in California the retail prices were fixed. There was no response from the customers because there were no signals from the wholesale market getting through to the retail market. One of the key lessons that can be seen from the California crisis is that there needs to be some kind of linkage of the wholesale market to the retail market that would allow customers to respond to the fact that the electricity prices have gone up. This is known as demand response.

There is a big distinction between what has happened to the residential customers versus the larger customers. With the industrial customers, a significantly higher number of customers are choosing a new provider. This says that, in California, under the systems that were set up, there wasn't a lot of incentive for residential customers to switch providers or for marketers to market to the residential customers.

SEN. STONINGTON asked what **Mr. Brown** is seeing as far as public policy and what people are thinking with regard to this. **Mr. Brown** said that the big question in a lot of states is, what's next. There are a couple things that state policy makers can do: keep the service reliable and reasonably priced and try to get some type of competition going. **SEN. STONINGTON** said that she thinks that people in Montana are experiencing apprehension about prices increasing and insecurity about being treated similar to the telephone long distance services. Is there another model that could be used rather than a default supplier leading to customer choice, which no one really wants? **Mr. Brown** said that there is some thinking in that area. One of the issues is aggregation. Customers aren't going to save that much. There also isn't a lot of reason on the residential side for marketers to market the business to them. Marketing to residential customers is costing 100 to 200 dollars per customer, since residential customers have relatively small bills, there isn't much impetus to market to residential customers.

The question was asked if the reason why states are backing away from retail choice is because of the fear of what has been happening in the last 6 months and how do we get back to a place where the states are confident that the link between wholesale and retail has to be there.

Mr. Brown said that California should be treated as a single issue. States aren't necessarily backing away, but they are delaying. There is a big difference there. The point of the rationale for delaying is to make sure that the wholesale market is set. Once the wholesale market is set, then the states can move forward with more confidence.

SEN. THOMAS said that in Montana, the aggregation was allowed for up front. Down the road when we get to competition, are people going to want to pick between providers? He has reluctance that people will want to switch, but it happens all the time in the long distance market. **Mr. Brown** responded that the key point with all of this is where the utilities commission sets the rate to provide power for people who don't switch. The regulated rate will determine how many people switch.

Bob Anderson, PSC, commented that there are some differences between the telecommunications market and the energy market. AT&T was broken up in 1984 and it took about 15 years for that long distance market to become competitive. The telecommunications industry has been a declining cost industry. The electricity market is a commodity industry, where telecommunications is a service. At the same time, there has been a rapid expansion in the demand for telecommunication services, so long distance companies have lowered their prices and spent money to acquire customers. AT&T was still able to make money despite the dropping market share because the total amount of money that consumers were spending on telecommunications was growing fast enough that its revenues were actually increasing. It will take quite a long time for the energy market to mature as the telecommunications market has.

MR. RITTER wanted to point out that the opportunity to jump on the lower market prices helped to keep the Montana Resources mine open for 2 years even with the declining price of copper.

A comment was made that SB 390 put default providers in there because people figured that there wouldn't be choice immediately and it was going to take time to get there. If you talk to the residential customers, they are comfortable with their existing provider. Another thing is that most residential customers would realize only a small savings. That is why there needs to be some emphasis on making sure that the default provider gets the best possible rate it can. How would Mr. Brown go about aggregating residential customers? **COMM. BRAINARD** said that there needs to be more generators and more marketers to provide competition. In all retail ventures, retailers take on a risk; they purchase a commodity and sell it. Their profit is based on the risk that they are willing to take. In the electric industry there aren't people that are willing to assume that risk.

Mr. Brown added that as far as how residential customers are aggregated, there are some models beginning to come out. It is very early and he can't say for certain what will happen. One of the models is to have municipalities acting as aggregators for the citizens of that municipality. There are two

kinds of aggregation: opt-in and opt-out aggregation. Opt-in aggregation is the kind that is most common; opt-out has existed in one form in Massachusetts and in Ohio. The idea in Ohio is that there is a vote on the part of the citizens of the municipality or county. That vote is whether or not the citizens of that municipality want the municipality to go out and act as an aggregator for all of those citizens. Almost every municipality said that the citizens would like the municipality to buy electricity for them. There have been a few instances of municipalities banding together to pull together a large group and using that purchasing power to buy power. That is what is known as opt-out aggregation. The opt-in aggregation is where it is not assumed that the people in the municipality are going to go with whoever the municipality chooses. People have to actively sign off to buy power from the municipality.

Mr. Brown said that Oregon thinks that competition is going to take off now for the industrials. They believe that there is a longer transition period for residential customers, so Oregon offered the residential consumers some choice. They could buy a market-based product, cost-based product, or an environmentally friendly product, but all of those products will be regulated in some way. Nevada has said that it will treat residential customers differently than large customers.

Jerry Allen, Energy West, was concerned with the way aggregation is being discussed with respect to residential customers. His company tried that, selling energy to a number of residential customers for a period of time. It was very challenging, but that is not to say that it can't happen eventually. It would be unfortunate to have the committee assume that aggregation was something out there in the future, because it is happening right now in Montana at the small commercial level. They are finding, in the business plans that they are developing, that it is the innovative products that you can attach to the energy that is producing some interesting options for the provider and the customer.

Mr. Brown said that there is not necessarily a need for legislation to make that happen. There is a need for the wholesale markets to be working. This is happening in state after state.

MR. WILLIS asked if the example where there is a larger discount for a longer contract was an aggregation type of price. **Mr. Brown** said that was correct. One of the things that reflects is going back to the wholesale market, the anticipation is that prices will come down.

SEN. STONINGTON asked if the example is a regulated product. **Mr. Brown** said that it has just been worked out between the aggregator and the provider. This is a product for the commercial customers.

MR. WILLIS said that he keeps hearing that transmission is a problem. There is a tremendous opportunity in Montana because we can get all of our energy needs for a long time if all of the plants that are on the books can be built, but they are not going to be built without some way to get some of the power out of the state.

Mr. Malowney commented that he doesn't think the system is broken, so don't throw it out. You

can't buy energy by committee, someone at MPC will have to be empowered to be able to make a decision, stand on a contract. Also, time is of the essence. Whoever is going to make that decision will need plenty of time to start developing that portfolio.

SEN. THOMAS thought that it would be helpful to get any further examination from NCSL that would be available. There is a lot of work to be done down the road. He would be interested in knowing what other states have done.

SEN. STONINGTON said that the committee should be scanning all the time as to what other states are doing, the kind of ideas that they are coming up with, et cetera. As we approach 2002, if there is more opportunity to have a plan as to how to help make this thing work, it will help. **Mr. Brown** said that most states are asking the same questions, specifically, what do we do to help the residential customers next. He would be more than happy to share what the NCSL finds in that respect. **SEN. THOMAS** said that some school districts bought power on the market and saved a lot of money in the meantime, but maybe the committee needs to hear more stories of what has actually worked. **Mr. Brown** said that the other thing that the NCSL is looking at case studies of how three or four different states have dealt specifically with residential concerns. He would also share that information.

SEN. THOMAS would also like to see information on metering and those controls.

SEN. STONINGTON said that there are four concepts that she would like to pursue in terms of ideas: the USBP, energy efficiency through public policy, green products and how the policy makers can promote those, and finally the real-time metering.

IV ADJOURNMENT

There being no further business, the meeting was adjourned.

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