

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

**Preventing Undue Discrimination and Preference in
Transmission Service**

**Docket Nos. RM05-17-001
RM05-25-001**

**REQUEST FOR LEAVE TO ANSWER AND ANSWER OF
THE ISO/RTO COUNCIL**

In accordance with Rules 212 and 213 of the Rules of Practice and Procedure,¹ the ISO/RTO Council (“IRC”)² respectfully requests leave to answer, and answers: (i) the request for clarification of Duke Energy Corporation (“Duke”); and (ii) the request for clarification and

¹ 18 C.F.R. § 385.212 and 213 (2006)

² The IRC was formed by the nine functioning Independent System Operators (“ISOs”) and Regional Transmission Organizations (“RTOs”) in North America in April 2003. It now includes The Independent System Operator operating as the Alberta Electric System Operator (“AESO”), California Independent System Operator, Inc. (“CAISO”), Electric Reliability Council of Texas (“ERCOT”), the Independent Electricity System Operator of Ontario (“IESO”), ISO New England, Inc. (“ISO-NE”), Midwest Independent Transmission System Operator, Inc. (“MISO”), New Brunswick System Operator (“NBSO”) (which joined the IRC in 2006), New York Independent System Operator, Inc. (“NYISO”), PJM Interconnection, L.L.C. (“PJM”), and Southwest Power Pool (“SPP”).

The AESO, IESO, and NBSO are not subject to the Commission’s jurisdiction. While they concur with these joint comments of the IRC, their concurrence should not be construed as agreement or acknowledgement that they are subject to the Commission’s jurisdiction. In addition, ERCOT is not subject to the Commission’s jurisdiction in this matter and is not participating in this filing.

The IRC’s mission is to work collaboratively to develop effective processes, tools, and standard methods for improving competitive electricity markets across North America. In fulfilling this mission, it is the IRC’s goal to provide a perspective that balances reliability standards with market practices so that each complements the other, thereby resulting in efficient, robust markets that provide competitive and reliable service to customers.

alternative request for rehearing of a group of New York transmission-owning utilities (“NYTOs”),³ with respect to penalty issues in this proceeding.

Duke asks that the Commission expand on Order No. 890’s ruling that ISOs/RTOs may not recover penalty costs associated with the untimely performance of transmission studies. Duke would have the Commission declare that all ISO/RTO penalty costs are unrecoverable. Duke’s request should be rejected because Order No. 890’s discussion of ISO/RTO cost recovery was clearly confined to study-related penalties. It is also inappropriate for Duke, which previously suggested that the question of ISO/RTO accountability might be better addressed in a separate docket,⁴ to now ask the Commission to suddenly switch gears and adopt a blanket rule against ISO/RTO cost recovery, no matter the circumstances or equities, at this late stage in the proceeding.⁵

The NYTOs take a different tack, arguing that if monetary penalties are assessed against an Independent System Operator (“ISO”) or Regional Transmission Organization (“RTO”) under Order No. 890,⁶ the payments should, as a blanket rule, be funded from the ISO/RTO’s

³ One major New York Transmission Owner, National Grid, has taken a different position and has not objected to ISO/RTO pass-throughs of penalty costs. It also argues that ISOs/RTOs should generally be subject to non-monetary penalties, with financial sanctions reserved for “extraordinary circumstances.” *See Request of National Grid USA for Clarification or, in the Alternative, Rehearing*, Docket No. RM05-25-000, et al., at 15 (March 19, 2007).

⁴ *See Reply Comments of Duke Energy Corp.* at 18, Docket Nos. RM05-25-000, et al. (Sept. 20, 2006)

⁵ Moreover, the NYISO and MISO have filed separate requests for rehearing which explain that Order No. 890’s finding with respect to study-related penalties was based on a faulty factual premise and was inconsistent with Commission precedent. Duke’s request for clarification is silent on those points. The NYISO and MISO continue to believe that the Commission should reverse Order No. 890’s holding with respect to study-related penalty costs, not broaden it.

⁶ *Preventing Undue Discrimination and Preference in Transmission Service*, Order No. 890, FERC Stats. & Regs., Regulations Preambles ¶ 31,131 (2007) (“Order No. 890”).

“compensation and incentive programs with respect to all . . . employees, officers, and directors.”⁷ This proposal must be rejected because: (i) it is beyond the scope of this proceeding; (ii) it is inconsistent with the Commission’s policies and precedent; (iii) it would prevent ISOs/RTOs’ from attracting and retaining talented personnel needed to perform critical market and reliability functions; and (iv) it asks the Commission to take steps that controlling precedent indicates are beyond its statutory authority.

The IRC recognizes that the Commission has high standards for ISOs/RTOs and has the authority to hold them accountable when necessary. It also understands that the Commission’s traditional prohibition against the recovery of penalty costs raises complex issues when applied to ISOs/RTOs given their structure. The Commission resolved the fundamental policy questions surrounding penalties in Order Nos. 672 and 672-A,⁸ which established that ISOs/RTOs would neither be generically authorized to recover, nor generically prohibited from recovering, reliability-related penalty costs. Order No. 672-A also invited ISOs/RTOs to make filings proposing penalty cost recovery mechanisms. Finally, Order No. 672 rejected the imposition of personal penalties on directors of reliability organizations that are dependent on cost pass-throughs. Thus, the Commission should respond to the NYTO and Duke rehearing requests by clarifying that it will follow Order Nos. 672’s and 672-A’s approach to both the potential recoverability of penalty costs and to personal monetary penalties.

⁷ NYTOs at 8-9.

⁸ *Rules Concerning Certification of the Electric Reliability Organization and Procedures for the Establishment, Approval, and Enforcement of Electric Reliability Standards*, Order No. 672, FERC Stats. & Regs., Regulations Preambles ¶ 31,204, 114 FERC ¶ 61,104 (2006) (“Order No. 672”); *order on reh’g*, 114 FERC ¶ 61,328 (2006).

I. Request for Leave to Answer

The IRC recognizes that Rule 213 generally does not permit, and that the Commission normally discourages, answers to rehearing requests. The Commission has allowed such answers, however, when they help to clarify complex issues, provide additional information that will assist the Commission, or are otherwise helpful in the development of a record.⁹

As an initial matter, the Commission should not apply the normal rule against answers to rehearing requests here. Duke cast its argument against the recoverability of ISO/RTO penalty costs as a request for clarification. The NYTOs styled their recommendations as a combined request for clarification and request for rehearing. The Commission normally allows answers to requests for clarification.¹⁰

Nevertheless, to the extent that the Commission concludes that the IRC needs permission to answer, the IRC respectfully requests that such permission be granted. The NYTOs and Duke both ask that the Commission adopt rules that were neither proposed in the Commission's original Notice of Inquiry ("NOI") and Notice of Proposed Rulemaking ("NOPR") in this proceeding, nor addressed by Order No. 890. Their pleadings are therefore both tantamount to a motion for affirmative relief which may ordinarily be answered as a matter of right. In addition, the record should reflect both the serious legal deficiencies with the NYTOs' proposal, and the harmful effects that it would have if implemented. Similarly, the Commission should allow the

⁹ See, e.g., *Dominion Cove Point LNG, LP*, 118 FERC ¶ 61,007 at P 10 (2007) (accepting answers to rehearing requests); *KeySpan LNG, LP*, 114 FERC ¶ 61,054 at P 7 (2006) (same); *Michigan Electric Transmission Co., LLC*, 106 FERC ¶ 61,064 at P 3 (2004) (stating that answer to rehearing request aided the Commission's understanding of the issues); *Entergy Gulf States, Inc.*, 99 FERC ¶ 61,095 at P 8 (2002) (accepting answer to rehearing request that assisted the Commission in resolving the issues); *PacifiCorp*, 98 FERC ¶ 61,117, at 61,347 (2002) (observing that prohibition on answers to rehearing requests can be waived when the answer helps develop a complete record).

¹⁰ See, e.g., *Consumers Power Co.*, 60 FERC ¶ 61,257 at 61,854 (1992) (observing that answers to requests for clarification are permitted under the Commission's rules).

IRC to answer Duke so that the record reflects the inconsistency of Duke's request for clarification with both the text of Order No. 890 and with Commission precedent.¹¹

II. Answer

A. **Duke's and the NYTOs' Requests Should Be Rejected Because They Ask for Relief that Is Beyond the Scope of this Proceeding**

As an initial matter, Duke's and the NYTOs' requests should be rejected because they ask the Commission to take actions that are outside the scope of this proceeding.

With respect to Duke, there is nothing in the record of this proceeding that supports interpreting Order No. 890 as barring the recovery of any and all ISO/RTO penalty costs. The Commission did not propose to depart from its reliability precedent by making all ISO/RTO penalty costs unrecoverable in the NOI or NOPR. Order No. 890 mentions recoverability solely in the context of untimely studies and there is no textual basis for concluding that the blanket rule against recoverability applies to other situations. It would therefore not be appropriate for the Commission to abruptly "clarify" on rehearing that Order No. 890 should actually be read as establishing a blanket rule against recovery.¹²

¹¹ To the extent that the Commission deems this answer to be untimely under Rule 213, the IRC respectfully requests leave to submit it out of time. The IRC charter requires the approval of each ISO/RTO chief executive officer before filings of this type may be made. It was not possible for the IRC's members to review the many requests for rehearing of Order No. 890, develop a joint position, and obtain the necessary internal approval within the fifteen days that Rule 213 ordinarily provides.

¹² To the contrary, as was referenced in footnote 4, above, Duke acknowledged in this proceeding that general ISO/RTO penalty issues might be better addressed in a separate docket.

Similarly, with respect to the NYTOs, the Commission did not propose personal monetary penalties in the NOI or NOPR.¹³ Nor did any of the NYTOs raise the issue in their NOPR comments. Nowhere did the Commission discuss personal penalties or suggest that they were under consideration in Order No. 890. It would be unreasonable, prejudicial, and beyond the scope of this proceeding for the Commission to accept the NYTOs' proposal given the lateness of its introduction, the limited record on the issue, and the fact that most interested parties have had no opportunity to be heard on the issue.

B. The Commission Should Not Adopt a Blanket Rule Against the Recovery of ISO/RTO Penalty Costs Regardless of the Facts and Circumstances

The Commission should deny Duke's request for clarification that Order No. 890's prohibition on ISO/RTO recovery of study-related penalty costs encompasses all penalty costs.¹⁴ It is unclear whether Duke intended to exclude reliability penalties from the scope of its request. The IRC therefore interprets it as calling for the Commission to reject Order No. 672's and 672-A's approach both with respect to penalties arising under Order No. 890, and, potentially, to reliability penalties.

Duke offered no arguments at any stage of this proceeding that would justify adopting a generic rule in this docket that would be contrary to the rule established under Order Nos. 672 and 672-A. There is no difference between violations of reliability standards and violations

¹³ Order No. 890 noted that a few parties had filed comments suggesting that the Commission assess personal monetary penalties against ISO/RTO directors, officers, and employees but Order No. 890 did not address these proposals.

¹⁴ The NYTOs do not request clarification on this point, instead simply assuming that Order No. 890's holding with respect to the non-recoverability of study-related penalties applies to all penalties imposed under Order No. 890. The IRC respectfully submits that the NYTOs' interpretation is not plausible. The NYISO addressed this point in its own *Request for Clarification and Alternative Request for Rehearing*, Docket No. RM05-25-000, et al., at n.10 (March 19, 2007).

under Order No. 890 that would justify different recovery rules under them.¹⁵ Order No. 890 itself recognized that the two were fundamentally the same when it invoked Order No. 672 as part of the basis for subjecting ISOs/RTOs to penalties in the first place.¹⁶

To the extent that Duke is asking the Commission to generically deny the recoverability of reliability penalty costs, its request must be rejected as an impermissible collateral attack on Order No. 672. Even if Duke's request is intended to be limited to penalties arising under Order No. 890, and is thus a collateral attack only on the principle established by Order No. 672, the Commission should still deny its request for clarification for attempting to re-open a settled policy question.¹⁷

¹⁵ Furthermore, the NYISO's *Request for Clarification and Alternative Request for Rehearing* explained that Order No. 890's holding with respect to study-related costs was itself erroneous. As the NYISO stated, Order No. 890 wrongly assumed that ISOs/RTOs have "other sources of money" beyond what they collect from their customers that they could use to pay penalties.¹⁵ It also noted that Order No. 890's discussion of study-related penalty costs overlooked Order Nos. 672's and 672-A's rulings on the recoverability question. The NYISO therefore argued that the Commission should correct this aspect of Order No. 890 on rehearing and adopt the Order No. 672 model. In addition, the MISO argued in its *Request for Rehearing and/or Clarification* that there is no reasoned basis to impose study-related penalties on ISOs/RTOs and that the Commission departed without reasoned explanation from Order No. 672 and 672-A. Nothing in Duke's request for clarification has caused the NYISO or MISO to reconsider any aspect of their respective requests for rehearing.

¹⁶ Order No. 890 at 1353.

¹⁷ The Commission has consistently rejected collateral attacks on prior orders. *See, e.g., California Independent System Operator Corp., et al.*, 115 FERC ¶ 61,237 at P 79 ("Fundamental principles settled in orders cannot be attacked in subsequent proceedings before the Commission."); *Southern Company Services, Inc.*, 109 FERC ¶ 61,070 at P 30 (rejecting collateral attack); *KeySpan-Ravenswood, Inc. v. New York Independent System Operator, Inc.*, 107 FERC ¶ 61,142 at P 22 (2004) ("Collateral attacks on final orders and relitigation of applicable precedent by parties that were active in earlier cases thwart the finality and repose that are essential to administrative (and judicial) efficiency; for these reasons, collateral attacks and relitigation are strongly discouraged.").

C. Imposing Personal Monetary Penalties on Directors, Officers, and Employees is Inconsistent with Commission Precedent, Unsound Public Policy, and Unlawful

1. Personal Monetary Penalties Would Be Inconsistent with Commission Precedent and Would Have Harmful Consequences

The NYTOs' proposal should also be rejected because it is inconsistent with recent Commission precedent. In the rulemaking process that resulted in Order No. 672, the Commission invited comments on, and carefully considered, the question of whether directors of the Electric Reliability Organization ("ERO") or of a regional reliability entity ("Regional Entity") should be personally subject to monetary penalties for violations of reliability standards or the FPA. Order No. 672 rejected the idea, explaining that:

The Commission agrees that assessing monetary penalties against ERO and Regional Entity board members would have a chilling effect on the recruitment and retention of highly qualified board members. Moreover, a board member of a not-for-profit ERO or Regional Entity would not have the opportunity to derive pecuniary gain from his or her position.¹⁸

Both of the factors noted in Order No. 672 apply with the same force to ISO/RTO directors, officers, and employees as they did to ERO directors. If the Commission were to adopt the NYTOs' proposal, it would introduce the pale of litigation and personal liability coloring critical, sometimes split second decision-making needed to maintain reliability and ensure well functioning markets. ISO/RTO employees would need to consider retaining counsel and personal insurance even for violations caused as much by market participant behavior as their own actions. The potential unfairness inherent in a system that would penalize employees for issues completely beyond their control would be an enormous incentive to leave. Similarly, the recruitment of new directors, officers, and employees of the high caliber required for the work that ISOs/RTOs perform would be impeded at the very time when attracting qualified and

¹⁸ Order No. 672 at P 790.

experienced employees in the electric industry presents an ever increasing challenge.

ISOs/RTOs seek to attract and retain talented people who can find comparable positions at other companies where they would not face the prospect of personal monetary penalties for corporate violations.

If they were deprived of qualified staff, ISOs/RTOs could lose the ability to adequately meet their critical reliability and market responsibilities. That outcome would be just as harmful to the public interest as it would be to ISOs/RTOs themselves.

Furthermore, holding directors, officers, or employees personally responsible for corporate violations, or for individual violations committed by others, is not the norm either in Commission proceedings or in other venues. Order No. 672 recognized that it is generally not appropriate to make individuals personally accountable if they are not in a position to personally benefit from violations.¹⁹ Like ERO directors, the directors, officers, and employees of an ISO/RTO cannot reap personal gains from corporate violations.

The NYTOs' proposal would also undermine the authority and effectiveness of ISO/RTO Boards. Each ISO/RTO Board has created a management incentive plan to encourage and reward excellence. Key indicators can include compliance with Commission rules including mandatory reliability standards. Similarly, each ISO/RTO Board has compensation policies that are designed to serve the Board's objectives. If the Commission were to take the NYTOs' approach it would prevent Boards from establishing their own policies and deprive them of a key management tool. There has been no showing that it is necessary for the Commission to displace ISO/RTO Boards or override their internal management decisions.

¹⁹ See, e.g., *Dole Food Co., et al. v. Patrickson*, 538 U.S. 468, 475 (2003) (“The doctrine of piercing the corporate veil . . . is the rare exception, applied in the case of fraud or other exceptional circumstances . . .”).

Finally, the NYTOs' proposal is inconsistent with Order No. 890's discussion of penalties for late transmission studies. The relevant part of Order No. 890 states that "transmission providers" would not be subject to penalties when studies are late due to factors beyond their control.²⁰ The NYTOs' proposed system of personal monetary penalties directly contravenes this principle because it would collectively punish ISO/RTO employees, despite the fact that many of them will, inevitably, have nothing to do with a given violation.²¹

2. Personal Monetary Penalties are Unlawful

In addition, to the reasons set forth above, the Commission should reject the NYTOs' proposal because it is unlawful. It is true that the Commission has authority under FPA Section 316A to impose civil penalties on "any person" who violates the FPA or a Commission order issued under it. Section 316A does not, however, authorize the Commission to impose penalties on an individual director, officer, or employee for a violation of a tariff provision that applies to a public utility, including an ISO/RTO. For example, it would not empower the Commission to penalize individuals at a public utility that failed to complete transmission studies in a timely manner because the violation would have been committed by a corporate "transmission provider" not by an individual.

Moreover, the NYTOs' proposal is inconsistent with Section 316A's due process protections. Section 316A is geared towards holding individuals accountable for their own offenses. It specifically provides that such penalties may only be assessed against individuals

²⁰ Order No. 890 at P 1349.

²¹ ISO/RTO compensation programs do not constitute an "other source of money" because they are also funded by customer charges. The NYTOs' proposal would therefore not even achieve its stated aim of preventing ISOs/RTOs from passing through penalty-related costs because the money taken away from the compensation programs and used instead to pay the penalty to FERC would have come from customers in any event.

after they are afforded adequate notice, an opportunity for public hearing, and after accounting for the extent to which they sought to remedy a violation.²² Section 316A does not allow the Commission to hold all of the directors, officers, and employees of a public utility personally responsible whenever another utility employee commits a violation, regardless of whether they bear any individual responsibility.

By contrast, the NYTOs' proposal would collect penalties from ISOs/RTOs' overall compensation programs, thereby affecting all ISO/RTO employees. Beyond its inconsistency with Section 316A, this kind of collective punishment is fundamentally incompatible with any concept of due process and is constitutionally invalid.²³

In addition, the NYTOs' proposal is unlawful because it would require the Commission to override internal public utility management decisions. The United States Court of Appeals for the District of Columbia Circuit addressed this point a few years ago in *California Independent System Operator v. FERC* ("CAISO").²⁴ CAISO held that the Commission's power under FPA Sections 205 and 206 to regulate the terms and conditions of Commission-jurisdictional services, and "practices" related thereto, does not empower it to dictate the composition of a public utility's Board of Directors.

²² See FPA § 316A, 16 U.S.C. § 825o-1 (providing for notice and opportunity for a public hearing).

²³ See, e.g., *Dusenbury v. United States*, 534 U.S. 161, 167 (2002) ("[W]e have determined that individuals whose property interests are at stake are entitled to 'notice and an opportunity to be heard.'" (quoting *United States v. James Daniel Good Real Property*, 510 U.S. 43, 48, 126 L. Ed. 2d 490, 114 S. Ct. 492 (1993)); *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1960) ("The fundamental requisite of due process of law is the opportunity to be heard.") (quoting *Grannis v. Ordean*, 234 U.S. 385, 394 (1914); *General Electric v. EPA*, 53 F.3d 1324, 1328-29 (D.C. Cir. 1995).

²⁴ 372 F.3d 395 (D.C. Cir. 2004).

More generally, the Court in *CAISO* held that the Commission’s statutory authority “to assess the justness and reasonableness of practices affecting rates of electric utilities is limited to those methods or ways of doing things on the part of the utility that directly affect the rate or are closely related to the rate, not all those remote things beyond the rate structure that might in some sense indirectly or ultimately do so.”²⁵ The Court stated further that the Commission had no more authority to “dictate the choice of CEO, COO, and the method of contracting for services, labor, office space, or whatever one might imagine” than it did to seat a new board. In short, *CAISO* stands for the proposition that the Commission does not have a free hand to modify a public utility’s internal governance or management practices even if it believes that such changes would serve other important policy objectives.

Order No. 890, like the Commission order at issue in *CAISO*, was promulgated under FPA Sections 205 and 206.²⁶ There have been no change to those provisions, or to any other part of the FPA, in the time since *CAISO* was issued that broadens the Commission’s authority over the internal governance and management of public utilities. Section 316A cannot be read as authorizing modifications to public utilities’ internal compensation programs. The NYTOs’ proposal that the Commission revise ISO/RTO compensation policies must therefore be rejected.

III. Conclusion

In conclusion, the IRC wishes to emphasize that it is not asking that ISOs/RTOs escape accountability to either the Commission or their stakeholders. The IRC acknowledges the Commission’s authority and the fact that the Commission has many enforcement tools that apply

²⁵ 372 F.3d at 403.

²⁶ See Order No. 890 at P 40. While certain aspects of Order No. 890 are also based on other provisions of the FPA (*e.g.*, Section 219, which governs transmission rate incentives), none of those FPA provisions provides the Commission with any authority to modify public utilities’ internal compensation policies.

to ISOs and RTOs. The IRC also recognizes that the Commission has high expectations and standards, which are shared by all ISOs and RTOs. As always, the IRC is prepared to work with the Commission and with stakeholders to address any concerns. The IRC is simply asking that the Commission adhere to its precedent on the recoverability of ISO/RTO penalty costs, not treat ISO/RTO directors, officers, and employees more harshly than other public utilities' personnel by making them uniquely subject to personal penalties, and not make important policy changes without the benefit of a complete record or the input of interested parties.

WHEREFORE, for the foregoing reasons, the IRC respectfully asks that the Commission: (i) grant its request for leave to answer (to the extent necessary); (ii) deny Duke's request for clarification that Order No. 890's prohibition on ISOs/RTOs' recovery of study-related penalty costs applies to all financial penalties; and (iii) deny the NYTOs' request that ISO/RTO directors, officers, and employees be made personally responsible whenever an ISO/RTO is assessed any kind of financial penalty.

Respectfully submitted,

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April 10, 2007

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document on the official service list compiled by the Secretary in the captioned proceedings, in accordance with 18 C.F.R. § 385.2010 (2006).

Dated at Washington, DC, this 10th day of April, 2006.

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