

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, DC 20426

January 21, 2009

OFFICE OF THE CHAIRMAN

The Honorable Jeff Bingaman
Chairman
Committee on Energy and Natural Resources
United States Senate
Washington, D.C. 20510

Dear Chairman Bingaman:

It appears likely that Congress will make a serious effort to pass significant energy legislation this year, based on statements by the new Administration and Congressional leaders. I support these efforts and believe there is a need for energy legislation. I am writing to offer specific recommendations for energy legislation for your consideration.

Since the 1930s, the Federal Energy Regulatory Commission's (FERC) primary mission has been to "guard the consumer from exploitation." FERC has also had a longstanding mission to strengthen the U.S. energy infrastructure. Congress reaffirmed these missions in the Energy Policy Act of 2005, which are reflected in provisions that prohibited manipulation of wholesale electricity and natural gas markets, enhanced FERC merger authority, granted the agency substantial civil penalty authority, accelerated the effective date for refunds of wholesale electric rates, granted FERC limited transmission siting authority, clarified FERC authority to authorize liquefied natural gas import projects, and provided for a consolidated record for gas project proceedings.

The Energy Policy Act represents the largest expansion in FERC regulatory authority since the New Deal, and gave FERC new tools it badly needed to guard the consumer and strengthen the U.S. energy infrastructure. The Act also gave FERC a new mission to assure reliability of the bulk power system and expanded the regulatory tools available to conduct effective enforcement.

Based in part on our experience administering the authority granted the agency in 2005, I believe there is a need for additional authority to improve our ability to discharge the important duties entrusted to FERC by the Congress:

Transmission Siting

I encourage Congress to revisit electric transmission siting and provide for exclusive and preemptive federal siting of transmission facilities used in interstate commerce. Congress drew the correct conclusion three years ago when it determined that

reliance on state siting for electric transmission facilities was not sufficient to support the development of an interstate power grid the country needs to assure reliability and support competitive wholesale power markets. That was the basis for enactment of the limited transmission siting provisions in the Energy Policy Act. However, in my view the transmission siting provisions of the Energy Policy Act are inadequate to assure reliability, support competitive markets, and meet the climate change challenge.

I urge the Committee to consider adopting the natural gas pipeline model for siting electric transmission facilities. Under this model, federal siting is exclusive and preemptive, and FERC is entrusted with siting of transmission facilities. This country has relied on exclusive and preemptive federal siting of natural gas pipelines for more than 60 years, and the result is a pipeline network that is far more robust than our interstate power grid.

In the three and a half years since enactment of the Energy Policy Act, FERC has certificated 7,400 miles of interstate natural gas pipelines. We have sited exactly zero miles of interstate electric transmission facilities, and there have been no applications for siting of electric transmission facilities by FERC under the limited federal transmission siting provisions in the Energy Policy Act. Perhaps the sharpest contrast between siting under the natural gas pipeline model and state siting of electric transmission facilities is with respect to the length of the siting proceedings. Over the past three and a half years, natural gas pipelines have been proposed, sited, constructed, and commenced operation – all with appropriate consideration of environmental concerns and environmental protection conditions where necessary. By contrast, the large backbone electric transmission projects are still slowly moving through multiple state siting review, with construction and operation far in the future. What takes months under federal siting of natural gas pipelines can take years under state siting of electric transmission projects.

This has important implications not only for grid reliability and competitive wholesale power markets, but also for climate change policy. For the United States to have any prospect of meeting the aggressive carbon reduction goals laid out by President Obama; it will be necessary to maximize our wind electric generation potential. But much of this renewable potential, particularly wind, is in areas remote from the grid. It will take significant investment to expand grid capacity to permit development of large-scale wind projects. A key consideration is the timeline for any carbon reduction targets. The earlier the target, and the more aggressive the reduction, the more necessary federal transmission siting will prove. Under state siting, this expansion will almost certainly occur slowly and fitfully. Under federal siting, transmission expansion would be more expeditious and more certain and invite greater levels of investment in both grid expansion and new wind generation projects. If we persist with state siting of electric transmission facilities, we will in all likelihood fail to maximize wind development.

In my view, the limited federal transmission siting authority granted by the Energy Policy Act is inadequate to address the energy and environmental issues facing our nation. First, the limited siting provisions are not a national solution. The national electric transmission corridors designated by the U.S. Department of Energy cover only six percent of the lower 48 states, so at best they represent a six percent solution to a national transmission problem. Second, bifurcating federal responsibility between two agencies, with one responsible for determining need and one responsible for siting, is not the proper solution. It results in large transmission corridors that have caused much controversy in some states. It would be far better to entrust a single agency with determining both need and siting. Third, the limited federal transmission siting provisions established a federal siting role without, in effect, disturbing the state role. While that may have been a way to avoid making difficult political decisions, it has produced a complicated siting scheme that promises years of litigation, while diffusing responsibility for siting electric transmission facilities.

I urge Congress to amend the Federal Power Act and provide for exclusive and preemptive federal transmission siting, based on the natural gas pipeline model.

Cease and Desist Authority

In the Energy Policy Act, Congress established an express prohibition of manipulation in wholesale power and gas markets through amendments to the Federal Power Act and Natural Gas Act. I had personally advocated in favor of such a grant of authority, and commend Congress for granting FERC anti-manipulation authority. I am pleased to report that this new authority has proven to be a vitally important tool in meeting our agency's mission to guard the consumer against exploitation. In particular, over half of the investigations we initiated last year were market manipulation cases.

However, in the course of exercising our new anti-manipulation authority, the need for some additional related authority has become apparent. The anti-manipulation authority in the Energy Policy Act applies not just to the traditional regulated community of public utilities and natural gas companies, but also to other market participants. In one case involving a market participant that is otherwise nonjurisdictional, FERC commenced litigation on the basis of a preliminary determination, but over the course of our investigation the company was able to distribute its assets, frustrating the agency's ability to collect civil penalties in the event we make a final judgment that a violation of our anti-manipulation rule occurred.

There is no reason to believe this situation is not capable of repetition. In my view, it would not be good public policy to allow market participants that violate our anti-manipulation rules to avoid payment of civil penalties. It would improve the effectiveness of our anti-manipulation authority if we had authority to issue cease-and-desist orders to prevent the distribution of assets by market participants. The Securities

and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC) have comparable authority to issue cease-and-desist orders.

There is another use for this cease-and-desist authority that would also be good public policy, namely ordering a market participant to cease behavior that FERC believes is manipulative in the course of an investigation. Such an order would be temporary, suspending behavior or transactions that FERC believes are manipulative before the agency reaches final judgment in the course of an investigation or proceeding.

If you agree there is a need to strengthen FERC's ability to prevent market manipulation, I encourage you to consider amending the anti-manipulation provisions of Federal Power Act section 222 and Natural Gas Act section 4A to authorize FERC to issue cease-and-desist orders to prevent the distribution of assets and suspend behavior the agency believes is manipulative. These provisions could be modeled on current law authorizing the SEC and CFTC to issue cease-and-desist orders.

Enforcement Litigation

I also believe there is a need for legislation to establish a consistent process for enforcement litigation. FERC favors settlement, and will generally pursue settlement. But sometimes settlement will not be possible, and it will be necessary to resort to litigation to impose civil penalties.

FERC now administers four statutes that provide for imposition of civil penalties, Part I of the Federal Power Act, Part II of the Federal Power Act, the Natural Gas Act, and the Natural Gas Policy Act of 1978. The process for assessment of civil penalties and administrative litigation vary among these statutes. The law prevents FERC from establishing consistent processes.

In my view, there should be harmony in the process for assessment of civil penalties and administrative litigation across these statutes. That would improve the administrative efficiency of the agency in enforcement proceedings, particularly matters that involve potential violations of more than one statute. In an investigation involving violations of both the Natural Gas Act and Natural Gas Policy Act of 1978, the inconsistency in statutory processes can force the agency to bifurcate administrative litigation.

In some cases, it might be preferable for litigation to occur in District Court, rather than before FERC administrative law judges. For example, the District Court may be a better venue for prosecution of market manipulation cases, since securities, commodities, and fraud precedent may be more relevant to the tribunal than the FERC case law typically relied on by administrative law judges. The agency does not currently have this

option, given statutory limitations. Other potential violations may be more suited to hearings before administrative law judges.

I encourage you to consider legislation to establish a consistent process for assessment of civil penalties among our principal statutes, one that allows FERC the discretion to commence litigation either before District Court or an agency administrative law judge.

Emergency Authority

Competition policy has been the foundation of federal electricity and gas policy since 1978. Competition policy is decidedly not “deregulation” for the simple reason that FERC never stopped regulating wholesale power sales, transmission, and gas transportation. Instead, competition policy relies on both competitive forces and regulation, and is dedicated to incremental reform to find the best possible mixture of competition and regulation. In the Energy Policy Act, Congress ratified the national commitment to competition policy, while giving FERC new regulatory tools.

However, I believe there is an additional regulatory tool that FERC needs to assure just and reasonable wholesale power rates. There are two different kinds of wholesale power markets in the United States. First, in major regions of the country organized markets are operated by regional transmission organizations and independent system operators, where centralized power auctions operate in a manner similar to securities and commodities exchanges in some respects. Second, there are bilateral markets, where wholesale sales are conducted by bilateral transactions rather than through auctions. The rules that govern power auctions in the organized markets must be approved by FERC and are contained in the grid operator’s filed tariff.

The problem is that market rules set by tariff cannot be established, modified or suspended quickly under current law in the event of market emergencies. In the event of an emergency, it may be necessary for FERC to establish a market rule governing centralized power auctions on an interim basis or modify or suspend an existing rule. Currently, FERC could only establish, modify or suspend a market rule after notice and opportunity for hearing, which could take weeks or months. In the interim, wholesale customers could be subject to significant disruption from market emergencies.

In order to guard the consumer from this eventuality, I ask you to consider amending the Federal Power Act to give FERC emergency authority to suspend approved market rules or establish interim rules in the organized markets, perhaps modeled on emergency authority long possessed by the SEC and CFTC. Such authority could be for a limited time period and subject to subsequent notice and opportunity for hearing. I would expect that any such FERC emergency authority would rarely if ever be used, but it could provide critical protection to consumers in the event of an emergency.

Gas Refund Reform

Another area where there is a need for legislation is accelerating the effective date for refunds ordered under section 5 of the Natural Gas Act, to match the refund protections contained in section 205 of the Federal Power Act. Under section 5 of the Natural Gas Act, the effective date for refunds ordered under a complaint or rate proceeding initiated by FERC on its own motion is set at the end of the proceeding, not the beginning. That is in sharp contrast with the refund effective date provided under the Federal Power Act, where the refund effective date is set at the date of the complaint or the commencement of the rate proceeding initiated by FERC on its own motion. As a result, potential refund liability under the Federal Power Act increases during a proceeding, encouraging settlement.

Since the refund effective date under the Natural Gas Act is set at the end of a proceeding, no refund liability accrues, and pipelines have no incentive to settle and every incentive to vigorously litigate. FERC has acted to strengthen the ability of gas consumers and shippers to file rate complaints against natural gas pipelines, by improving the access to information necessary to support a complaint. However, the complaint remedy is impaired by the refund effective date provided under current law.

Congress recognized the need to accelerate the refund effective date under the Federal Power Act when it enacted the Energy Policy Act. Previously, the refund effective date was 60 days after a complaint or the initiation of a proceeding by FERC on its own motion. In response to proposals from the Bush Administration, Congress eliminated the 60 day waiting period. I urge you to amend section 5 of the Natural Gas Act to establish the same refund effective date as under the Federal Power Act.

Cyber Security

As I testified before the Energy and Air Quality Subcommittee last September, in my view FERC does not have adequate legal authority to protect the bulk power system from cyber attacks and other national security threats to reliability of the electric system. In the Energy Policy Act, Congress gave FERC a new mission to assure the reliability of the interstate power grid, specifically charging FERC with setting cyber security standards. We have made great progress in improving reliability, by setting mandatory reliability standards and developing effective enforcement.

However, the cyber threat is an entirely different threat than the reliability threat envisioned by Congress in 2005, and the tools Congress granted FERC in the Energy Policy Act are inadequate to guard against cyber threats. To protect the grid against cyber threats there is a need to quickly establish mandatory cyber security measures and to guard certain information from public disclosure. In my view, that cannot be

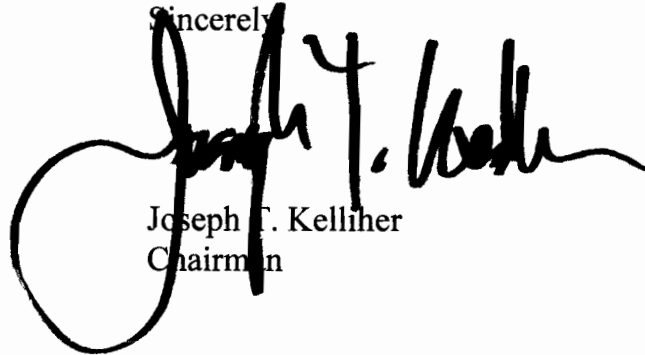
accomplished under the procedural framework contained in the reliability provisions of the Energy Policy Act, where mandatory reliability standards typically take years to develop and establish, and where security information cannot be effectively protected from disclosure.

The cyber threat is different than other reliability threats. It is a threat posed by nation states and organized groups that may be sponsored by other nations. FERC is not a national security or intelligence agency, and we are not in the best position to identify specific threats. However, FERC was charged by Congress with assuring reliability of the bulk power system, specifically charged with developing cyber standards, and most of the reliability expertise of the U.S. Government resides at FERC.

I recommend that you pass legislation that authorizes FERC to require compliance with measures necessary to protect the grid, upon a finding by a national security or intelligence agency that there is a cyber threat to the bulk power system.

I appreciate the opportunity to submit my views to you. I also encourage you to request the views of the next Chairman and the Commissioners on energy legislation.

Sincerely,

A handwritten signature in black ink, appearing to read "Joseph T. Kelliher". The signature is fluid and cursive, with a large loop at the beginning and a long tail extending to the right.

Joseph T. Kelliher
Chairman

cc: The Honorable Lisa Murkowski
Ranking Member
Committee on Energy and Natural Resources
United States Senate
Washington, D.C. 20510