

TESTIMONY OF THE HONORABLE JOSEPH T. KELLIHER

**NOMINEE TO BE A MEMBER OF THE FEDERAL ENERGY
REGULATORY COMMISSION**

May 10, 2007

Chairman Bingaman, Senator Domenici, and distinguished members of the Committee, I am honored to be here today as a nominee to be a member of the Federal Energy Regulatory Commission (FERC). I would like to thank Chairman Bingaman for scheduling this hearing. I also express my appreciation to President Bush for renominating me to this post. I believe my renomination represents a vote of confidence in the entire Commission and the good work we have achieved together.

Much of my work as FERC Chairman has been dominated by implementation of the Energy Policy Act of 2005. I applaud the Committee for its good work on the Act. This law represents the most important change in the laws FERC administers since the New Deal, and the largest single grant of regulatory power to the agency in 70 years. You gave us the tools we needed to protect the public and strengthen our energy infrastructure, and we are using them in a careful and disciplined manner.

FERC has been very diligent in its implementation of the Energy Policy Act. We met every deadline you set for us, and beat a few. Very few of the orders and rules we issued during implementation of the Act were challenged in court, which I take as a sign that stakeholders, while not agreeing with every decision we made, believe we acted fairly and listened to all sides. You wrote a good law and we implemented it efficiently. I am proud of our work implementing the Energy Policy Act.

Perhaps the best way to share my perspective with you is to discuss what I see as the Commission's five principal missions, some of which are new, and some of which have changed over time.

Economic Regulation

As the courts have recognized, the primary task of the Commission is to guard the consumer from exploitation by noncompetitive electric and gas companies. The way FERC has discharged that responsibility has changed over time, however. Historically, FERC relied principally on regulation to control market power exercise. Over time, however, competition has played a greater role in disciplining commodity prices and

FERC now relies on a mix of regulation and competition to protect consumers.

I am proud of our record in the past two years of adopting reforms to strengthen competition and protect consumers. We adopted Order No. 890, a comprehensive reform of our open access rules, which will ensure that available grid capacity is measured in a fair and transparent manner and that customers have a seat at the table in the transmission planning process. We approved a final rule to ensure customers in organized markets have long-term transmission rights to support their investments in new resources.

We adopted reforms to increase customer access to renewable sources of energy. Order No. 890 created a "conditional firm" service important to wind resources, and reformed energy imbalance charges to ensure that wind and other intermittent resources are treated fairly. More recently, we approved California's proposal to facilitate renewable development by reforming our interconnection pricing policies.

We continue to work to strengthen wholesale power markets. In 2006, we initiated a rulemaking to improve our market-based rate program. We also commenced a generic review of competition in wholesale power markets, with a goal of identifying additional reforms to ensure that these markets benefit consumers.

We also have adopted reforms related to natural gas markets. In order to guard against gas price volatility, we issued a final rule to encourage greater investment in storage expansion. Last month we proposed a rule to increase gas market transparency.

We remain active in all these areas because power and gas markets are highly dynamic. In my view, static regulatory policy is likely to fail when the markets themselves are dynamic and we must adapt to changes occurring in regulated industries.

Energy Infrastructure

Strengthening our energy infrastructure has been a central agency mission since 1920. Energy infrastructure is the network of facilities that produce energy and transport it to where it is needed by consumers and businesses. If our energy infrastructure is inadequate, consumers are exposed to higher prices and greater price volatility.

FERC has proved very efficient in its work to strengthen our energy infrastructure. Since 2000, we have approved more than 9,400 miles of new interstate natural gas pipelines. These pipelines contribute to domestic energy production. By improving pipeline takeaway capacity, we promoted the surge of natural gas production in the Rocky Mountains. We adopted reforms to encourage additional pipeline capacity, modifying our certificate process to eliminate unnecessary barriers to pipeline additions

that raise no significant environmental issues. Pricing reform should encourage storage expansions. In the fall of 2005, we acted quickly after hurricanes Katrina and Rita to approve actions to facilitate greater supplies of gas during that winter's heating season.

We are also acting to strengthen the electric transmission grid. We issued final transmission siting rules consistent with Congressional intent in the Energy Policy Act, recognizing that states remain the primary siting body for transmission facilities, and that FERC authority is secondary and supplemental. We also adopted final rules to ensure our ratemaking policies provide adequate support for new transmission investment.

Safety

Safety is not a new mission for FERC, but is one that has taken on increased importance in recent years. Safety has been a FERC mission since it established the dam safety program in the 1960s, and a principal focus of our hydropower program is assuring the safety of licensed projects. I am committed to a strong dam safety program.

FERC also acts as a safety regulator when it reviews proposed liquefied natural gas (LNG) projects and when it oversees the construction and operation of these facilities. This role is widely misunderstood. When FERC reviews a proposed LNG project, its primary role is as a safety regulator. We apply high safety standards, and impose conditions if necessary to assure those high standards are met. In some cases, we have imposed scores of conditions to protect public safety.

We also reject projects that fall short of our safety standards. It is important to understand that we do not balance safety considerations against other considerations, such as need. Doing so would compromise the integrity of our safety review. For example, despite the significant need for new gas supplies in New England we denied approval of the Keyspan project because it did not meet our strict safety standards.

Reliability

Congress gave us broad new authority over electric grid reliability in the Energy Policy Act. We exercised that authority promptly. Within 180 days of enactment, we adopted final rules governing the reliability program. Last summer, we approved the North American Electric Reliability Corporation as the Electric Reliability Organization. This March we approved national reliability standards that are mandatory and enforceable this summer. In April, we approved eight regional delegation agreements to provide enforcement of these standards at the regional level. For the first time, the U.S. now has a mandatory, enforceable reliability regime.

In moving quickly to implement this new authority, we have been respectful of regional differences and the concerns of small users of the grid. We approved the funding of regional reliability coordinators in the West, as well as approving the funding of the Western Interstate Regional Advisory Board. We also modified our initial proposal to assure greater due process for small users.

I am proud of our ability to undertake this new responsibility in such a timely and effective manner. Much work remains to be done, however.

Enforcement

The newest FERC mission is enforcement. One of the hallmarks of my Chairmanship has been the focus on enforcement. Civil penalty is the basic tool of an enforcement agency, and by and large FERC lacked that tool before 2005. We needed enforcement authority comparable to other federal regulatory bodies to prevent market manipulation and market power abuse, and I urged Congress to establish an express prohibition of market manipulation, and expand our enforcement powers. You gave us these enforcement tools, and we are using them. I want to thank Chairman Bingaman in particular for his leadership on this issue.

We acted quickly to exercise our enforcement authority. We adopted an Enforcement Policy Statement in October 2005 modeled on the best practices of federal enforcement agencies. The focus of our program is firm but fair enforcement, and we use our civil penalty authority to encourage compliance. The subsequent enforcement actions we have taken were all guided by the Enforcement Policy Statement. Earlier this year, FERC exercised its new civil penalty authority for the first time, approving six settlements with electricity and gas companies for a range of violations.

We also acted quickly to implement our new anti-manipulation authority, issuing a proposed rule in October 2005 and a final rule in January 2006. We invoked emergency authority to make the final rule effectively immediately. We combined this new authority with an aggressive oversight of electricity and gas markets and initiated a number of investigations into alleged market manipulation of both power and gas markets.

If confirmed by the Senate to another term, these five missions will continue to be focus of my chairmanship.

When I was named Chairman by President Bush, I established certain institutional goals. One was to improve the relationship between the Commission and Congress. Development of wholesale competition policy and transmission open access policy was characterized by close cooperation between Congress and FERC, both moving towards

common policy goals. I wanted to restore that relationship. We have made progress, but continued improvement is necessary.

Another institutional goal was to improve our standing in the courts. FERC has significant authority, with new powers granted by the Energy Policy Act, but there are limits on our legal authority and we must respect those limits. Since I became Chairman, we have taken great care to assure that our decisions are rooted in the law and fact. We are making progress, and our solid record in the courts is a testament to that progress.

A third institutional goal was to improve the relationship between FERC and the states. The U.S. has adopted a federalist system for regulating the electricity industry in this country; FERC has an important role, and state regulators have an important role. The California and Western power crisis showed that when federal and state regulators work at cross purposes, consumers suffer. If we act in good faith the system can work. We have made great progress, and some state regulators have observed that the relationship between FERC and the states is stronger now than it has been in ten years.

I have enjoyed my public service at the Federal Energy Regulatory Commission, both as Commissioner and as Chairman. It would be an honor to continue that service.

I appreciate the opportunity to testify before you today and am happy to answer any questions you may have.