

JOSEPH T. KELLIHER NOMINATION

HEARING
BEFORE THE
COMMITTEE ON
ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE
ONE HUNDRED EIGHTH CONGRESS
FIRST SESSION

TO CONSIDER THE NOMINATION OF JOSEPH T. KELLIHER TO BE A
MEMBER OF THE FEDERAL ENERGY REGULATORY COMMISSION

FEBRUARY 11, 2003



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JOSEPH T. KELLIHER NOMINATION

TUESDAY, FEBRUARY 11, 2003

U.S. SENATE,
COMMITTEE ON ENERGY AND NATURAL RESOURCES,
Washington, DC.

The committee met, pursuant to notice, at 2:33 p.m., in room SH-216, Hart Senate Office Building, Hon. Larry E. Craig presiding.

OPENING STATEMENT OF HON. LARRY E. CRAIG, U.S. SENATOR FROM IDAHO

Senator CRAIG. The room will be in order, and the hearing by the Senate Energy and Natural Resources Committee will be convened. This hearing is to consider the nomination of Joseph T. Kelliher to be a Commissioner of the Federal Energy Regulatory Commission.

Senator Domenici was called to The White House and apologizes for not being here. I am Senator Larry Craig of Idaho. I am pleased to sit here and chair in his stead. He did express his regrets.

We have agreed to defer opening statements until after the nominee has presented his statement. With this, I will recognize Senator Bingaman and then swear in the witness and ask him to respond to the standard questions and introduce his family before recognizing members for opening statements and questions.

[The prepared statements of Senators Bunning and Feinstein follow:]

PREPARED STATEMENT OF HON. JIM BUNNING, U.S. SENATOR FROM KENTUCKY

Thank You, Mr. Chairman.

Today, we have before us Mr. Joseph Kelliher, who has been nominated to be a member of the Federal Energy Regulatory Commission.

The Federal Energy Regulatory Commission is an important agency within the Department of Energy. Its responsibilities include regulating electricity, natural gas pipelines, and oil pipelines and licensing hydroelectric projects.

Kentucky residents enjoy the lowest electricity rates in the country. This low electricity rate has helped Kentucky's economy grow by attracting businesses and keeping money in the pockets of its consumers.

Further, Kentucky's electricity market has worked. Our residents have continually enjoyed low cost uninterrupted service. Kentucky has not experienced rolling blackouts, price spikes, or market manipulation seen in other parts of the country, and Kentucky does not expect to under its current power grid.

As a member of FERC, it will be Mr. Kelliher's job to examine the nation's current electricity policies and determine a structure that allows consumers to benefit from a competitive market. This is a big job and I expect Mr. Kelliher will stay receptive to suggestions and comments by members of Congress.

I would like to see Kentucky's consumers keep their low rates and good service and would like for FERC to work to maintain this.

I know that one job Mr. Kelliher will face as a member of FERC concerns FERC's Standard Market Design proposal to create a power grid operated under uniform national rules.

I have some questions about this, and am looking forward to Mr. Kelliher's response.

Thank you.

PREPARED STATEMENT OF HON. DIANNE FEINSTEIN, U.S. SENATOR
FROM CALIFORNIA

Mr. Chairman, I look forward to questioning Mr. Kelliher today because the regulatory body he has been nominated to join—the Federal Energy Regulatory Commission—must be a strong and aggressive enforcer to keep the energy markets from being abused.

Over the past few years we have seen corporate scandal after corporate scandal in the news—and nowhere has there been more fraud and market abuse than in the energy sector.

Last week, Jeffrey Richter, the former head of Enron's Short-Term California energy trading desk, pled guilty to conspiracy to commit fraud as part of Enron's well known schemes to manipulate Western energy markets. Richter's plea follows that of head Enron trader Tim Belden in the fall of 2002. Belden admitted that he schemed to defraud California during the Western energy crisis and also pled guilty to conspiracy to commit wire fraud.

The Enron plea last week came on the heels of FERC's release of transcripts from Reliant Energy that reveal how their traders intentionally withheld power from the California market in an attempt to increase prices. This is one of the most egregious examples of fraud and manipulation that affected the Western Energy Market in 2000 and 2001 and it is clear and convincing evidence of coordinated schemes to defraud consumers.

The list of incidents of fraud and manipulation in the energy sector over the past six months is astounding, and the Reliant conversations are only the most recent example. Let me read just one part of the transcript to demonstrate the greed behind the market abuse by Reliant and its traders.

On June 20, 2000 two Reliant employees had the following conversation that reveals the company withheld power from the California market to drive prices up:

Reliant Operations Manager 1: "I don't necessarily foresee those units being run the remainder of this week. In fact you will probably see, in fact I know, tomorrow we have all the units at Coolwater off." (The Coolwater plant is a 526 plant).

Reliant Plant Operator 2: "Really?"

Reliant Operations Manager 1: "Potentially. Even number four. More due to some market manipulation attempts on our part. And so, on number four it probably wouldn't last long. It would probably be back on the next day, if not the day after that. Trying to uh . . ."

Reliant Plant Operator 2: "Trying to shorten supply, uh? That way the price on demand goes up."

Reliant Operations Manager 1: "Well, we'll see."

Reliant Plant Operator 2: "I can understand. That's cool."

Reliant Operations Manager 1: "We've got some term positions that, you know, that would benefit."

Mr. Chairman, only six months later, as this Committee was attempting to get to the bottom of why energy prices were soaring in the West, the President and CEO of Reliant testified before this Committee that the State of California "has focused on an inaccurate perception of market manipulation."

Reliant's President and CEO went on to say, "We are proud of our contributions to keep generation running to try to meet the demand for power in California. Reliant Energy's plant and technical staffs have worked hard to maximize the performance of our generation."

Reliant made similar statements before FERC, that high prices were "not an attempt by suppliers to withhold capacity from the market in order to drive up market clearing prices."

The conversations documented in these transcripts reveal the exact opposite—that Reliant employees intentionally held power off line at the direction of senior executives.

Despite this clear and convincing evidence of fraud, on January 31 of this year, the Federal Energy Regulatory Commission chose to give Reliant a slap on the wrist for this behavior. The company paid only \$13.8 million to sweep this criminal behavior under the rug and settle with FERC.

Over the past three years FERC has gone from an obscure government agency to a federal enforcement body people look to be a strong and aggressive cop on the beat.

I strongly believe that in order to restore confidence in the economy, we must bolster the authority of the Securities and Exchange Commission, the Federal Energy Regulatory Commission, and the Commodity Futures Trading Commission and other regulatory agencies.

The marketplace must be fair and transparent and FERC must show it will live up to its regulatory responsibility.

Which brings me to my questions for Mr. Kelliher:

1. Since FERC has an obligation to ensure rates are just and reasonable, and selling energy at market-based rates is a privilege, not a right, shouldn't the Federal Energy Regulatory Commission have rescinded Reliant's authority to sell power at market-based rates to send a message that fraud and manipulation like we see in these transcripts will not be tolerated?

2. What type of fraud and manipulation would there have to be for you to vote to rescind a wholesale generator's authority to sell at market-based rates? If all Reliant has to do is pay back the money they made withholding the power, what is to stop them or another company from manipulating the market again?

3. Do you believe Reliant's withholding of power from the Western Energy Market was confined to only two days—June 21 and 22 of 2000? Do you believe Reliant was the only company to withhold power during the Western Energy crisis?

4. When Reliant held power offline and prices soared, other wholesale generators profited as much as Reliant, if not more, because the market clearing price was paid to all parties bidding into the California market. Is there a remedy for this? If not, what is to prevent Reliant from holding power off line one day and another firm doing it the next day and a different firm doing it the day after that?

5. I strongly believe that FERC has an obligation to families and businesses in the West to use its subpoena authority to get all of the tapes from Reliant and review the conversations to see if the company intentionally withheld power other days besides June 21 and 22. Do you agree?

Would you support releasing these tapes and other evidence of wrongdoing to the public?

6. Last week, I sent a letter to FERC Chairman Pat Wood asking the Commission to lift its order that keeps all evidence of fraud and manipulation that is uncovered before February 28th secret. I sent the letter because I believe FERC must serve the public interest and people have a right to know the extent of fraud and manipulation that has occurred in the energy sector. Would you support lifting the protective order that keeps information found by the California parties seeking refunds confidential?

7. What should be the punishment for companies and individual employees that deliberately withhold power to drive prices up and cause blackouts?

8. As you know, I plan to introduce legislation with Senators Fitzgerald, Lugar, Harkin, Cantwell, Wyden, and Leahy to bring oversight to unregulated energy trading and increase penalties for misconduct. Will you support this bill?

Senator CRAIG. With that, I am pleased to recognize the ranking member of this committee, Senator Bingaman.

Senator BINGAMAN. Thank you very much, Mr. Chairman. And I am glad to abide by the order that you set out and look forward to hearing from the witness, and then look forward to a chance to make a short statement and ask a few questions.

Senator CRAIG. Thank you very much, Senator. The rules of the committee, which apply to all nominees, require that they be sworn in, in connection with their testimony.

So, Joe, if you would rise with me and please raise your right hand.

Do you solemnly swear that the testimony you are about to give to the Senate Energy and Natural Resources Committee shall be the truth, the whole truth, and nothing but the truth?

Mr. KELLIHER. I do.

Senator CRAIG. Please be seated. And please feel free to introduce your family to the committee.

Oh, I am following instructions here, Joe, so I am going to ask you to do this first: Before you begin your statement, I will ask you three questions addressed to each nominee before this committee.

Will you be available to appear before this committee and other Congressional committees to represent departmental positions and respond to issue of concern to the Congress?

Mr. KELLIHER. I will.

Senator CRAIG. Are you aware of any personal holdings, investments or interests that could constitute a conflict or create the appearance of such a conflict should you be confirmed and assume the office to which you are being nominated by the President?

Mr. KELLIHER. My investments, personal holdings, and other interests have been reviewed both by myself and appropriate ethics counselors within the Federal Government. I have taken appropriate action to avoid any conflicts of interest. There are no conflicts of interest or appearances thereof, to my knowledge.

Senator CRAIG. Thank you. Are you involved or do you have any assets held in blind trust?

Mr. KELLIHER. No.

Senator CRAIG. Thank you.

I understand you do have family with you. And the committee would be pleased that you might introduce them to us.

Mr. KELLIHER. Thank you. Thank you for the privilege.

First of all, I would like to introduce my wife Karen, who is formerly from New Mexico, which I have been pointing out to members of the committee as often as I can.

[Laughter.]

Mr. KELLIHER. She is actually from Glenwood, which is up the road from Senator Bingaman's home town. And with Karen are our two children, Aidan and Nora. And Aidan has been practicing a special bow that he would like to do for members of the committee to thank you for holding this hearing.

Senator CRAIG. Have at it, Aidan.

Mr. KELLIHER. Do you want to take a bow?

[Laughter.]

Senator CRAIG. Thank you.

Mr. KELLIHER. Thank you.

Senator CRAIG. Well done.

Mr. KELLIHER. And also Nora, our daughter Nora. She is 3 years old. She just had her third birthday. And she is wearing her special nomination hearing dress.

[Laughter.]

Mr. KELLIHER. And I do not think she will do a bow. She is a little more shy.

And my parents are also here, Joseph and Joan Kelliher, my sister Janet, my brother-in-law Eric Langborgh, and a close friend family Helen Mobley. And I have also seen a number of friends in the audience. But I just want to acknowledge their presence and thank them for being here.

Senator CRAIG. Well, Joe, thank you.

And to all of the family, I am sure you are proud of Joe. And we are pleased that you have been able to be with him and attend today.

So, Joe, before I or Senator Bingaman make opening comments, we would now turn to you for your opening statement.

TESTIMONY OF JOSEPH T. KELLIHER, NOMINEE TO BE A MEMBER OF THE FEDERAL ENERGY REGULATORY COMMISSION

Mr. KELLIHER. Thank you, sir.

Senator Craig, Senator Bingaman, distinguished members of the committee, I am honored to be here today as a nominee for the Federal Energy Regulatory Commission. I would like to express my appreciation to President Bush for nominating me to this position. And I want to thank Chairman Domenici for scheduling this hearing and moving it so quickly.

I have worked on energy policy matters from various perspectives for nearly 20 years. For much of this period, I was a congressional staffer, either on the personal staff of Chairman Barton on the House side or as majority counsel to the House Energy and Commerce Committee, your sister committee.

As majority counsel, I was responsible for electricity, hydropower, conservation, and other issues. I was privileged to work closely with this committee on a range of legislation between 1995 and 2000. And I developed a great respect for the members and staff.

Since January 2001, I have served as senior policy advisor to Secretary of Energy Spence Abraham. During this period, I advised the Secretary on energy policy issues and participated in the development of the National Energy Policy. I also worked closely with this committee during the development of energy legislation in the last Congress.

Electricity markets today are facing tremendous challenges. In recent years, we have witnessed dramatic price spikes in wholesale power markets, attempts to manipulate power markets, a large expansion of generation by independent power producers, followed by serious challenges confronting many of those producers. And we have also seen stagnant investment in the transition grid.

Current Federal electricity policies promoting competition in wholesale power markets are the result of close collaboration between Congress and FERC that goes back 25 years. Since 1978, Congress has twice passed laws to promote competition in electricity power markets. FERC has pursued the same goal through its open access policies. Increased competition has resulted in dramatic changes in electricity markets.

In addition to electricity, there are three other substantive areas of FERC responsibility, hydropower licensing, natural gas pipelines, and oil pipelines. I plan to make hydropower issues a personal priority, if confirmed to this office, and look forward to working with members of this committee on those issues. Natural gas and oil pipeline regulation are the substantive areas of FERC responsibility in which I have the least direct personal experience.

For much of my professional career, I have worked on Capitol Hill. If confirmed by the Senate, I believe my professional experience will be an asset at FERC. I have enormous respect for Congress and recognize the critical role that Congress plays on energy policy. It is essential that Congress and FERC continue to work closely together, just as they have on development of electricity pol-

icy over the past 25 years. If confirmed by the Senate, I pledge to work closely with this committee to that end.

I have enjoyed my years of public service on Capitol Hill and at the Department of Energy. It would be a privilege and honor to continue that public service at the Federal Energy Regulatory Commission. I appreciate the opportunity to testify before you today. And I am happy to answer any questions you might have.

Thank you.

[The prepared statement of Mr. Kelliher follows:]

PREPARED STATEMENT OF JOSEPH T. KELLIHER, NOMINEE TO BE A MEMBER OF THE
FEDERAL ENERGY REGULATORY COMMISSION

Chairman Domenici, Senator Bingaman, and distinguished members of the Committee, I am honored to be here today as a nominee for the Federal Energy Regulatory Commission (FERC). I would like to express my appreciation to President Bush for nominating me to this position and I want to thank Chairman Domenici for moving so quickly to schedule this hearing.

I have worked on energy policy matters from various perspectives for nearly twenty years. For much of this period, I was a Congressional staffer, either on the personal staff of Chairman Barton or as Majority Counsel to the House Energy and Commerce Committee. As Majority Counsel, I was responsible for electricity, hydro-power, conservation, and other issues. I was privileged to work closely with this Committee on a range of legislation between 1995 and 2000, and I developed great respect for its members and staff.

Since January 2001, I have served as Senior Policy Advisor to Secretary of Energy Spencer Abraham. During this period, I advised the Secretary on energy policy issues and participated in development of the National Energy Policy. I also worked closely with the Committee during development of energy legislation early in the last Congress.

Electricity markets today are facing tremendous challenges. In recent years, we have witnessed dramatic price spikes in wholesale power markets, attempts to manipulate power markets, a large expansion of generation by independent power producers, followed by serious challenges confronting many of those producers, and stagnant investment in the transmission grid.

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For much of my professional career, I have worked on Capitol Hill. If confirmed by the Senate, I believe my Congressional experience will be an asset at FERC. I have enormous respect for Congress, and recognize the critical role that Congress plays on energy policy. It is essential that Congress and FERC continue to work closely together, just as they have on development of Federal electricity policy over the past 25 years. If confirmed by the Senate, I pledge to work closely with this Committee to that end.

I have enjoyed my years of public service on Capitol Hill and at the Department of Energy. It would be a privilege and an honor to continue that public service at the Federal Energy Regulatory Commission.

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

Senator CRAIG. Joe, thank you very much. I had mentioned that I and Senator Bingaman and others would make their opening statements following your comment.

Let me suggest that we will turn to each one of our members in the order in which they have come for their first 5 minutes. We will

do 5-minute rounds, whether they be opening statement and/or questions. Acceptable?

Senator BINGAMAN. Yes.

Senator CRAIG. Okay. With that, Joe, again, welcome to this committee. We appreciate you being here. We appreciate your willingness to serve our country.

The Commission is one of the oldest agencies within the Federal Government. It was created, as you know, in the 1920's to oversee the development of non-Federal hydropower projects throughout our Nation. Its role was particularly critical to the successful development of my part of the country in the Pacific Northwest.

Over the years, the Commission's authority has been extended to regulate natural gas and the interstate transmission of wholesale electricity. It is a testament to the Commission's ingenuity that during a time of industry's deregulation in both the natural gas and the electricity sectors, FERC is more powerful today than it was when it was fully regulating the natural gas and the electric utility monopolies.

The Commission's current quest is to restructure the electric utility industry and manage markets, which is an enormously complicated task fraught with dangers not only to consumers but to investors of the utility companies that were for so long guaranteed solid returns from very stable and well-run companies.

This is no longer the case. The financial stability of this industry is currently very questionable. And I fear that current Commission policy decisions are having an adverse effect on this extremely delicate situation. I have seen what happens when the Commission gets committed to policies that ignore economic realities in certain regions of the country that are perhaps not as densely populated as other regions.

Such was the case in the late 1980's and the 1990's, when the Commission solely but methodically began to abrogate its responsibilities under Part One of the Federal Power Act and allow other government and non-governmental entities to shape hydroelectric licensing policies. That policy path effectively paralyzed the Commission's hydro program and frustrated any creative efforts to ensure the relicensing of many needed existing projects within a reasonable time frame.

That Commission approach also had and continues to have devastating consequences for my region. And I commend you for your willingness, as you mentioned in your opening statement, to make hydropower a priority.

I am certainly not pleased to observe that many of my colleagues here in the Senate from other regions of our country are now experiencing similar anxieties with the manner in which the Commission is proceeding in restructuring the electrical markets. Decisions affecting existing contracts for power and rules affecting State authority over transmission rates are deeply troubling.

The need for commissioners with technical and practical expertise have never been more compelling. The very stability of this important industry depends on a high degree of competency for each member of this Commission.

Your resume certainly shows that you have a great deal of technical and legal experience, although I believe that the depth of

your knowledge is sufficient to handle the application of regulatory formulas necessary to ensure the adequate prosecution of the Commission's responsibilities. I can only hope that your level of practical business common sense will serve you well in this future.

The most well-researched economic theory is useless in the hands of those with an inadequate understanding of business systems and poor business judgments. We must never forget that regulation is an extraordinary grant of government power that must be applied cautiously, responsibly, and respectfully. And I look forward to the response that you will give to the questions that many of us will ask.

With that, I turn to my colleague from New Mexico, Senator Bingaman.

**STATEMENT OF HON. JEFF BINGAMAN, U.S. SENATOR
FROM NEW MEXICO**

Senator BINGAMAN. Thank you very much, Mr. Chairman.

Let me begin by making a short statement. We have two vacancies on the Federal Energy Regulatory Commission. One is, by statute, reserved for a Republican nominee. Mr. Kelliher has been nominated for that position. One is also reserved, by statute, for a Democratic nominee. Last year I thought the administration had agreed to move ahead with nominations for both positions. That is what they had indicated to me, and that they would be sending us a nominee for the Democratic position, as well as the Republican position. And obviously they have not done that. They now urge that we proceed to pass on the Republican nominee.

That being the case, I am not in a position to support moving ahead with just one of those positions. I have indicated this to various people in the administration. And I hope very much that they will correct the situation very quickly so that we can have both a Republican and a Democratic nominee and move ahead, as was originally committed.

I think clearly everything I have seen indicates Mr. Kelliher is well qualified for the position he has been nominated for. And I do not say any of this by way of criticism of him. But unfortunately, the way the Congress functions sometimes in order to get the administration to honor its commitment in some of these areas, you have to be prepared to raise objections. So I will not be able to support going forward with the nomination at this time.

But I do have some questions I would put to the nominee. Is it appropriate to do that right now, Mr. Chairman, or should—

Senator CRAIG. Within your first five, absolutely.

Senator BINGAMAN. Let me ask a question that has been raised by several, and that is relating to the work you did with the Vice President's energy task force.

Mr. KELLIHER. Yes, sir.

Senator BINGAMAN. As you know, the work of that task force has become quite controversial and was subject to some litigation. Is there anything that you know of that should concern us about work you did for that task force or anything that you—any work you did for that task force that might compromise your ability to be an impartial member of the Federal Energy Regulatory Commission or serve appropriately on that Commission?

Mr. KELLIHER. No, sir. I do not believe so. I do not think so.

Senator BINGAMAN. Okay.

Mr. KELLIHER. I can describe my role at length, if you would like, but—

Senator BINGAMAN. Well, do not describe it at length, but maybe give us a short description.

Mr. KELLIHER. Okay. Just to be clear, I was not a member of the energy task force staff. I was an advisor to the Secretary of Energy. I was not a member of the Vice President's staff. I was an advisor to the Secretary of Energy.

And my role in that capacity was to present options to the Secretary. I was not a decision-maker. The principal decisions on what was in the energy policy were made by the Vice President and the other members of the task force, the Cabinet level members of the task force.

My function was to try to develop options. And we did that a number of ways. We had an internal process with about 90 career employees. And we encouraged them to come forward with their ideas on what would make sense in an energy policy. And we encouraged them to be creative and not to edit themselves, not to worry that an idea might seem crazy. We wanted every idea they had.

We also looked on the outside. We reviewed bills introduced by members of this committee, by Chairman Murkowski, by your bill, sir, S. 597 and S. 352. You had a LIHEAP bill and a comprehensive energy bill. Senator Murkowski had a comprehensive energy bill. So we went through bills introduced by Congress and also ideas from think tanks, public interest groups, environmental groups, and business groups.

And we tried to—we looked far and wide for ideas. But once those ideas were collected, the decisions were made by the Secretary, the Vice President, and the other members of the task force.

Senator BINGAMAN. Thank you. One issue that you are going to be faced with at the Federal Energy Regulatory Commission is the whole issue of how to ensure an adequate supply of natural gas. That is a concern that many of us on this committee have. We tried to include some provisions in the energy legislation we considered in the Senate last year to ensure that work on an Alaska gas pipeline would be expedited.

Do you support going ahead with that? Do you have any views as to the importance of proceeding with a natural gas pipeline to bring gas from the north slope of Alaska to the lower 48?

Mr. KELLIHER. Well, it does seem clear that we need more natural gas supplies. I do not have a personal view as to whether it should come from Alaska or other sources. And I think FERC's role would be to be in a position to act promptly in the event people come forward and want to invest the substantial sums needed to build a natural gas pipeline. FERC's job would be to handle that application expeditiously and make a prompt decision one way or the other.

FERC has another role, ensuring adequate natural gas supplies with respect to LNG. The United States right now, something like one-and-a-half percent of our gas supplies come from LNG. New England relies more heavily on LNG. But nationwide it is some-

thing like one-and-a-half percent. But that is expected to grow substantially, and FERC policies that—were recently changed to encourage investment in more LNG facilities, so that we could import more liquified natural gas.

And one promising aspect of that is that that gas might arrive earlier and be available earlier than Alaska natural gas might be. So FERC's duties seem to fall into those two camps.

Senator BINGAMAN. Thank you, Mr. Chairman.

Senator CRAIG. Thank you, Senator.

Now, let me turn to Senator Craig Thomas of Wyoming.

**STATEMENT OF HON. CRAIG THOMAS, U.S. SENATOR
FROM WYOMING**

Senator THOMAS. Thank you, Mr. Chairman.

Welcome, Mr. Kelliher. Glad to have you here.

Mr. KELLIHER. Thank you, sir.

Senator THOMAS. We certainly need to fill those seats on FERC. And you seem totally qualified to do that. Obviously, we need some changes in our energy policy. We worked through some of that last year, did not complete our work, but intend to go back and do some more of it.

Part of that responsibility belongs to the Congress. Part of it belongs, of course, to FERC and the administrative agencies. Certainly, the Federal rules that we either put in through administrative or legislative efforts—we need to delegate as much authority as we can to the States. And I think there is an appropriate role for the interstate issue to be addressed. And perhaps it has not been as addressed as it might.

The electric generation transmission and distribution system in the Western United States is often referred to as the Western interconnect, as you know, highly interconnected and a complex system. It is characterized by widely diverse loads, equally diverse generation sources. More and more of them are becoming market generators and so on.

Loads range in size from the large in the densely populated areas of California on the west coast, to small and sparsely populated areas in the inner mountain region. Generation research includes large coal-fired plants, base-load plants, nuclear, wind, and hydro-power, of course.

The Western interconnect is also characterized by a wide diversity of ownership, including investor owned, vertically integrated utility systems, public power systems, such as Bonneville and Western Area Power in the Rocky Mountains. Amid this diversity, the challenge has always been to operate an entire Western system in such a way as to optimize the productive capacity of generation and transmission.

That is basically an opening statement. But I want to follow it with a question. And that is: Do you believe that we can put together an RTO in the western area in which we can get enough coming together among these different kind of users to have a system that will be most useful for the consumers?

Mr. KELLIHER. I agree with your—you describe a lot of the differences between the Western market and other markets. And that is one characteristic of the United States, is we do not have a na-

tional electricity market. We have a series of regional power markets. And there are important differences among those regions. As you have said, the West is different from other parts of the country. The transmission grid physically is different. The generation mix is very different, particularly in the Pacific Northwest.

And also, the West legally is different. FERC has very little, virtually no authority over the Federal utilities like Bonneville and WAPA and very little authority, virtually no authority, over municipal utilities. And they account for a very large share of the Western market, much more so than in other parts of the country.

So all that means—to me, that means that the West is significantly different. There is a great need to allow for regional flexibility and to take into account regional characteristics in developing any kind of market rules.

Senator THOMAS. Thank you, Mr. Chairman.

Senator CRAIG. Thank you very much.

Now let me turn to Senator Ron Wyden of Oregon.

Senator WYDEN. Thank you very much, Mr. Chairman.

And welcome to you, Mr. Kelliher.

Mr. KELLIHER. Thank you, sir.

Senator WYDEN. On that specific point, you have just said that there are differences in power markets in various parts of the country. But that is not what the FERC is looking at right now. What the FERC is looking at with the standard market design proposal is sort of a one-size-fits-all approach, saying that the whole country has to set up a transmission system to look like what they are doing in New Jersey, despite the fact that the Pacific Northwest is so different.

So tell me specifically, in terms of the concept, what do you think about the standard market design proposal, which is the principal issue on the plate at FERC? The people in my part of the country think that this is poison. They just think this is a disaster, the public utilities and others. I would like to know what you think conceptually about the single biggest issue on the FERC plate right now.

Mr. KELLIHER. Well, it is a big question. I am trying to be very careful, too, because I do not want to have to recuse myself from—

Senator WYDEN. Just tell me conceptually what you think about standard market design.

Mr. KELLIHER. I think conceptually FERC has identified certain goals they are pursuing in standard market design. They are trying to prevent market manipulation. They are trying to promote competition in the electricity power markets. They are trying to prevent market power abuse. They are trying to promote investment in generation and promote investment transmission.

And I—conceptually looking at those goals, I think those are good goals for the agency to pursue. I think the big fact question is: do the means advanced by FERC and standard market design advance those goals? Are the means in the FERC standard market design the right ones?

I mean, I think those general goals that I have laid out, I tend to think those are the right goals. But how to accomplish them is an open question. FERC right now, the standard market design

rulemaking is underway. There have been something like 500 comments received, totaling thousands of pages. And the comment period is still open. It will not close until the end of this month.

I understand Chairman Wood has agreed, in discussion with Chairman Domenici, to put out a white paper later in the spring. And the committee may hold hearings. So a lot of these issues are—first of all, there is an open record. And if I am confirmed to this position, I would have to make a decision based solely on the record before FERC. So I am reluctant to make specific comments.

Senator WYDEN. I understand that. But I will tell you, if you gave that answer at a town hall meeting in central or eastern Oregon, people would be up in arms. And you said in response really to two of my colleagues from the West, Chairman Craig and my colleague from Wyoming, that you recognized that there were tremendous differences between different markets. Your answer seems to minimize those differences.

And I want to ask about something else. But just note—

Mr. KELLIHER. Could I elaborate on that point, though, to try to reassure you?

Senator WYDEN. Please. Of course.

Mr. KELLIHER. That I think it is essential that there be regional flexibility, essential in the way FERC proceeds developing market rules. There is a separate proceeding, the RTO West proceeding. And to my understanding, FERC has allowed for regional flexibility in that proceeding.

For example, the Bonneville contracts, which I know is a concern for some of the members from the region, Bonneville has long-term power transmission contracts. And that, in the RTO West order, FERC, to my understanding, approved a proposal from the region to allow voluntary conversion of those contracts, not to abrogate those contracts, to allow voluntary conversion, to allow the contract holder to decide whether they want the new service or to retain their existing service. I think it is essential to—

Senator WYDEN. But all that is, of course, part of the past. We are looking at the future. And I am going to do everything in my power as a Senator to block standard market design. I think it would be a disaster for our area. I think it, by the way, is inconsistent with what you said earlier. I recognize you do not want to lock in on a position. But just know how strongly we feel about this issue.

Mr. KELLIHER. Yes, sir.

Senator WYDEN. The other area I wanted to touch on very briefly, Mr. Chairman, is FERC's enforcement record. And I think it is a dismal one. The General Accounting Office has been very critical about FERC's enforcement record. In our part of the country, we have had two of Enron's energy traders plead guilty to criminal violations for their energy trading activities in the west coast market, including Enron's head west coast trader. And yet FERC has not taken any action to rectify the impacts of the illegal trading on west coast utilities and consumers.

If you are confirmed as a member of FERC, what are you going to do to get the lead out of the agency's regulators and get us some real enforcement on these issues like the Enron violations?

Mr. KELLIHER. Sir, going back to 1998, I have believed that FERC's authority to impose criminal penalties has been inadequate. So going back 5 years, I have advocated—and in some cases, I am not aware that others have advocated; I think I have been on somewhat of a lonely crusade—to raise FERC's criminal penalties.

Criminal penalties right now are capped at \$500 a day. They are the same penalties that were set in 1935. I have thought that as markets become more competitive, it is clear that people have an incentive to violate the law if they are only subject to a \$500-a-day penalty. So I have advocated that for years. So I am not a recent convert on that issue.

But I do agree with your general thrust that FERC may need additional authority. Criminal penalty provisions, I think, are obviously inadequate.

Senator WYDEN. Well, it is a constructive answer again about having new penalties for the future. But we want to see action with respect to what is pending now. And that is my last question.

Bonneville has contracts with Enron that they were induced to sign at the time Enron was manipulating the market. We have these smoking gun memos showing how the major traders, if not the largest trader, was manipulating the market. If Bonneville could get out from under those worthless Enron contracts, our region—including my State, which has the second highest unemployment rate in the country—could save more than \$200 million. Now that is a significant amount of money.

Bonneville, at my request, has made a filing at FERC for relief from its Enron contracts. And my question is: I am sure you have seen these memos, because they have been out in wide circulation. Do you think that these memos provide Bonneville and the other Northwest utilities with a legal basis in which to get out from under these worthless contracts when Enron was manipulating the market?

Mr. KELLIHER. When you refer to memos, you mean the Enron marketing memos, the ones that—

Senator WYDEN. Yes, right, the smoking gun memos that describe how they were manipulating the market.

Mr. KELLIHER. As a legal matter, I do not know, sir. I thought that those memos were designed to manipulate spot markets. And I am just not familiar with the nature—

Senator WYDEN. We are talking about the Enron documents that were released last May.

Mr. KELLIHER. Yes, sir.

Senator WYDEN. That talk about manipulating the west coast market.

Well, I will wrap this up, because I have taken plenty of my time. I hope that you will specifically look at FERC's actions with respect to the west coast market, because I do not think the agency has followed up with the speed and the force that is necessary. And I want to see that changed.

But also with respect to this Bonneville filing, those are my priorities. And I felt that you were candid with me when you came to meet with me in my office. But I am troubled with respect to

what I am hearing today. And I may be following this up with some additional questions for you.

Thank you, Mr. Chairman.

Mr. KELLIHER. Thank you.

Senator CRAIG. Thank you, Senator.

Now let me turn to the Senator from Alaska, Lisa Murkowski.

Senator MURKOWSKI. Mr. Chairman.

And welcome, Mr. Kelliher.

Mr. KELLIHER. Thank you.

Senator MURKOWSKI. I would like to follow up with your comments to Senator Bingaman with regards to the Alaska natural gas pipeline. You have indicated that you have not expressed a personal preference as to whether the gas comes from Alaska or somewhere else. And, of course, we in Alaska would like to be able to supply everybody back here in Washington, D.C., and all over the country with our abundance of natural gas. We just need to get that gas line.

You have indicated that your role would be to ensure that the permitting is as expeditious as possible. And I just want to understand clearly that, in fact, should we work in the direction that we are going right now to get this gas line moving forward, that we will have the cooperation from the FERC in getting the permits in place, so that we can provide this domestic gas to the country at a time when it is seriously needed, and recognizing the incredible lag times that are involved here.

We would like to think that it is going to be as expeditious as possible.

Mr. KELLIHER. I will do everything I can, Senator.

Senator MURKOWSKI. Thank you.

I have no further questions, Mr. Chair.

Senator CRAIG. Thank you very much, Senator.

Now let me turn to Senator Byron Dorgan from North Dakota.

Senator DORGAN. Mr. Chairman, thank you very much.

Mr. Kelliher, you know that when we went through the hearings with respect to Enron and also other suppliers on the west coast, we had testimony on schemes to manipulate energy pricing, schemes that were called "get shorty," "fat boy," and "death star." The energy companies, of course, were insisting that, gee, they really were not doing anything wrong at all.

FERC was sitting on the sidelines dead from the neck up, doing nothing. And now, in the rearview mirror, it is quite clear that people on the west coast were literally fleeced out of perhaps hundreds of millions, and maybe even billions, of dollars.

We had hearings during this period in the Energy Committee. I told FERC that they reminded me of a potted plant, just sitting there, perfectly interested, and willing to do nothing in the face of a fair amount of evidence that what was happening in these markets was just byzantine and clearly wrong.

Give me your assessment of what you think happened during that period with the information we now know. And give me your assessment of how FERC behaved and acted during that period.

Mr. KELLIHER. With respect to Enron's behavior, the Commission, I understand, has an Enron investigation they are hoping to complete by the end of March. And that report would have to be

voted on by the Commission. So I am in a difficult position because if I were to express some clear views, I would have to recuse myself from that, from any kind of deliberations on that report. So I am not sure how I can satisfy you on that first question.

Senator DORGAN. Maybe I should not have asked the question specifically with respect to Enron. As you know, there were a number of market suppliers on the west coast.

Mr. KELLIHER. Yes, sir.

Senator DORGAN. They were engaged in the type of deregulation whose construct was inherently unworkable, but whose construct also made it possible for some energy suppliers to manipulate markets. In fact, in recent weeks we have read a piece about one company—and I think there was a guilty plea by executives of one company, or workers of one company—which took the load off the system in order to manipulate prices in the short term.

We know all of these things happen. I guess I am not going to ask you about Enron itself. You are an expert in the area of energy. You have a very impressive background. You clearly have some thoughts about what happened in California. Do you have any thoughts about FERC's role in the face of something like this, if it was to happen again?

Mr. KELLIHER. I can offer some general comments, if the question is how can we prevent this from recurring. I mean, I can offer some general thoughts on that.

One is: I do think there may be a need to consider adding some provisions to expressly prohibit market manipulation, that right now, under Federal electricity law, there is—a certain end state is prohibited. Unjust and unreasonable rates are barred under the Federal Power Act. So that end state, regardless of how it is achieved, is barred in the Federal Power Act.

But there is not an express prohibition on market manipulation that might lead to that end state. There is that kind of provision in securities law, for example. There is a prohibition of market manipulation. There is a prohibition of market manipulation in commodities law. And I think that is something that there may be a need to consider.

If the goal, if the concern is, “How do we prevent market manipulation,” and there is a consensus that market manipulation should be prohibited in electricity markets, then there may be a need to consider some legislation on that point.

Senator DORGAN. But is it not, on its face, obvious that FERC has the capability of now preventing market manipulation?

Mr. KELLIHER. Well—

Senator DORGAN. Are you saying that capability does not exist?

Mr. KELLIHER. Well, what I would say—you pointed to the Enron, the guilty pleas of the two traders. I think you referred to that earlier.

Senator DORGAN. That is correct.

Mr. KELLIHER. They pled guilty to wire fraud and conspiracy to commit wire fraud charges. There was no violation of the Federal Power Act, no violation of electricity law that they pled guilty to. They pled guilty to general wire fraud and conspiracy charges.

Senator DORGAN. Okay. But we are talking about two different things then, because on the criminal side, if people are engaged in

criminal behavior and criminal conduct, that is one set of issues. If companies, as what happened on the west coast, were manipulating price and supply in order to enrich themselves and disadvantage the consumers—in this case, in my judgment, they stole hundreds of millions of dollars and perhaps more. And they stole it right under the nose of FERC. And FERC had the capability to step in and did not.

Would you agree with me that FERC had the capability along the way to set caps on wholesale prices in California and stop the manipulation?

Mr. KELLIHER. FERC has an absolute duty under the Federal Power Act to prevent unjust and unreasonable rates. And price caps are one means—

Senator DORGAN. Right.

Mr. KELLIHER [continuing]. And not necessarily the only means. But price caps are a means that they can use to prevent unjust and unreasonable rates.

Senator DORGAN. What I am trying to get at is: During that critical period in which there was a fleecing of consumers, FERC took no action. And that is why I was very critical of FERC. I was trying to get some sense of whether you were critical of FERC taking no action. Mr. Wood, to his credit, came in and said, “We are taking action.”

Mr. KELLIHER. Yes, sir.

Senator DORGAN. Good for Mr. Wood. I have told him that. Is your assessment of FERC prior to Mr. Wood the same as mine?

Mr. KELLIHER. Many believe that FERC should have acted earlier to adjust price caps.

Senator DORGAN. How about you?

Mr. KELLIHER. I am a little hesitant because some of those matters, they are not just historical. They are pending before the Commission. There are proposals to amend the west-wide mitigation proposal. And that does involve price caps. So I do not want to have to recuse myself from considering those issues.

But what I am trying to say is, prospectively, if the concern is market manipulation, I think there are ways to address that prospectively. And some of them may require legislation.

Senator DORGAN. Mr. Chairman, would I have just another minute or two? I do not know what your time situation is.

Senator CRAIG. We will give you one more minute. Please ask another question. Then we will turn to Ms. Cantwell.

Senator DORGAN. I am sorry. I did not realize you were—okay.

I guess I am trying to understand your feeling about the role of FERC and your role as a commissioner. I really am not interested in sending a person to serve as they served during this period of manipulation with California, or, excuse me, the west coast, I should say—a person who is content to sit around and do nothing.

Mr. KELLIHER. Sir—

Senator DORGAN. I want people who are tigers in support of the consumer interest to be there addressing that interest.

Mr. KELLIHER. I think protecting the consumer interest is FERC’s principal responsibility. FERC has an absolute duty to prevent unjust and unreasonable rates. That is not discretionary. They

have to do so. There is not—they have discretion on how to prevent unjust and unreasonable rates.

So I would wake up in the morning knowing that is my number one duty, to protect the consumer interest. And I would have an absolute duty to prevent unjust and unreasonable rates. I would also have an absolute duty, if confirmed, to prevent undue discrimination and preference.

There is—FERC has discretion on how to achieve those ends. But it is an absolute duty that they have to fulfill.

Senator DORGAN. Well, Mr. Kelliher, you have a fine background. And I have no reason to believe you would not be a good addition to FERC. I feel that I would support your nomination and be voting for your nomination.

Mr. KELLIHER. Thank you, sir.

Senator DORGAN. I also fear that you are going to be a victim of this problem that Senator Bingaman mentioned. There was an agreement with The White House that we would fill both seats. You are well aware of these issues. If The White House sends a Republican nominee for the Republican seats and says, "We agree we will send the Democratic nominee so that we can fill these two seats at FERC," but does not send the Democratic nominee, Senator Bingaman is quite right; that is a problem.

My hope is that The White House will hear that, send us the Democratic nominee, who I hope will also be well-qualified. It will be my intention to support your nomination, because I think you will be a fine addition to FERC. And I hope to be able to support the Democratic nominee, as well.

But I do think that Senator Bingaman is right. The nomination will not move until The White House sends us the other, at which point we should move both of them.

I wish you well. We need good people on FERC. I thank you for offering yourself for public service.

Mr. KELLIHER. Thank you, sir.

Senator DORGAN. Your son actually yawned once during my questioning, which I think was a signal to me.

[Laughter.]

Senator DORGAN. You have a fine-looking family, as well. Thank you very much.

Mr. KELLIHER. Thank you, sir.

Senator CRAIG. Senator, thank you.

Now, let me turn to Senator Cantwell from the State of Washington.

Senator CANTWELL. Thank you, Mr. Chairman.

Senator CRAIG. Senator, we are doing 5-minute rounds. You can do your—if you have an opening statement, you can use the first round for that, if you wish, or go right into questions, of course.

**STATEMENT OF HON. MARIA CANTWELL, U.S. SENATOR
FROM WASHINGTON**

Senator CANTWELL. Thank you, Mr. Chairman.

And welcome, Mr. Kelliher.

And thank you, Mr. Chairman, for clarifying that. I am sure I could spend an easy 5 minutes explaining, hopefully not news to you, the crisis that has happened in Washington State. So my

questions are going to be similar to my colleague from North Dakota. Although I have to say, for Washington residents, and those in my home county particularly, who are stuck with a 50-percent rate increase because of the long-term Enron contracts that they have signed probably for 5 and 6 years, the fact that FERC has failed to act on this when people have owned up to being crooks, and the only policeman on the watch is FERC, is a tragedy.

And the fact is now, some of these people have even gone to court to find standing to challenge those contracts, only to have the courts dismiss them, saying it is FERC's responsibility to act. So ratepayers in my State are stuck, even after the guilt admitted by these manipulators of pricing, stuck with these high rates because FERC is failing to act.

Now, I would just like to clarify some of the issues, just—and I know that there is action before FERC. But some of this, some of the members of FERC have come before the committee and made statements. So I just want to see if you will answer those same questions.

But first of all, do you believe that price manipulation went on in the western markets? And I am sorry I did not hear all the questions before this. So if you have already answered this—

Mr. KELLIHER. I am trying to be very careful, because I do not want to have to recuse myself from matters that are pending. But there have been guilty pleas. People have pled guilty to committing fraud in power markets. There have been settlements and guilty pleas where people have admitted making false statements. They have admitted to criminal violations, making false statements with an intent to manipulate gas prices.

So I think, yes, I would have to agree there is evidence that there was manipulation in both power and gas markets.

Senator CANTWELL. And do you think in a broad sense now, in a broad sense, if there has been manipulation of contracts, that those prices could ever be just and reasonable?

Mr. KELLIHER. If there is manipulation of contracts or manipulation of markets?

Senator CANTWELL. Of markets and, therefore, in the contracts.

Mr. KELLIHER. That really does go to the heart of some of the contract cases before FERC. One of the fact issues in those cases is the relationship between spot markets and long-term markets. And so I have to be—

Senator CANTWELL. I am trying to get a sense of whether you think price manipulation, if somebody had openly admitted that they had manipulated the markets, whether those rates then could be considered just and reasonable.

Mr. KELLIHER. Under—FERC only has the tools that Congress has given it. And under the Federal Power Act, what is prohibited is an end state of unjust and unreasonable rates. Congress has never put into the Federal Power Act a prohibition of market manipulation. That is not in the Federal Power Act. What is in the Federal Power Act is a prohibition of unjust and unreasonable rates by whatever manner that is achieved, whether it be poor market rules, whether it be manipulation. So I think—

Senator CANTWELL. Are you saying that you think we need further clarification of FERC responsibility?

Mr. KELLIHER. I think if Congress wants to prohibit market manipulation, there are other laws that you could look to as a model. But there is no express prohibition of market manipulation in the Federal Power Act.

Senator CANTWELL. So the answer to the question of whether you think that market manipulation, that prices arising from agreed-to, market manipulation by various companies could be just and reasonable, you seem to be arguing that yes, that could be possible.

Mr. KELLIHER. I am sorry. I did not follow the question. You are saying that I—

Senator CANTWELL. I am asking you whether you think companies who admitted that they manipulated contracts and markets, whether those contractor rates could be just and reasonable. Would you say that they could be, even if the parties have admitted that they purposely try to scheme to increase the prices in the West?

Mr. KELLIHER. One complication is the first step you have to take in that kind of a question is, "Which markets?" There are different electricity markets. There is not just one electricity market. There is a spot market. There is a day ahead market. There is a real-time market. There is an ancillary services market. There is a long-term market.

And, you know, just conceptually, manipulation in one market does not necessarily affect prices in every other market. That is one of the major fact questions in the FERC contract reform cases.

This is a matter that, if I am confirmed, I would have to—I may have—if I am confirmed, I would have to make—I may have to vote on this. And I have a duty not to prejudge these matters.

Senator CANTWELL. Mr. Kelliher, the Commission, in a 2001 order, wrote that there is and was, during this critical crisis, a "critical interdependence" among the prices of California's ISO in the spot markets, in the bilateral markets, and the rest of the West. I mean, they made that statement. Do you agree with that?

Mr. KELLIHER. I believe their decision said that spot markets are dysfunctional and that prices in spot markets are unjust and reasonable. That is one of the issues in the contract cases, is that FERC finding, with respect to spot markets, to what extent does it carry over into disputes over long-term power sales contracts. What is the relationship? There is a factual question. What is the relationship between spot markets and long-term markets? And that is at the very heart of the contract cases.

There is also the other issue you are very familiar with and you have spent a lot of time on, which is: Which standard, which legal standard, governs? Is it the just and reasonable standard or the public interest standard in the contract cases?

But the major fact question is: What is the relationship between spot markets and long-term markets? The Commission did make that finding, as you said, insofar as it applies to spot markets. It certainly begs the question, "Well, does that mean there is—that necessarily in long-term markets prices were unjust and unreasonable?"

Senator CANTWELL. Mr. Kelliher, unfortunately I think my constituents believe that FERC is playing a shell game. They are playing a shell game using different standards of review when they have never used different standards before. They are leaving my

constituents without the ability to go to court and get relief or get relief from FERC.

And the Chairman and other members of the commission have been before this committee saying there was a relationship between the Northwest and spot markets. And now the Commission wants to. We will see what happens with FERC.

But I am telling you, the Congress set up FERC with this authority to give relief to consumers. And we have not even gotten into standard market design and all the other actions that FERC wants to take.

I see my time is up, Mr. Chairman. And I probably have not gotten to the degree of specificity I'd like. May we submit more questions?

Mr. KELLIHER. May I say one thing?

Senator CANTWELL. But I just want to finish that we could not be more displeased in the Northwest with the fact that we are going to be stuck with these prices even though companies have admitted guilt. FERC is the only policeman on the street, the only policeman on the street.

And you are asked to come here and answer questions for your nomination to this commission. And yet I see some of the same issues that FERC is now dealing with, the same kind of round-about answers here today that have frustrated citizens and businesses in my region. Mr. Chairman, I will submit for the record an article about businesses, Weyerhaeuser, other paper companies that have said, "We are paying the highest rates in the entire country in the Northwest."

A company in Everett, Washington, with several hundred employees probably will go out of business or have to shut down because of these rates. And they are looking to FERC as the only answer.

Thank you, Mr. Chairman.

Mr. KELLIHER. Thank you.

Senator CRAIG. Thank you, Senator.

Let me remind all of our members that we will have until 6 p.m. today to submit further questions for the record. And a copy of the questions should be provided to the chief counsel's office, if you have additional questions.

Mr. Kelliher, as you know, one thing we must all insist on is that the lights stay on. In other words, that reliability not be jeopardized. Would you agree that maintaining reliability is of paramount concern of a member of FERC?

Mr. KELLIHER. Yes, I do.

Senator CRAIG. Will you commit to this committee and to the Congress that you will place reliability of service at the top of your list of priorities as a commissioner, and that you will not support any measure that threatens it?

Mr. KELLIHER. Yes, sir. I make that commitment.

Senator CRAIG. Would you agree that some fundamental decisions on restructuring are for the Congress and not for FERC to make?

Mr. KELLIHER. Yes, sir. As I pointed out in my testimony, at one level I consider myself a creature of Congress. I have spent a lot

of my career working for Congress, and I have a tremendous respect for Congress's role in energy policy.

Senator CRAIG. We are in the midst of trying to structure an energy policy for this country. We were talking a moment ago about penalties. And you mentioned or referenced penalties that were put in place in the 1930's. The bill we attempted to move last year had substantial increases in penalties.

Do you have any suggestions for how FERC can work more closely with the Congress?

Mr. KELLIHER. Well, just as a general observation, our current policy is a result of collaboration. Really, for the past 25 years, Congress and FERC have worked very closely to develop electricity policy, open access policy, in particular. But with respect to how to maintain that—so I think it is essential that that collaboration continue.

But with respect to how to assure it continues, I can only say that I think hearings are helpful, because hearings are a way to make sure that Congress is familiar with what FERC's policies are and what policies they are considering, and also informal communications. And that is an area where I plan to spend a lot of my time. I hope my Congressional background will be an asset and help result in strong collaboration between Congress and FERC.

Senator CRAIG. Thank you. I am concerned that with FERC's focus on market design they are losing sight of the plain fact that without adequate transmission capacity, no competitive markets can truly work. Would you agree with that?

Mr. KELLIHER. I agree that a robust transmission grid is essential for a competitive market.

Senator CRAIG. Would you also agree that FERC ought to pay a little more attention to incenting the expansion of needed transmission capacity?

Mr. KELLIHER. I think FERC has to take steps to encourage investment in transmission in order to remove those constraints.

Senator CRAIG. Would you agree that this is key to expanding the scope of the market or markets?

Mr. KELLIHER. Yes, sir. Yes, I do.

Senator CRAIG. The proposed standard market design rule contains no evidence of systematic discrimination in access to the transmission system. The minimal anecdotal evidence is the proposed rule—in the proposed rule, is from experiences in the eastern interconnection. The Commission has been unwilling or unable to provide systematic evidence of transmission discrimination in the western interconnection despite the fact that the Commission's order 888, which prohibits such discrimination, has been in effect since 1996.

Before jettisoning the Commission's original remedy for discrimination order 888 in favor of imposing standard market design in the West, the Commission should be obliged to present systematic evidence for transmission discrimination in the Western interconnection.

My question, Joe, is: Prior to making decisions on the Commission, will you require that systematic evidence be presented on this issue?

Mr. KELLIHER. Sir, you have raised one of the fundamental issues in standard market design, under the status quo today, is there undue discrimination and preference in the electricity markets that are subject to FERC jurisdiction. And that is a fundamental aspect of standard market design.

And if I am confirmed to this position, that is—I have not prejudged that question, whether or not there is discrimination. And if I am confirmed to this position, I would make a decision on that issue based solely on the record before the Commission.

Senator CRAIG. So I am trusting that the answer to that question is yes, in relation to requiring that systematic evidence be presented on the issue.

Mr. KELLIHER. I think there would be a need for a record on that point.

Senator CRAIG. In the case of the proposed standard market design rule, the Commission has not presented systematic or even anecdotal evidence on discrimination in access to transmission in the western interconnection. Remedying discrimination is the fundamental objective of the standard market rule. Will you commit to developing such information prior to remedying a design on the proposed SMD rule?

Mr. KELLIHER. Yes, sir. I would have to be persuaded that there is evidence of discrimination.

Senator CRAIG. Okay. My colleague from Wyoming.

Senator THOMAS. Thank you, sir.

Let me scoot back over. You have jurisdiction also over pipelines, gas pipelines particularly.

Mr. KELLIHER. Yes, sir.

Senator THOMAS. The envelopment of methane gas production in Wyoming has run up against some problems that results in a very extreme price differential between the producer, the well price, and the market. Some say it is the lack of pipeline. Some say it is marketers buying space on the pipeline that will not let the independents on unless they sell at the lower price.

Would you be interested in helping to expedite to find the problem and expedite the development of new pipelines, in terms of FERC's role?

Mr. KELLIHER. Yes, sir. With respect to the second issue of whether or not there is a kind of gaming going on, I think that is something FERC should investigate. And with respect to the first question, whether pipeline capacity is inadequate and it may need to expand, I understood that there were—there are four—there are a few pipeline projects that are under discussion to try to remove those bottlenecks.

I do not think there are any applications before FERC right now. But hopefully one or more of those will bear fruit, and there will be an application. And if so, FERC should move expeditiously on it.

Senator THOMAS. That is good. And I think there is some responsibility of FERC to look into, when there are problems of that kind, to at least help find a solution. I think El Paso and Colorado Interstate are trying to do something.

With respect to—back to the electricity thing: It seems like if you are going to be able to resolve the movement of wholesale elec-

tricity, you are going to—and let the States have a good voice in interstate movement, you are going to have to have regional transmission organizations. We seem to be slow in getting one there.

The States involved and the Western Governors have outlined five areas. One of them is that FERC should specifically set aside the western interconnect from SMD rule and concentrate on working with the States to develop RTOs. Does that make sense to you?

Mr. KELLIHER. Well, right now FERC is proceeding on a two-track basis. There is SMD, and then they also are looking at individual RTO proposals in the West. The big question—and some of those orders, like in the RTO West order, FERC included a provision saying that to the extent there were differences between SMD and RTO West, RTO West would trump standard market design.

So I think there is an effort to try to show regional flexibility. And I think that is essential. The Western grid is different. And there is need to accommodate those differences.

Senator THOMAS. One of the real conflicts in terms of transmission is the heavy involvement of Bonneville and WAPA who apparently resist being part of an RTO and sharing their transmission in order to get on other people's transmission. So a little bit of a problem there.

We have heard a lot about the Northwest and California, of course. And they did have some very difficult things. Now there has been some ordered refunds to the States. My concern is: Are the utilities in other States, like Wyoming, Colorado, Utah, going to be disadvantaged as these companies have to raise their rates to pay off what they are owed in the west coast? It does not seem like that is quite fair.

Mr. KELLIHER. Yes. I thought that there was discussion of license plate rates where—instead of taking off different transmission rates for a certain RTO, adding up the cost and averaging all the different transmission rates, I thought initially the goal was to have license plate rates, so that there would be one rate, that the rate—there would be one transmission rate. It would not be pancaked. But the rate would be the rate that governed where the buyer, wherever the wholesale purchaser, was.

I know that is a confusing answer. But I think there was an attempt to avoid that problem of averaging and cost shifts and shifting into raising transmission rates in low cost areas.

Senator THOMAS. Well, there are those who feel like the companies, who are now going to be penalized perhaps in the west coast, will be raising their rates in Wyoming to help offset those costs.

Mr. KELLIHER. I think there is a way to guard against that. And I look forward to working with you on it.

Senator THOMAS. Yes. Well, thank you. I look forward to working with you. And I hope we can get this confirmation done quickly.

Mr. KELLIHER. Thank you, sir.

Senator THOMAS. Thank you very much.

Senator CRAIG. Joe, a couple more questions on my part before we conclude the hearing: One of the most controversial issues in the electricity debate in Congress has been to define the line between State and Federal jurisdiction, both as a matter of law and as a matter of sound policy. In your view, what should be the State and Federal roles in electricity regulation?

Mr. KELLIHER. I think Congress laid that line down in 1935 in the Federal Power Act. In that law, Congress defined clearly what the State and Federal roles were. The State role, Congress did not grant the States' role, because States had a role before the Federal Power Act. But Congress preserved the State role over retail markets. States have exclusive jurisdiction in that area.

Congress preserved State role over generation, over transmission siting, generation siting, local distribution lines, and transmission of electric energy in intrastate commerce. FERC was given jurisdiction over transmission of energy in interstate commerce and wholesale power markets. And I think that the lines that were drawn in 1935 still work. And there is no reason to change them.

Senator CRAIG. Thank you. There are a number of critics who feel that the last time Congress tried to streamline the hydro relicensing process under part one of the Federal Power Act in 1986, all we did was double the cost and add 50 percent to the time involved. Whether that is accurate or not, the process is not going quickly. And it is increasingly more expensive and usually results in a reduction in generating capacity.

I have been concerned about that for some time and have attempted to move legislation. And we attempted to deal with that last year, as we were trying to shape energy policy. What is your opinion of the current process? And do you believe that the problems are administrative at FERC and other agencies, or are they legislative, or a mix of both?

Mr. KELLIHER. Well, I certainly agree with you that the process is expensive and very lengthy. In at least one case, I think the Tacoma case, it took 22 years to relicense the project.

Senator CRAIG. That is a bit long, is it not?

Mr. KELLIHER. It seemed a bit long.

Senator CRAIG. Yes.

Mr. KELLIHER. And so there is some room for administrative reforms at FERC. And I think some of those reforms should focus on trying to move up decision making; instead of having decision making occur at the end of the process, try to have it occur as early as possible. And that might involve, or that might require to involve FERC staff earlier in the process.

FERC has encouraged settlements to try to get the parties to agree to the terms of a new license, of a relicense. And I think FERC does have a proposal right now, a hydro licensing reform proposal, that is intended to improve the administrative—make administrative improvements at FERC. But when it comes to the broader question of what kind of legislative reforms should be made, a lot of that falls outside the FERC domain. I mean, as you know, the hydro licensing process is an extremely complicated one. And it involves the interplay of something like 20 or 22 different laws.

I think FERC can do some things to improve the administrative side. But I think with respect to legislative changes, I would have to defer to Congress and—on what changes might be appropriate.

Senator CRAIG. I mentioned our efforts in the past several years. There is a perception that Federal agencies use their mandatory conditioning to require actions unrelated to the protection of the reservation or to avoid FERC's balancing test under section 10(j).

Concerns were also expressed over the timing of other Federal agencies' actions. Do you have any comments on this?

Mr. KELLIHER. I guess my only comment is—my perception is that the 10(j) process has worked pretty well. The last time I saw information in this area in 10(j)—you certainly know 10(j). But 10(j) is an area where agencies submit conditions to FERC, and FERC does not have to accept the conditions. FERC can accept or reject the conditions.

And the last time I saw any kind of numbers on that, which I admit was awhile ago, FERC accepted well over 90 percent of the, for lack of a better term, voluntary conditions submitted to it under 10(j). So I thought 10(j) worked well.

But with respect to mandatory conditioning, again, that is an area where only Congress can make decisions on whether or not to address mandatory conditioning of other agencies.

Senator CRAIG. In numerous orders, the Commission has stated that electricity markets are regional in nature and specifically that the boundary of the Western electricity market is defined by the electrically separate Western connection, which covers all or parts of 14 States, 2 Canadian provinces, and northwest Mexico.

Do you agree that electricity markets are fundamentally regional in character and that FERC's policies need to reflect the needs of such regional markets?

Mr. KELLIHER. Yes, I do. And I said earlier that the United States does not have a national electricity market. We have regional power markets. And there are differences among those regions, and it is essential that FERC consider those differences when developing market rules.

Senator CRAIG. In devising policies to meet the needs of regional markets, do you believe that States within those regions that are affected by such policies should have a role in deciding each policy, those such policies?

Mr. KELLIHER. Yes, sir. I think FERC has to work very closely with the States. If you look at the electricity regulatory scheme—I hate to use that word. It sounds pejorative. But our electricity regulatory scheme is a very Federalist approach. States have extremely important responsibilities. And FERC has important responsibilities. And I think that has to be borne in mind. And the two have to work together to develop rules.

Senator CRAIG. Specifically, do you support FERC's granting deference to the collective advice it receives from the States in the Western interconnection?

Mr. KELLIHER. Yes, I think FERC should give deference to the States in the Western interconnection.

Senator CRAIG. Senator from Wyoming, do you have any further questions?

Senator THOMAS. No, sir. I do not believe so. I am pleased with what we have heard today. And it is very indicative of the fact that those of us in the West are concerned about the differences there, which you agreed to. And of course, one of the real difficult decisions at some point is going to be whether the Federal power agencies are going to have to participate, like others, if there is any sort of an interstate transmission grid and some of those kinds of things. And those will be tough issues.

Mr. KELLIHER. Yes, sir.

Senator THOMAS. But, you know, as people generate more than their native load, why, they will be wanting to go into a sales system. And I think we are going to have to really take a look at the changes that have taken place in the electric energy business. And, of course, generation being deregulated is a good thing.

Thank you.

Senator CRAIG. Well, Joe, I have one more question. And I will move with some haste. Both of your children are asleep. That ought to be indicative of the fact that we should be wrapping this hearing up.

Senator THOMAS. I hope it is only the children so far.

[Laughter.]

Senator CRAIG. We are not going to debate who has put them to sleep.

[Laughter.]

Mr. KELLIHER. They usually nap at this time. I should point that out for the record.

Senator CRAIG. I see.

[Laughter.]

Senator CRAIG. All right. Well, then we will blame it on you and your wife.

Mr. KELLIHER. They are on a good schedule.

Senator CRAIG. All right.

For many years, no Commissioner on the FERC has brought to the Commission firsthand experience in working in the Western interconnection. This serious lack of experience with Western electricity, with the Western electricity system, has hampered the Commission in taking appropriate action in response to challenges to the West.

You share this lack of experience in Western interconnection. To overcome this commission handicap, would you advocate that the Commission hold decision meetings in the West when addressing Western issues?

Mr. KELLIHER. I think it is appropriate to have meetings in the West on the issues that are of fundamental importance to the West.

Senator CRAIG. Existing FERC Commissioners have undertaken some effort to make FERC less of a Beltway insular agency through devices such as regional panels. However, this attempt has been halfhearted and typically amounts to little more than an opportunity for State PUC commissioners to get on a conference call with FERC Commissioners.

For FERC Commissioners to understand the realities of Western electricity systems and hear directly from the people impacted by the Commission's policies, the Commission, in my opinion, needs to better engage those affected by FERC policies.

Would you advocate that the Commission experiment in the Western interconnection with new approaches, such as joint boards under section 209-1 of the Federal Power Act to provide for joint decision making by the Commission and the States on electricity issues before FERC that affect citizens of the West?

Mr. KELLIHER. I agree with you that any collaboration between FERC and the States has to be meaningful to be of any value. And

I think the proposal to form a joint board is an interesting one. That authority in FERC is rarely used. And to be honest, I do not know why. I think it has been in the act since 1935, but it is rarely used. And that is—I am open to that idea. I think it is an interesting one. I will look into that.

Senator CRAIG. Well, as you know, the dysfunctional character of the West during the last energy crisis, you have heard from many of the Western Senators, very frustrated and concerned about what it did to regional power costs and the action and/or inaction that has resulted and the impact of that pricing still existing. So I think to move the FERC West for a while to begin to understand it would be an appropriate effort. And I would hope you would encourage that.

We have just been graced with the presence of the Senator from Louisiana.

Senator Landrieu, I was making this my last question under the due caution that both of Joe Kelliher's children are now asleep. I know you have small children.

Senator LANDRIEU. Sometimes that happens to us.

[Laughter.]

Senator CRAIG. But I will turn the hearing to you for any opening comment and/or question you would like to ask of the nominee.

Senator LANDRIEU. Thank you, Mr. Chairman. I appreciate the opportunity just to ask a few brief questions. I know the hearing has been going on for some time, and I wanted to submit a statement for the record and ask unanimous consent at this time for my statement to be entered in the record.

Senator CRAIG. Without objection.

[The prepared statement of Senator Landrieu follows:]

PREPARED STATEMENT OF HON. MARY L. LANDRIEU, U.S. SENATOR
FROM LOUISIANA

Mr. Chairman, this hearing takes place at a difficult time in the energy industry, especially the electric industry. There have been many times in the past when the nomination of a new Commissioner attracted little attention. This is clearly not one of those times. While many companies in the energy industry are in financial distress, we are treated to the sight of some of their employees being led off in handcuffs. We see many states slowing, stopping, and even reversing the move toward retail competition in the electricity industry that just a year or so ago seemed to be in such favor. Most would say that this sense of caution with regard to changes in retail electricity markets is well-placed, considering the events of the past several years.

However, despite the well-publicized difficulties with retail competition, competitive wholesale electricity markets have been benefiting consumers across the country. The competitive wholesale market is not going to go away, nor should it. There are actions that can, and should, be taken to make it work even better. I understand that this was the goal of the FERC proposed rulemaking on Standardized Market Design. Generally, I have no problem with this goal. I do have serious concerns about part of the SMD proposal and whether these controversial provisions are necessary to improving wholesale competition.

The traditional division of authority between state regulators, who oversee retail markets, and Federal regulators, who oversee wholesale markets has served us well for almost seventy years. And, as we have seen, a well-placed sense of caution about sudden changes can be a good thing. This is particularly true of regulators in states with relatively low electricity costs, who don't see where their current system is broken.

With the SMD proposed rulemaking, FERC has gone beyond "designing" the wholesale market, and intruded into areas of historic state authority. This has transformed what could have been polite skepticism from state regulators into outright hostility. By attempting to assume authority over transmission used to serve

retail customers, system planning and other areas of state jurisdiction, FERC has taken steps that are NOT necessary to improve wholesale electricity markets. If these Federal/state conflicts are not resolved, a long stalemate and endless litigation could be the result. I believe that FERC can achieve the quickest and most significant improvement in the wholesale market, and avoid this impasse, by taking only those actions necessary to improve wholesale electricity markets.

In addition to resolving the jurisdictional issues, a key to obtaining the support of many state regulators is ensuring that costs for transmission upgrades and interconnections are paid for by those who cause those costs. Because we are blessed with abundant natural resources, the State of Louisiana has experienced a huge construction boom in power plants that are built in large part to participate in competitive wholesale markets. These plants will require several billion dollars worth of new facilities to hook up to the grid and move their power to markets in and out of Louisiana. If all these costs are "rolled into" the rates of Louisiana's retail ratepayers, they could face a major rate increase. These are already some of the poorest people in the nation. The answer to this problem is "participant funding," which will assign these costs to the cost-causers.

The proposed rulemaking on Standardized Market Design states that it has a preference for participant funding. Chairman Wood also has endorsed participant funding in his public statements. However, I am quite dismayed that in recent orders, the FERC has chosen to force the ratepayers of Louisiana to subsidize participants in the wholesale electricity market by abrogating existing interconnection contracts and placing the burden of interconnection costs for wholesale generators onto the Louisiana retail consumer. These are costs that these generators had previously agreed to pay. While I appreciate the financial condition many generators are in, there is absolutely no justification for making the citizens of Louisiana bear the burden of these poor investments.

With all due respect, these orders call into serious question whether FERC is truly committed to participant funding. As indicated in a cost-benefit study conducted by the Southeastern Association of Regulatory Utility Commissioners, participant funding is the key to making SMD a net benefit for the Southeast. For SMD to work, participant funding must be a reality, not just a promise.

In conclusion, I look for Mr. Kelliher's responses to the following questions that are of great importance to Louisiana and the southeast.

Senator LANDRIEU. Mr. Kelliher, I have enjoyed working with you and Secretary Abraham on so many issues. And there would have been a time when an appointment to a board such as this would not have attracted too much attention. But that, of course, is not the case today, because it is a very critical issue for our Nation and one that has really not been decided. And there have been, of course, many, many situations that have been very tough on consumers, as well as providers from one part of the country to another.

So you are coming at this job in a very critical time. But representing the Southeast part of the country—and, of course, Louisiana does generate a tremendous amount of energy, not just for ourselves but for the country—I have been particularly focused on the issue of cost causation for participant funding, trying to think if we are going to move in the direction of expanding the grid and the reliability of the grid and trying to keep affordable prices, that expanding the transmission lines in this Nation are very important.

So I wanted to ask you just if you could comment just briefly on your general philosophy about how that should be accomplished in terms of charging customers in one region of the country for the construction of transmission lines. Because this is a very contentious issue in Louisiana, as you may be aware. And I need to be clear about your views, so that I can communicate that to the people of my State and to the Public Service Commission, particularly.

Mr. KELLIHER. Senator, I am aware of your interest in this area. And you had legislation in the last Congress on participant funding. And I agree with the general concern that there are serious

issues of cost shifting. If the transmission grid in one region of the country has to be expanded in order to accommodate exports from that region to a neighboring region, the region that is receiving the power should not—they should not receive some kind of subsidy in the process.

I think cost causation is generally a good approach that FERC should bear in mind when it makes decisions on transmission pricing. And participant funding is one of the issues that has come up in the context of standard market design.

Senator LANDRIEU. Well, I appreciate those comments and just want to say to you and to my colleagues how important I think this issue is, because we are never going to build the kind of transmission or capacity that we need, if we are going to ask the States that do not need the extra capacity to bear the cost of its construction. There has to be a fair way that the people who need the energy are paying for the cost of receiving the energy or the electricity.

And I am not saying that our plan is perfect. And I think that there are some weak points of it. But it is a very important issue, and I am not sure how we are ever going to resolve the situation that we are in at this time.

One other question, just for now, and I will submit the rest for the record. And I appreciate your answers, and I thank you for that.

What about the role of State regulators in terms of siting transmission planning decisions between the State regulators and the Federal? Could you just give a comment about your general philosophy about where the lines should be drawn, or just a general comment?

Mr. KELLIHER. Who should site transmission?

Senator LANDRIEU. Yes, site transmission and how much authority should be given at the local level or at the State, the Federal level.

Mr. KELLIHER. Okay. I mean, under current law, States site transmission. And that is the way it has been since 1935. And I think Congress should only change that if a compelling case can be made that State siting is not working and there is a need to shift it to the Federal level.

This issue has come up before in the natural gas pipeline context. When the Natural Gas Act was first enacted in 1938, States had siting over natural gas pipelines. FERC, or its predecessor agency, the Federal Power Commission, was not given authority to site pipelines.

Ten years later, in 1948, Congress stepped in, preempted the States, and transferred it to FERC, again, its predecessor. Something happened in that 10 years to convince Congress that State siting was not going to work on interstate natural gas pipelines. We have nearly 70 years of history in the area of siting electricity transmission lines. And Congress has not come to the same conclusion.

Senator LANDRIEU. Okay. Thank you.

Mr. Chairman, I appreciate it. That ends my questions.

Senator CRAIG. Senator, thank you for your participation.

Mr. Kelliher, thank you very much for being with us, for your candidness. I cannot prejudge timetables here. You have heard some concern expressed by some of my colleagues today about another commissioner slot and how that gets filled, and I know that is being addressed at this time. So I am sure that you have waited some time already and will anticipate a bit longer in that wait.

But at the same time, I think this committee, and certainly this Senator, recognizes the importance of filling these positions on the Commission so that it can be at full force in its decision making. And so I will—I trust that we will act expeditiously and encourage the administration to move quickly, also.

With that, I had mentioned that the record will stay open until 6 p.m. this evening for any additional questions to be offered for your response, to Senators who might offer.

With that, this hearing will stand adjourned. And again, I thank you.

Mr. KELLIHER. Thank you, sir.

[Whereupon, at 3:50 p.m., the hearing was adjourned.]

APPENDIXES

APPENDIX I

Responses to Additional Questions

February 21, 2003.

Hon. PETE V. DOMENICI,
Chairman, Committee on Energy and Natural Resources, U.S. Senate, Washington, DC.

DEAR CHAIRMAN DOMENICI: Enclosed are my responses to questions for the record of the Senate Energy and Natural Resources Committee's February 11, 2003 hearing to consider my nomination to be a member of the Federal Energy Regulatory Commission.

If you have further questions or need additional information, please let me know.
Sincerely,

JOSEPH T. KELLIHER.

RESPONSES TO QUESTIONS FROM SENATOR CAMPBELL

Question 1a. As a FERC Commissioner, one of your first duties would be to implement the proposed Standard Market Design Rule. As I am sure you are aware, the SMD is extremely controversial with large regions of the country.

In fact, Colorado's Public Utilities Commission stated that the "SMD embodies the dictionary definition of impudence: the quality of being offensively bold. While boldness may be required where problems are manifest and immediate, it becomes offensive when it upsets settled jurisdictional understanding and offers expensive Procrustean solutions for yet-to-be documented problems."

In large measure, Colorado is concerned that the SMD fails to recognize regional differences, and that FERC's broad approach could injure ratepayers.

Do you agree that electricity markets are regional in nature?

Answer. I agree the United States does not have a national electricity market, and electricity markets in this country are regional in nature.

Question 1b. In devising policies to meet the needs of regional markets, do you believe that the states within those regions should have a role in deciding such policies? Specifically, would you support FERC granting deference to the collective advice it receives from states in the Western Interconnection?

Answer. I agree States should have a role in devising regional market rules. I also agree FERC should work closely with the States in the development of market rules and regulatory policies, and grant States deference. Collaboration between FERC and the States is essential. To have any value, collaboration must be meaningful. Our electricity laws reflect a Federalist approach. States have very important responsibilities; FERC also has important responsibilities. I respect the role of the States in electricity regulation and assure you if confirmed I will work closely with the States.

Question 2a. Colorado and other western states are concerned with the SMD's jurisdictional application. Much of the West's transmission and generation infrastructure is owned by non-FERC jurisdictional entities. For example cooperative and municipally owned utilities, as well as the Western Area Power Administration are not FERC jurisdictional, yet provide a large share of Colorado's electricity.

How do you imagine the SMD would work considering these entities are not covered by the SMD?

Answer. Congress made a very deliberate decision in 1935 when it consciously refrained from granting FERC authority over State and municipal utilities, rural electric cooperatives, and Federal utilities such as the Bonneville Power Administration

and Western Area Power Administration. I respect the judgment of Congress. I understand these nonjurisdictional utilities represent roughly half the Western power market. It is necessary that FERC work closely with the region to develop regional market rules. Under current law, FERC cannot command nonjurisdictional utilities to adhere to any market rules, and nonjurisdictional utilities are free to decide whether to voluntarily bind themselves. They will only do so if these rules make sense in the West.

Question 2b. If confirmed as a FERC commissioner, how would you balance the detrimental effect on consumers against broad policy objectives?

Answer. If confirmed by the Senate, I would place the interests of consumers first and foremost.

RESPONSES TO QUESTIONS FROM SENATOR SMITH

Question 1. In response to a question at the hearing, you stated that the Federal Power Act provided clear guidance on the jurisdiction of federal and state regulators with respect to electricity, and that those lines of authority still work. Can you tell me where “bundled” retail sales fall in the guidance provided by the Federal Power Act?

Answer. There is no question retail sales are under the jurisdiction of the States. Under the Federal Power Act, States have exclusive jurisdiction over retail sales and “facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter.” The Act also provides that FERC jurisdiction “extend[s] only to those matters which are not subject to regulation by the States.”

Question 2. If FERC’s Order 888 prevents undue discrimination on the transmission system, why is the proposed rulemaking on standard market design necessary? Doesn’t the FERC have the tools through Order 888 or through any orders on regional transmission organizations to remedy undue discrimination in those limited geographic areas where it may actually be shown to exist?

Answer. In the Standard Market Design proposed rule, FERC found that Order 888 has not eliminated undue discrimination and preference and “unduly discriminatory transmission practices have continued to occur That finding is the legal basis for the proposed rule. Under section 206(a) of the Federal Power Act, if FERC determines that “any rate, charge[, or classification . . . for any transmission or sale subject to the jurisdiction of the Commission . . . is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.” So, if FERC finds undue discrimination and preference exists in transmission subject to its jurisdiction, it has a statutory duty to act. The Standard Market Design proposed rule is the specific action FERC has proposed to remedy undue discrimination and preference. I have not prejudged whether I agree with this finding. If confirmed by the Senate, I would make a decision based solely on the record. If I were to make an independent judgment that the record supports such a finding, in my view FERC would have a legal duty to take some action. That action need not take the form of the Standard Market Design proposed rule. I agree FERC has a number of tools at its disposal, and has discretion on what specific action it can take.

Question 3. FERC’s standard market design rule is based on the theory that essential electricity services like transmission should be “allocated to those who value them most.” As I’ve stated before publicly, those who value them the most and those who can pay the most for them are not always the same thing. How does such an allocation scheme benefit rural and residential customers?

Answer. I am not convinced that allocation of transmission rights based on an auction is appropriate. If confirmed by the Senate, I would have to be persuaded by the record before I would support an allocation based on auction.

Question 4. How does a financial tool to handle transmission congestion, or locational marginal pricing, benefit the retail customer?

Answer. I am not convinced that locational marginal pricing and congestion revenue rights benefit consumers. If confirmed by the Senate, I would have to be persuaded by the record before I would support locational marginal pricing and congestion revenue rights in Standard Market Design or regional transmission organization proceedings.

RESPONSES TO QUESTIONS FROM SENATOR FEINSTEIN

Question 1. Since FERC has an obligation to ensure rates are just and reasonable, and selling energy at market-based rates is a privilege, not a right, shouldn’t the

Federal Energy Regulatory Commission have rescinded Reliant's authority to sell power at market-based rates to send a message that fraud and manipulation like we see in these transcripts will not be tolerated?

Answer. I have reviewed the transcript of the conversations of the Reliant employees and on a personal level find the statements reprehensible. I agree authorization to sell power at market-based rates is a privilege, not a right, and FERC can revoke market-based rate authorization. Under the right circumstances, FERC should do just that. I am not familiar with the record in the Reliant case. All I have seen is the transcript. If confirmed by the Senate, I may have to make a decision on this matter, and I would have a legal responsibility to make a decision based solely on the record. I assure you if I am confirmed I will review the record and make an independent judgment on whether revocation of Reliant's market-based rate authorization is appropriate.

Question 2. What type of fraud and manipulation would there have to be for you to vote to rescind a wholesale generator's authority to sell at market-based rates? If all Reliant has to do is pay back the money they made withholding the power, what is to stop them or another company from manipulating the market again?

Answer. Under certain circumstances, it is appropriate to hold a corporation liable for the acts of directors, officers, employees, and agents. It all depends on the facts of the case. As I indicated, I am not familiar with the record in the Reliant case. I agree authorization to sell power at market-based rates is a privilege, not a right, and FERC can revoke market-based rate authorization. I agree penalties must be sufficient to discourage market manipulation. As I noted at the hearing, for years I have believed the criminal penalties in the Federal Power Act are woefully inadequate. Well before the Enron marketing strategies were revealed, I advocated tougher criminal penalties, both higher monetary penalties and longer prison terms. In my view, the penalties authorized by Congress in the Federal Power Act are unlikely to discourage criminal behavior. I discuss my views on appropriate penalties in my response to question 7.

Question 3. Do you believe Reliant's withholding of power from the Western Energy Market was confined to only two days—June 21 and 22 of 2000? Do you believe Reliant was the only company to withhold power during the Western Energy crisis?

Answer. I have no basis to believe Reliant's withholding of power was confined to the two days in question, and have no reason to believe Reliant was the only company to engage in withholding during the Western power crisis. However, any determination would have to be based on the record.

Question 4. When Reliant held power offline and prices soared, other wholesale generators profited as much as Reliant, if not more, because the market clearing price was paid to all parties bidding into the California market. Is there a remedy for this? If not, what is to prevent Reliant from holding power offline one day and another firm doing it the next day and a different firm doing it the day after that?

Answer. I agree there is a need to take firm steps to prevent market manipulation. One approach would be for FERC to use its existing legal authority to prohibit manipulative practices such as withholding. FERC has a legal duty under section 206 of the Federal Power Act to prevent unjust, unreasonable, unduly discriminatory or preferential rates, charges, classifications, rules, regulations, practices and contracts. An argument could be made that FERC has legal authority to prohibit manipulative practices as inherently unjust, unreasonable, unduly discriminatory or preferential. I would support that approach. There would likely be legal challenges to any Commission effort in this area. Regardless of the means, conspiracy to manipulate markets should be prohibited.

Question 5a. I strongly believe that FERC has an obligation to families and businesses in the West to use its subpoena authority to get all of the tapes from Reliant and review the conversations to see if the company intentionally withheld power other days besides June 21 and 22. Do you agree?

Answer. There is a need to investigate whether there were other instances of withholding during the Western power crisis. If it were necessary to use FERC's subpoena authority to get additional information and conduct such an investigation, I would support doing so.

Question 5b. Would you support releasing these tapes and other evidence of wrongdoing to the public?

Answer. As a general matter, I support disclosure consistent with other legal constraints. I would support releasing evidence of market manipulation to the public.

Question 6. Last week I sent a letter to FERC Chairman Pat Wood asking the Commission to lift its order that keeps all evidence of fraud and manipulation that is uncovered before February 28th secret. I sent the letter because I believe FERC must serve the public interest and people have a right to know the extent of fraud and manipulation that has occurred in the energy sector. Would you support lifting

the protective order that keeps information found by the California parties seeking refunds confidential?

Answer. As a general matter, I support releasing evidence of market manipulation to the public. I am not familiar with the legal issues associated with the use of protective orders, however. If confirmed by the Senate, I would have a responsibility to make decisions based solely on the law and the facts.

Question 7. What should be the punishment for companies and individual employees that deliberately withhold power to drive prices up and cause blackouts?

Answer. There is a need for a range of penalties for both companies and individuals that engage in market manipulation. Penalties for corporations could include significant civil and criminal penalties and revocation of market-based rate authorization. Penalties for individuals could include significant civil and criminal penalties, longer prison terms, and a lifetime ban on employment in the electricity industry.

Question 8. As you know, I plan to introduce legislation with Senators Fitzgerald, Lugar, Harkin, Cantwell, Wyden, and Leahy to bring oversight to unregulated energy trading and increase penalties for misconduct. Will you support this bill?

Answer. I agree there is a need to prevent market manipulation, agree there is a need for legislation, and support the goals of your legislation.

RESPONSES TO QUESTIONS FROM SENATOR LANDRIEU

Question 1. Do you believe it is proper to charge customers in one region of the country extra costs for constructing transmission facilities, in order solely to benefit customers in another region of the country with higher wholesale electric costs?

Answer. No.

Question 2. Do you believe that it is appropriate for the states to retain the authority to veto any transmission planning decision based on legitimate and reasonable concerns?

Answer. Under current law, States retain the authority to site transmission facilities. In my view, Congress should only consider changing the law if a compelling case can be made that State siting is not working.

Question 3. Do you believe state regulators should retain a role in market[] monitoring after the implementation of SMD? What role?

Answer. I agree States should retain a role in controlling market power. Under current law, States retain exclusive authority over retail markets. So, States have responsibility to control market power in retail markets. Market monitoring in Standard Market Design is one of the areas addressed by public comments. I believe a State role in market monitoring is appropriate, and will review public comments that discuss the State role.

Question 4. Do you believe that it would be appropriate to do economic studies to determine the costs and benefits of SMD implementation, prior to requiring such implementation?

Answer. I agree there should be some rationale basis to believe Standard Market Design will result in consumer benefits before implementation of a final rule. Economic studies could provide such a basis.

RESPONSES TO QUESTIONS FROM SENATOR CANTWELL

Question 1a. The western electricity crisis continues to devastate the economy of my home state. And yet, consumers in Washington continue to await any action by FERC to help remedy the situation. I know that you cannot comment on the specifics of any particular case. However, these questions resemble those I have previously asked FERC Chairman Wood in hearings before the Energy Committee.

Specifically, I know that you are acquainted with the smoking-gun Enron memos, in which the company laid out strategies such as Fat Boy, Get Shorty, Death Star and the like, to drive up prices in the west. Similarly, I assume you are acquainted with FERC's recent order involving Reliant, in which that company agreed to a settlement after transcripts were revealed in which traders admitted the marketer was withholding power.

Do you believe that these strategies in general—using various means to create phantom congestion, shipping power out of California to evade price caps and deliberately withholding power, to name a few—indicate market manipulation?

Answer. The Enron marketing strategies certainly indicate an intent to manipulate markets; many of these strategies were rooted in outright fraud and deception.

Question 1b. Do you agree with Chairman Wood's statement before this Committee, that there is no circumstance in which a transaction resulting from manipulative market practices can be "in the public interest," or "just and reasonable?"

Answer. Under the Federal Power Act, FERC has an absolute duty to prevent unjust and unreasonable rates, regardless of causation. Market manipulation is one possible cause of unjust and unreasonable rates. Securities and commodities law draw a distinction between market manipulation and attempts to manipulate markets, because the possibility exists an attempt to manipulate markets may be unsuccessful. Manipulative practices in electricity markets should also be prohibited regardless of whether they are successful.

Question 1c. Do you agree with the Commission when, in its June 19, 2001 order, it wrote that there is and was during the crisis “a critical interdependence among prices in the [California] ISO’s organized spot markets, the prices in the bilateral spot markets in California and the rest of the West, and the prices in forward markets”?

Answer. As a general matter, I believe there is a relationship among prices in the spot markets in the West and forward markets. The exact nature of that relationship is a question of fact that is central to the refund and contract cases before the Commission. If confirmed by the Senate, I would have a legal responsibility not to prejudge, the issues in those cases, and make decisions based solely on the record.

Question 1d. Because prices in the Northwest are directly impacted by prices in California and FERC has determined prices in California were unjust and unreasonable, don’t you agree that the Commission would be discriminating against Northwest consumers if FERC granted refunds for overcharges to California consumers, but not refunds for overcharges to other consumers, including my constituents?

Answer. It is my understanding the Commission has ongoing proceedings to address the relationship between spot market prices in California and those in the Pacific Northwest. I generally believe there is a relationship between spot markets in California and spot markets in the Pacific Northwest. The exact nature of that relationship is a question of fact that is central to the refund cases before the Commission. I believe decisions involving refunds should reflect a consistent approach. However, I must state I am not familiar with the record of these cases, and if confirmed by the Senate I would have a legal duty to make decisions solely on the law and the facts.

Question 2a. When you joined the Bush Administration, the President, the Vice President and Secretary of Energy were all outspoken opponents of implementing price caps in California and throughout the west. Fortunately, Chairman Wood and others brought sanity to the situation and imposed caps to reign in the skyrocketing electricity prices that have had such a devastating impact on the economy of the Northwest.

Were you aware of then-Enron Chairman Ken Lay’s memo to Vice President Cheney, urging the Administration to “reject any attempt to re-regulate wholesale power markets by adopting price caps . . .”?

Answer. I learned of the memo from an article that appeared in *The San Francisco Chronicle* on January 30, 2002, seven months after FERC adopted price mitigation.

Question 2b. Did you, in your capacity as a senior advisor to Secretary Abraham, advocate Enron’s position, in opposition to the price caps that proved so necessary to rein in western energy markets?

Answer. No.

Question 2c. If, hypothetically, you had been a commissioner during June 2001, would you have voted for the Commission’s price mitigation order?

Answer. I may have advocated a different form of price mitigation, but if I had been a Commissioner I would have supported price mitigation.

Question 2d. If your nomination is confirmed by the Senate, and a situation similar to the western energy crisis were to transpire, would you support FERC action to limit the market price for power?

Answer. If confirmed by the Senate, I would have an absolute legal duty to prevent unjust and unreasonable rates. If a situation similar to the Western power crisis were to arise, I would support FERC action.

Question 3a. It seems to me we have learned a number of lessons about market manipulation from the western energy crisis. In response to the findings of FERC’s investigation thus far, would you:

Support the Commission’s adoption of a general tariff provision that would explicitly bar companies from withholding available generation if it’s necessary to meet demand, similar to the tactics Reliant employed? If not, why?

Answer. There is a need to take firm steps to prevent market manipulation. The question is how best to accomplish that goal. One approach would be for FERC to use its existing legal authority to prohibit withholding and other manipulative practices. FERC has a legal duty under section 206 of the Federal Power Act to prevent unjust, unreasonable, unduly discriminatory or preferential rates, charges, classi-

fications, rules, regulations, practices and contracts. An argument could be made FERC has legal authority to prohibit manipulative practices as inherently unjust, unreasonable, unduly discriminatory or preferential. I would support that approach. There would likely be legal challenges to any Commission effort in this area.

Question 3b. Support the Commission's adoption of a general tariff provision that makes automatic the disgorgement of profits once FERC has found that a company has charged unjust and unreasonable rates? If not, why?

Answer. I agree penalties must be sufficient to discourage market manipulation. As I noted at the hearing, I have believed for years the criminal penalties in the Federal Power Act are woefully inadequate. Well before the Enron marketing strategies were revealed, I advocated tougher criminal penalties, both higher monetary penalties and longer prison terms. In my view, the penalties authorized by Congress in the Federal Power Act are unlikely to discourage criminal behavior. I would support a general tariff provision that provides for disgorgement of profits in the event a market participant violates clear rules governing market manipulation. The legal authority of FERC to impose higher penalties through a general tariff provision than provided in statute would likely be challenged. For that reason, it may be appropriate to consider legislation.

Question 4a. As you likely know, the Commission's standard market design proposal has sparked quite a bit of controversy from the western region of the country—including my home state of Washington. To put it succinctly, many folks in the Northwest believe that SMD was conceived to address problems that don't exist in our region; that FERC's proposed pricing scheme might not work on an integrated, hydro-based system on the scale of the Federal Columbia River Power System; and that the proposal (as written) could void existing transmission contract rights and leave consumers holding the bag for higher costs.

Do you agree that FERC should not and cannot proceed to impose uniform national policies such as Standard Market Design—which would create new market structures and expose consumers to new risks—without clear and accepted evidence that benefits from those policies will outweigh the costs, on a region by region basis?

Answer. I agree FERC should not proceed with Standard Market Design unless the record shows that doing so is in the public interest.

Question 4b. Do you believe FERC has met that burden of proof? What, in your opinion, must FERC do to make an affirmative showing that the benefits outweigh the risks on a region by region basis?

Answer. The record of the Standard Market Design proceeding is extensive. Public comments total thousands of pages, and reply comments were only recently filed. I have not had an opportunity to review the complete record, and have reached no final judgment about the proposed rule. I agree FERC should not proceed with Standard Market Design unless the record shows that doing so is in the public interest.

Question 4c. Will you commit that you will not support any version of Standard Market Design in the absence of concrete evidence that it would either lower costs for, or hold harmless, consumers and businesses in my home state of Washington?

Answer. Protecting consumers is FERC's primary responsibility. If confirmed by the Senate, I would not support market rules for the Pacific Northwest unless I were convinced, based on the record, that such rules were in the public interest.

Question 4d. Do you agree with my opinion that, given the devastating impact the FERC-approved California restructuring debacle had on the entire economy of the Northwest, that the burden of proof should lie with FERC, to demonstrate why its SMD proposal will work, rather than with market participants and consumers, who are otherwise forced to disprove the Commission's theoretical model of market design?

Answer. The burden lies with FERC to support the legal foundation for Standard Market Design, namely its finding that "unduly discriminatory transmission practices have continued to occur . . ." The burden would also be on FERC to demonstrate Standard Market Design remedies any undue discrimination and is in the public interest. I agree Standard Market Design must be based on a record and on facts.

Question 5a. Obviously, the Federal Power Act unequivocally states that wholesale electric rates under FERC's jurisdiction must be "just and reasonable." But yet another issue that has recently surfaced—which bears on the Commission's willingness to act on behalf of consumers—pertains to the Mobile-Sierra doctrine. Again, while I know you cannot tell me how you would vote on various cases now pending before the Commission, I would like to understand a little about your thinking related to the Mobile-Sierra doctrine.

In response to a question I asked at a hearing of this Committee last summer, Chairman Wood told me that, in his view, the Mobile-Sierra "public interest" stand-

ard can't apply to market-based rate contracts unless the parties agree to explicitly bind themselves to the "public interest" standard of review. Do you agree with Chairman Wood on this point—that the Mobile-Sierra doctrine doesn't apply in a market-based rate context unless the parties affirmatively agree to waive the just and reasonable standard?

Answer. I understand the importance of this issue to your State and am aware of your strong interest in this matter. Your question goes directly to the heart of contract reform cases pending before FERC. The principal legal issue in those cases is which legal standard governs, the just and reasonable standard or the public interest standard. If confirmed by the Senate, I would have an affirmative duty not to prejudge the issues and to rely solely on the record. I assure you if I am confirmed I will personally review the legal precedents and make an independent judgment based on the law and the facts.

Question 5b. The marketers that made outrageous amounts of money from forward contracts signed during the western energy crisis argue that FERC implicitly approves contracts as "just and reasonable" when the Commission grants the general authority to charge market-based rates. Thus, they argue, any further review of these contracts should be conducted under the "public interest" standard. If the Commission were to adopt this view, why shouldn't Congress explicitly prohibit marketers from charging market-based rates in order to ensure that the plain meaning of the Federal Power Act—the just and reasonable standard—is not ignored?

Answer. FERC has an absolute legal duty under the Federal Power Act to prevent unjust and unreasonable rates. The Act grants FERC discretion on how to discharge this duty. Authorization to sell power at market-based rates is a privilege, not a right, and FERC can revoke authorization. Under the right circumstances, FERC should do just that.

Question 5c. I am also concerned about this issue because, as you know, the Commission has already declared spot market transactions in California "unjust and unreasonable" and is in the process of assessing refunds for those consumers. Due to the interconnected nature of the western markets, it's clear that a number of utilities in my state sold into these markets—sometimes under federal order to do so. Given this debate over the Mobile-Sierra doctrine, I am concerned that with regard to both spot transactions in the Northwest and forward contracts throughout the West, the Commission might chose to apply the more stringent public interest standard to the claims of utilities in my state. Do you see any reason that consumers in Washington and other states in the West should be treated more harshly than California ratepayers, which are being protected by the just and reasonable standard?

Answer. As I stated earlier, I generally believe there is a relationship between spot markets in California and spot markets in the Pacific Northwest. The exact nature of that relationship is a question of fact central to cases before the Commission. I also believe decisions involving refunds should reflect a consistent approach. However, I must state that I am not familiar with the record of the pending cases, and if confirmed by the Senate I would have a legal duty to make decisions solely on the law and the facts.

Question 6. During oral testimony before the Energy Committee, you failed to answer numerous questions on the grounds you may have to recuse yourself in matters on which the Commission may vote at some time in the future.

In your view, do recent statements by Commissioner Brownell, widely reported by the energy trade press, in which she suggested at a conference that "I did not [come to FERC] to undo contracts" and that "I'm not sure that manipulation in the market in fact affected prices as significantly as people may have thought and therefore may have affected contract prices," constitute grounds for her recusal from pending cases at FERC that involve the reformation of contracts?

Answer. FERC has authority to reform contracts, and in certain circumstances contract reform is appropriate. If confirmed by the Senate, I would have no predilection against reforming contracts if the circumstances so demand.

Question 7. As you may be aware, the Performance and Management Assessment included in the President's Fiscal Year 2004 budget included statements challenging the structure of all the federal Power Marketing Administrations, including the Bonneville Power Administration—which is of obvious concern to me and my constituents. I was a bit puzzled, however, because these statements directly conflict with assurances Energy Secretary Abraham gave me at his confirmation hearing.

If you are confirmed by the Senate, would you—like Secretary Abraham—support the continuation of the statutorily-mandated system of cost-based electricity rates and regional preference that have long been the engine of the Northwest economy?

Answer. Since enactment of the Bonneville Project Act of 1937, Bonneville has operated under a regime of cost-based rates, public preference, and regional preference. I respect the judgment of Congress.

Question 8. As you may be aware, the Senate energy bill passed during the 107th Congress included an additional 81.3 billion in borrowing authority for the Bonneville Power Administration, primarily to make much needed improvements to the Northwest transmission system, but also for the purpose of assisting the agency in meeting its multiple public purpose obligations. The Omnibus Appropriations bill now the subject of conference deliberations includes 5700 million in this borrowing authority.

Chairman Wood has previously stated before this Committee that he supports the \$1.3 billion in borrowing authority included in the energy bill, and would support even more if it were available. Do you agree with Chairman Wood on this point?

Answer. There is a need for more transmission in the Pacific Northwest. Bonneville owns roughly 80 percent of the grid in the region, and to my knowledge the other transmission owners have no plans to significantly expand their transmission systems. So, an expansion of the Bonneville transmission grid seems warranted. I understand Bonneville needs an increase in borrowing authority to fund such an expansion. I am not familiar enough with the details to have a view on the appropriate size of any increase.

RESPONSE TO QUESTION FROM SENATOR SCHUMER

Question 1. Mr. Kelliher, you once represented Public Service Electric and Gas. PSEG is currently involved in a dispute before FERC regarding contracts from 1975 and 1978 in which PSEG contracted to transmit power from upstate New York to New York City until 2012. The New York utility that entered into the contract claims that PSEG has failed to meet its full obligations to transmit power under the contract. Given your previous relationship with PSEG, would you be willing to recuse yourself from this or any other PSEG related decision laid before FERC?

Answer. If confirmed by the Senate, I commit to consult with the FERC Designated Agency Ethics Official and follow his or her advice to avoid any real or perceived conflicts of interest with respect to matters in which Public Service Electric and Gas is a party.

RESPONSES TO QUESTIONS FROM SENATOR BINGAMAN

ELECTRICITY

Question 1. Do you believe that the movement toward competitive markets that we have been seeing the last few years is positive, or negative? Can it be sustained successfully?

Answer. Congress set us on the path to competitive wholesale power markets 25 years ago with enactment of the Public Utility Regulatory Policies Act of 1978. Congress further promoted competitive markets with enactment of the Energy Policy Act of 1992. FERC has pursued policies consistent with the direction set by Congress. Competitive wholesale markets have great potential to benefit consumers, but the record of competitive markets has been mixed. Between 1989 and 1999, wholesale power prices fell 27 percent. Much of this decline was reversed by the Western power crisis, although prices have fallen significantly since then. I believe the potential of competitive markets can be realized and competition in wholesale markets can be sustained.

Question 2. If you believe that this movement is positive, but is not as successful as it should be, what needs to be done to get it on the right track? At the FERC? Legislatively?

Answer. We have been going through a long transition to competitive power that began 25 years ago. The record of competitive markets has been mixed, and we are at an important crossroads in that transition. There is a need to take steps to realize the potential of competitive wholesale power markets for consumers. In my view, it is important to first reach agreement on broad policy goals. Once agreement is reached on broad policy goals, it should be easier to come to terms with the specific policy proposals that advance those goals, and to what extent action is required by FERC or by Congress. There are a number of broad policy goals that could make markets more competitive, such as preventing market manipulation and market power abuse, providing regulatory certainty, assuring adequate electricity supplies, encouraging investment in new generation and transmission, lowering barriers to entry, providing greater transparency, and promoting energy efficiency. It is difficult to draw the line between which steps FERC should take and which steps Congress

should take. Current Federal electricity policy is the result of a long collaboration between FERC and the Congress. It is vital this collaboration continue.

Question 3. Does the threat of consolidation in the industry endanger the development of competitive markets? If so what should be done to prevent such consolidation?

Answer. The potential for abuse of market power does endanger the development of competitive electricity markets. Consolidation may increase concentration of market power. In order to prevent such concentration, FERC must properly weigh both horizontal and vertical market power. There also is a need to lower barriers to entry into the electricity industry. In addition, it is important to promote investment in electricity generation and transmission. It is more difficult to abuse market power if electricity supplies are adequate and transmission constraints are removed. Price transparency also promotes competitive markets.

Question 4. Is the movement to competitive markets at the retail level, which seems to have reversed itself recently, inevitable? If so, how long do [you] think it will take before retail competition plays an important role in electricity markets?

Answer. I do not believe that movement to competitive markets at the retail level is inevitable, and defer to the judgment of the States on whether to open their retail markets to competition, and, if so, under what terms. FERC is responsible for regulating wholesale power markets. In my view, making sure wholesale power markets operate effectively is important regardless of whether States open their retail markets.

Question 5. Do captive ratepayers of vertically-integrated utilities still need the protections contained in Federal statutes?

Answer. You answered this question best in the nomination hearing for Chairman Wood and Commissioner Brownell on May 16, 2001, when you recalled what the U.S. Court of Appeals for the District of Columbia Circuit stated in *National Association for the Advancement of Colored People v. Federal Power Commission*: "Of the Commission's primary task there is no doubt, however, and that is to guard the consumer from exploitation by non-competitive electric power companies." Unless Congress amends the Federal Power Act otherwise, that task remains paramount.

Question 6. Some concern has been expressed in a number of quarters about the Vice-[P]resident's Energy Task Force. What role, if any, did you play in that Task Force? Is there any reason that you know of that we should be concerned about your role in the Task Force and that would make you an inappropriate candidate for the Commission?

Answer. Since January 2001, I have served as Senior Policy Advisor to Secretary of Energy Spence Abraham. I was not a member of the staff of the National Energy Policy Development Group. I advised the Secretary during development of the National Energy Policy. In that capacity, I helped develop policy options for possible inclusion in the National Energy Policy. The Department of Energy developed its policy recommendations for inclusion in the National Energy Policy in the following manner. First, we had an internal process where about 90 career civil servants from various program offices were charged with developing policy proposals.

Second, we had an external process where we reviewed ideas from Congress, think tanks, public interest groups, environmental groups, and trade associations. Policy proposals from both tracks were combined, and I presented them to the Secretary for his consideration. We worked through each policy proposal, and the Secretary decided which proposals would be forwarded to the National Energy Policy Development Group for its consideration. I did not decide which proposals were presented to the task force, the Secretary did. Once each agency had presented its policy recommendations, the National Energy Policy Development Group members, which included the Vice President, various Cabinet members, and senior White House staff, made decisions on all major policy proposals. A staff-level working group made preliminary recommendations on noncontroversial policy proposals. I was a member of that working group.

Those preliminary recommendations were made by consensus and were subject to appeal by any agency to the National Energy Policy Development Group principals. At no time did I have authority to unilaterally adopt policy proposals for inclusion into the National Energy Policy, and at no time did I do so. There is no reason I know of why you should be concerned about my role in development of the National Energy Policy.

HYDROPOWER

Question 1. Do you believe that the section 4(e) conditioning authority of the resource agencies should be modified legislatively in order to facilitate the hydroelectric relicensing process?

Answer. I believe Congress should only modify the section 4(e) conditioning authority of Federal resource agencies if it determines such conditioning authority is being abused, and that alternative approaches provide for adequate protection of fish and wildlife and other beneficial public uses.

Question 2. What policies would you like to see the Commission pursue in order to improve the hydroelectric relicensing process?

Answer. Generally, I believe the hydroelectric relicensing process could be improved by moving decisionmaking up to earlier stages in the process. That should shorten the length of relicensing proceedings, lower the costs to parties and stakeholders, and provide greater regulatory certainty. That may require involving FERC staff earlier in the process. I also believe FERC should continue to encourage settlements.

RESPONSES TO QUESTIONS FROM SENATOR JOHNSON

Question 1. Municipal utilities, cooperatives and federal power marketing agencies are considered non-jurisdictional and do not fall under FERC jurisdiction currently. Do you feel it will be necessary to give FERC jurisdiction over the agencies in order for SMD to work? If so, why? If not, why not?

Answer. Congress made a very deliberate decision in 1935 when it consciously refrained from granting FERC authority over State and municipal utilities, rural electric cooperatives, and Federal utilities. I respect the judgment of Congress. Under current law, FERC cannot command nonjurisdictional utilities to adhere to any market rules, and nonjurisdictional utilities are free to decide whether to voluntarily bind themselves. They will only do so if these market rules make sense.

Question 2. FERC has proposed "license plate" transmission pricing with a transition to "postage stamp" pricing as well as some discussion about "participant funding" pricing for new transmission. Which of these are appropriate? What would the affects of the different methods be in South Dakota where we have great distances and miles of transmission with little new load growth?

Answer. There are concerns rate pancaking impedes competition in wholesale power markets. Elimination of rate pancaking is an appropriate goal. However, I am concerned about cost shifting that may occur as a result, and believe it is important to take steps to avoid substantial cost shifts. There is no question there is a need to expand the transmission grid. Which transmission pricing approach best serves that need may vary depending on regional characteristics. If confirmed by the Senate, I will carefully weigh those considerations in any decisions I may make on transmission pricing.

RESPONSES TO QUESTIONS FROM SENATOR BUNNING

Question 1. Kentucky has the lowest residential electricity rates in the country. The FERC's proposed Standard Market Design rule, or SMD, appears to penalize states with low costs to benefit those with high costs. Do you believe that FERC's SMD rule will negatively affect Kentucky's rates?

Answer. The record of the Standard Market Design proceeding is extensive. Public comments total thousands of pages, and reply comments were only recently filed. I have not had an opportunity to review the complete record, and have reached no final judgment about the proposed rule. In my view, FERC should not proceed with Standard Market Design unless the record shows that doing so is in the public interest.

Question 2. One size does not fit all. The nation's electricity market is not uniform, and instead, each region of the country has different needs. Do you believe the SMD takes into account regional differences and individual state interests?

Answer. I agree the United States does not have a national electricity market, and electricity markets in this country are regional in nature. There are significant differences among these regional power markets. In my view, it is essential that market rules reflect these regional differences.

Question 3. A portion of Kentucky is served by TVA. It is my understanding that public power companies within TVA will not be subject to SMD. How do you propose that the SMD rule will benefit the country if public power companies and TVA, which make up a large portion of the nation's electricity market, do not even have to follow it? How will this affect the rest of Kentucky companies that will be forced to follow SMD?

Answer. Congress made a very deliberate decision in 1935 when it consciously refrained from granting FERC authority over State and municipal utilities, rural electric cooperatives, and Federal utilities such as the Tennessee Valley Authority. I respect the judgment of Congress. Under current law, FERC cannot command nonjurisdictional utilities to adhere to market rules, and nonjurisdictional utilities are

free to decide whether to voluntarily bind themselves. They will only do so if these rules make sense.

Question 4a. TVA recently announced a rate increase for its customers. Currently, TVA is not subject to FERC jurisdiction for its rates, charges, and terms, and therefore, is not subject to any oversight other than by themselves and Congress. Placing TVA under FERC would require it to be subject to the same regulatory requirements as other utility companies. What do you think of FERC overseeing TVA for how it operates its transmission grid and how it charges its customers for wholesale electricity?

Answer. As you say, for all practical purposes FERC has no regulatory authority over the Tennessee Valley Authority (TVA). TVA is largely exempt from FERC regulation under section 201(f) of the Federal Power Act, since TVA is an “agency, authority, or instrumentality” of the United States. That exemption also applies to other Federal utilities, namely the four power marketing administrations. Other Federal laws—the Flood Control Act of 1944 and the Pacific Northwest Electric Power Planning and Conservation Act—provide for limited FERC review of wholesale power rates charged by power marketing administrations. Under current law, Congress is TVA’s regulator. For that reason, and since only Congress can change the law, I defer to Congress.

Question 4b. Do you think FERC oversight will bring more competition into TVA’s region that right now operates under its monopoly?

Answer. Under current law, there is no wholesale competition in the region. There have been a number of legislative proposals in the past to amend the Tennessee Valley Authority Act of 1933. Proposed reforms include lowering the so-called “TVA fence,” reforming TVA’s power sales contracts, providing open access to the TVA transmission grid, and assuring stranded cost recovery. Legislation would be required to introduce competition into the region. I defer to Congress on the threshold issue of whether to change the law to introduce wholesale competition into the Tennessee Valley.

APPENDIX II

Additional Material Submitted for the Record

PUBLIC CITIZEN,
Washington, DC, February 11, 2003.

Senate Committee on Energy and Natural Resources, Dirksen Building, Washington, DC.

DEAR CHAIRMAN DOMENICI: Today your Committee will discuss the President's appointment of Joseph Kelliher to one of two open seats at the Federal Energy Regulatory Commission (FERC). While the Energy Committee traditionally gives wide latitude to the President's FERC nominees, Public Citizen believes that Mr. Kelliher's controversial role as liaison to Vice President Cheney's National Energy Policy Development Group make the nominee uniquely unfit for a FERC commissioner. We therefore ask the Committee to oppose or delay Mr. Kelliher's appointment to FERC until the questions raised in this letter are answered in a satisfactory manner.

Public Citizen challenges the selection of Mr. Kelliher because he abused his responsibilities to the public while at the Department of Energy. As one of the primary coordinators of the Administration's National Energy Policy Development Group, Kelliher actively solicited the advice of large energy industry corporations and associations while ignoring similar requests from organizations representing the public interest. Although these meetings and conversations were carried out in private, the Administration has so far successfully fought to limit the release to only a small percentage of these communications. From this sliver of information, it is clear that whole email passages and other correspondence were simply lifted from language supplied by lobbyists and placed not only into the *National Energy Policy*, but also carry the force of law through Executive Order and regulatory rulemakings.

Although the U.S. Government Accounting Office has recently declined to pursue its landmark legal action against the Executive Branch to force the Administration to turn key documents over to the public, they only did so because continued pursuit of the case would consume resources the agency does not have.¹ So the legal merits of the case remain, as evidenced by the lawsuit brought by the conservative watchdog organization Judicial Watch remains active and continues to proceed through the courts.²

Kelliher's inappropriate relationship and communications with corporate lobbyists not only tainted the Administration's National Energy Policy, but raise questions about the ability of Mr. Kelliher to be an impartial voice at FERC. FERC is weathering a storm of criticism for its deficient handling of the west coast energy crisis, the Commission's failure to maintain any effective enforcement of dozens of corrupt energy corporations, the deteriorating relations between FERC and nearly half of the state utility regulators who continue to be mistrustful of the Commission's jurisdictional intentions, and the Commission's poor track record protecting consumers.³ With FERC at its most crucial juncture in its history, now is not the time to nominate an individual with a tarnished record like Mr. Kelliher. For these reasons, Public Citizen asks the Committee to oppose or delay Mr. Kelliher's appointment to FERC until the questions raised below are answered in a satisfactory manner.

Following are summaries of a few of the private email correspondences between Kelliher and various lobbyists representing energy corporations that saw much of their demands incorporated not only into the President's *National Energy Policy*, but also adopted into law through executive fiat.

¹ Dana Milbank, "GAO ends fight with Cheney over files," *Washington Post*, February 8, 2003.

² D.C. District Court, *Judicial Watch, Inc. v. National Energy Policy Development Group*.

³ Government Accounting Office, *Concerted Actions Needed by FERC to Confront Challenges That Impede Effective Oversight*, GAO-02-656, June 2002, <<http://www.gao.gov/audit.htm>>.

KELLIHER DELIVERS ENRON'S "DREAM LIST"

Stephen Craig Sayle, former Counsel to the House Commerce Committee, worked for Texas Rep. Joe Barton. Sayle and Kelliher shared the same boss, although Sayle left the Committee in 1993, whereas Kelliher joined in 1995. Sayle now serves as a Vice President of the Dutko Group, accepting money from mostly energy and telecom corporations to lobby the federal government.

During the time Kelliher was compiling information for Vice President Cheney's National Energy Policy Development Group, Sayle was lobbying on behalf of Calpine, El Paso Corp, Enron, NiSource and Trigen Energy (a subsidiary of France-based Suez). Together, these corporations paid Sayle's firm \$550,000 in the first six months of 2001 alone.⁴ These five companies formed the Clean Power Group, and collectively gave 80 percent of their \$5.6 million in campaign contributions since 1999 to Republican candidates.⁵

Two of the five companies now face serious legal problems. Since Enron declared bankruptcy in December 2001, it has been revealed that top executives and the company's board of directors were aware of widespread accounting fraud and of the role the corporation played in causing the west coast energy crisis of 2000-01. El Paso Corp. is under numerous federal and state criminal investigations for intentionally withholding delivery of natural gas in the major pipeline serving all of southern California during the energy crisis in order to jack up prices and for feeding false data to natural gas publications.

On behalf of these clients, Sayle corresponded with Kelliher through a series of emails beginning on March 23, 2001. Sayle began with a long, somewhat rambling email describing his clients' goals regarding New Source Review (NSR) and a "multipollutant strategy," ending the email with the comment, "Obviously, this is a dream list. Not all will be done. But perhaps some of these ideas could be floated and adopted."⁶

With the political capital of companies like Enron behind Sayle's proposals, most of the "dream list" was in fact incorporated into the Bush-Cheney energy plan. Hours after penning the long email, Kelliher asked Sayle to summarize the email's main points. Sayle responded the same day by writing, "A multipollutant regulatory strategy should be estimated for the power generation sector including: Gradually phased in [mercury, nitrogen oxides and sulfur dioxide emissions] reductions; Reform/replacement of NSR; Use of market-based/emission trading programs; Inclusion of both existing and new plants and equal treatment for both. The last bullet is the critical one to ensure that: a) we encourage the new generation that is required b) we ensure that the new technologies developed through DOE programs can come into the market."

This email, along with a follow-up Powerpoint presentation Sayle sent to Kelliher (*A Comprehensive Multipollutant Emission Control Strategy for Power Generation*), outlined the Clean Power Group's support of the "cap and trade" approach to address emissions of mercury, nitrogen oxides and sulfur dioxide from power plants, but proposed a voluntary cap on carbon dioxide. The proposal also sought reforms to New Source Review (discussion of this issue to follow in the next section). The Clean Power Group would benefit from such a proposal because they could release more emissions under such a "flexible" plan than under the more stringent rule-making process the Clinton Administration had initiated.

After receiving Sayle's email, Kelliher incorporated much of the lobbyist's text into Vice-President Cheney's National Energy Policy Development Group: "The NEPD Group recommends that the President direct the Administrator of the Environmental Protection Agency (EPA) to propose multi-pollutant legislation . . . that would establish a flexible, market-based program to significantly reduce and cap emissions . . . provide regulatory certainty to allow utilities to make modifications to their plants without fear of new litigation, provide market-based incentives, such as emissions-trading credits to help achieve the required reductions."⁷ And indeed, President Bush's "Clear Skies" initiative, which is directly built upon the recommendations in the *National Energy Policy*, embraces the strategy laid out months earlier in Sayle's email.

⁴Mid-year lobbying disclosure report filed by the Dutko Group on behalf of their client, the Clean Power Group, on August 14, 2001 with the U.S. Senate Office of Public Records, <<http://sopr.senate.gov>> The five corporations listed were members of the Clean Power Group at the time of Sayle's communications with Kelliher.

⁵Center for Responsive Politics, <http://www.opensecrets.org/industries>>.

⁶All email communications referenced in this letter involving Mr. Kelliher can be accessed here: <www.nrdc.org/air/energy/taskforce/tfinx.asp>.

⁷Page 3-3. <<http://www.whitehouse.gov/energy/Chapter3.pdf>>.

KELLIHER SETS STAGE FOR FEDERAL FAVOR TO FRENCH COMPANY

The Powerpoint presentation Sayle sent to Kelliher also advocates an “output-based allocation system to reward efficiency (include CHP).” Combined Heat & Power (CHP) is a technology which can improve the efficiency of fossil fuel power plants.

Sayle’s request resulted in the *National Energy Policy* recommending “that the President direct the EPA Administrator to promote CHP through flexibility in environmental permitting.”⁸ President Bush has proposed spending \$52 million in fiscal year 2004 for corporate partnerships on distributed generation technologies and CHP.⁹

Five months after the National Energy Policy Development Group released its report, Bush’s EPA selected Trigen Energy as a “founding partner” for the Administration’s Combined Heat & Power Partnership, which was “established as a direct result of President Bush’s *National Energy Policy* report.”¹⁰

SOUTHERN CO., CLEAN POWER GROUP’S SUCCESSFUL PUSH TO REDEFINE
NEW SOURCE REVIEW

The Clean Air Act imposes sensible public health standards to protect people from coal power plant and oil refinery emissions. To be fair to industry, the Act exempts, or grandfathers, plants that were already built at the time the law was passed in the 1970s. New Source Review (NSR) was authorized in the 1977 amendments to the Act to apply the tougher environmental standards should grandfathered plants choose to make significant modifications or upgrades to their facilities, thereby increasing emissions. NSR, therefore, levels the playing field by not granting older plants a competitive advantage.

But lobbyists contacting Kelliher loudly complained that their clients needed to do away with NSR because the law inhibited the ability of these dirty facilities to continue operating after undergoing an upgrade. Sayle, in his communications with Kelliher on behalf of the Clean Power Group, argued for “Reform/replacement of NSR.” But the most extensive email traffic on the issue was between a lobbyist for Southern Co. and Kelliher.

Southern Co. is the second largest operator of coal-fired power plants in America, and the largest campaign contributor from the entire energy industry since 1999. The company showered 71 percent of its \$3.2 million in campaign contributions over that time period on Republicans.¹¹

On March 23, 2001, Michael J. Riith, a lobbyist for Southern Co, wrote this email to Kelliher: “Good morning. This is the document I told you was in ‘the works’ on NSR in relation to the national energy strategy. As promised, it is attached. I hope this is helpful. After talking with you yesterday, the last thing you need is another issue to deal with. Thanks for your consideration. Again. I look forward to lunch on Tuesday. Best regards, Mike.”

The document referenced in this email to Kelliher is titled *A National Energy Strategy Should Include Reform of EPA’s New Source Review Program*. The document recommends that “a National Energy Strategy that is focused on increasing supply should find ways to resolve the inconsistency between the Strategy’s goals and EPA’s current NSR interpretation . . . which would exclude from NSR review projects that are routine repair and replacement and allow utilities and other industries to move forward with needed projects.” Southern Co. had a lot to gain from redefining NSR, since the Justice Department and the EPA named Southern as one of several utilities in a November 1999 lawsuit for violation of NSR.

After Kelliher accepted this language from the Southern lobbyist, the Bush *National Energy Policy* adopted passages quite similar: The National Energy Policy Development Group “recommends that the President direct the Administrator of the Environmental Protection Agency, in consultation with the Secretary of Energy and other relevant agencies, to review New Source Review regulations, including administrative interpretation and implementation . . . [and] recommends that the President direct the Attorney General to review existing enforcement actions regarding New Source Review to ensure that the enforcement actions are consistent with the Clean Air Act and its regulations.”¹²

⁸Page 4-9. <<http://www.whitehouse.gov/energy/Chapter4.pdf>>.

⁹Page 378, <<http://www.whitehouse.gov/omb/budget/fy2004/pdf/appendix/DOE.pdf>>.

¹⁰Trigen press release, October 15, 2001. <<http://www.trigen.com/news/releases/EPA-Partnership.shtml>>.

¹¹Center for Responsive Politics, <<http://www.opensecrets.org/industries/contrib.asp?ind=E>>.

¹²Page 7-14. <<http://www.whitehouse.gov/energy/Chapter7.pdf>>.

President Bush took this recommendation and ran with it: the Administration announced in November 2002 that factories, oil refineries and coal power plants would win exemptions from NSR, fulfilling the requests asked of Kelliher.¹³ Granted, opposition to NSR within the energy industry was widespread: but the FOIA records released thus far reveal zero communication between Kelliher and public interest organizations who could argue the merits of retaining the status quo interpretation of NSR.

BIG OIL PRESENTS KELLIHER, AN OFFER BUSH DOESN'T REFUSE:
READY-MADE EXECUTIVE ORDERS

A series of emails in March 2001 between Kelliher and Jim Ford, a registered lobbyist with the American Petroleum Institute, documents Kelliher's reliance on the industry's proposals to preempt state regulation, and includes two proposed Executive Orders, both of which Bush eventually adopted and signed into law.

The American Petroleum Institute represents over 200 oil and gas companies. Oil and gas corporations lavished 79 percent of their \$57 million in campaign contributions to Republicans since 1999.¹⁴

On March 20, 2001, the oil industry lobbyist emailed Kelliher a document titled, *Overview: U.S. Oil and Natural Gas Supply Situation*. The third page of this document suggests that Bush "require Executive Branch agencies to avoid significant adverse energy consequences in proposing regulatory other administrative actions." On May 18, 2001, Bush signed an Executive Order mirroring the lobbyist's request to Kelliher: "I [President Bush] am requiring that agencies shall prepare a Statement of Energy Effects when undertaking certain agency actions . . . such Statements of Energy Effects shall describe the effect of certain regulatory actions on energy supply, distribution, or use."¹⁵

The oil lobbyist's email also asked Kelliher to recommend "Executive Branch agencies to review existing rules and policies and revise them as necessary to eliminate significant adverse energy consequences . . . [and] provide a 'strike force' to complement existing staff of public land management agencies to immediately reduce the tremendous backlog of pending applications for permits to develop federal oil and gas leases." A similar memo addressed to Kelliher was penned by Darrell Henry, director of public affairs for the American Gas Association, which sought a strike force "to streamline regulation of exploration and production on federal lands." The American Gas Association had originally been turned down by the Clinton Administration for such an Executive Order when the Association first requested it in January 2000.¹⁶

President Bush again complied, signing a second Executive Order on May 18 which read: "it is the policy of this Administration that executive departments and agencies shall take appropriate actions . . . to expedite projects that will increase the production, transmission, or conservation of energy . . . For energy-related projects, agencies shall expedite their review of permits or take other actions as necessary to accelerate the completion of such projects . . . There is established an interagency task force to monitor and assist the agencies in their efforts to expedite their review of permits or similar actions, as necessary, to accelerate the completion of energy-related projects, increase energy production and conservation, and improve transmission of energy. The Task Force also shall monitor and assist agencies in setting up appropriate mechanisms to coordinate Federal, State, tribal, and local permitting in geographic areas where increased permitting activity is expected."¹⁷

KELLIHER AND OIL FIGHT THE STATES, AND THE FED WINS

The American Petroleum Institute lobbyist emailed Kelliher a second document titled *Recommendations for a National Energy Policy* on March 20, 2001. The first regulation about which the oil lobbyist complained in this document was the Coastal Zone Management Act of 1972. The law guarantees coastal states input in the development of offshore oil exploration, especially off the coast of California and in the Gulf of Mexico. The oil industry grumbles that some states, like California, have used the law to prioritize environmental protection and coastal preservation over increased oil drilling. As a result, the oil lobbyist urged Kelliher to "amend the Coastal Zone Management Act to ensure that valid offshore natural gas and oil lease

¹³Nick Anderson, "Bush Prevails in Clean Air Duel," *Los Angeles Times*, January 23, 2003.

¹⁴Center for Responsive Politics, <<http://www.opensecrets.org/industries/indus.asp?Ind=E01>>.

¹⁵<http://www.whitehouse.gov/news/releases/2001/05/20010518-6.html>

¹⁶Don Van Natta, Jr., "Executive Order Followed Energy Industry Recommendation," *The New York Times*, April 4, 2002.

¹⁷<http://www.whitehouse.gov/news/releases/2001/05/20010518-5.html>

rights are protected in the CZMA process.” Such an amendment would limit the ability of states to have adequate input over oil development projects off their shores.

While the Bush Administration declined to copy the exact text used by the oil lobbyist, Kelliher and the Administration parroted the lobbyist’s complaints and recommendations. For example, the oil lobbyist email complained that the Coastal Zone Management Act became “a tool for unnecessary delay and duplicative regulation of offshore exploration and production.” Bush’s *National Energy Policy* echoes the lobbyist’s request: “These delays and uncertainties can hinder proper energy exploration and production projects.”¹⁸ The oil lobbyist’s email asks Kelliher to “direct the Department of Commerce to administer state consistency programs to ensure priority consideration is given to responsible oil and natural gas development [with regards to the Coastal Zone Management Act].” The Bush Administration produced this recommendation on CZMA: “The NEPD Group recommends that the President direct the Secretaries of Commerce and Interior to re-examine the current federal legal and policy regime (statutes, regulations, and Executive Orders) to determine if changes are needed regarding energy-related activities and the siting of energy facilities in the coastal zone and on the Outer Continental Shelf (OCS).”¹⁹

That Bush Administration recommendation came after Kelliher returned this email on March 21, 2001 to the oil lobbyist: “Do you have more detail on the CZMA issue? Your description suggests that legislation is not needed, and that changing the regulations would suffice. Is that true? Also, please explain in more detail how the current regulations relating to consistency impede offshore development, it is not clear what the problem is. Thanks.” The oil lobbyist responded on March 22. “We do have more. I’ll get back to you with supplementary material as soon as possible. Curious as to whether any of the other suggestions we’ve made—particularly the short-term administrative measures recommended in the first e-mail I sent you—have any traction. By the way, I heard some word yesterday that the NEP development group may have produced a draft. Can you shed any light on this? “Bush Administration lawyers unsuccessfully argued that the state of California, through the Coastal Zone Management Act, had no right to review the Clinton Administration’s decision to allow increased drilling off the state’s coast by renewing existing leases.²⁰ The Bush Administration’s willingness to take California to court contrasts with the President’s approach to his brother, governor of Florida. President Bush announced plans to protect Governor Bush’s coast by spending \$120 million to buy oil and gas rights in the Everglades and another \$115 million to pay oil companies to stop drilling plans in the Gulf of Mexico. President Bush rejected a similar offer proffered by Governor Davis of California.

KELLIHER, TREATS OIL COMPANIES ROYALLY

The oil lobbyist’s memo also recommends promoting and expanding the federal government’s *royalty in kind* pilot program. The program allows corporations drilling for oil on public land to forgo paying cash royalties to taxpayers. Instead, companies provide an amount of the oil as an in-kind contribution to the federal government. Since federal land supplies one-third of the oil and gas produced in the United States, expansion of this program could have a significant impact on the federal treasury.

The Bush Administration accepted the lobbyist’s recommendation, as the National Energy Policy requests that the Secretary of the Interior “explore opportunities for royalty reductions.”²¹ A recent Government Accounting Office report, however, criticizes the current royalty in kind program, concluding that the government is unable to determine whether taxpayers receive a fair shake from the program. For example, the GAO concluded that since the pilot program currently “relies upon royalty payers to self-report the amount of oil and gas they produce, the value of this oil and gas, and the cost of transportation and processing that they deduct from royalty payments, there are concerns about the accuracy and reliability of these data.”²² Indeed, the industry’s cheerleading for the royalty in-kind program stems from recent court decisions that found U.S. oil companies, equipped with an “honor system” self-reporting system, routinely underreported the volume of oil and natural gas removed from taxpayer land, therefore allowing the companies to cheat the public. By

¹⁸ Page 5-7, <<http://www.whitehouse.gov/energy/Chapter5.pdf>>.

¹⁹ Page 5-8, <<http://www.whitehouse.gov/energy/Chapter5.pdf>>.

²⁰ Unanimous decision by a three-judge panel of the 9th U.S. Circuit Court of Appeals, *State of California vs. Norton*, December 2002.

²¹ Page 5-7, <<http://www.whitehouse.gov/energy/Chapter5.pdf>>.

²² Government Accounting Office, *A more Systematic Evaluation of the Royalty-in-Kind Pilots is Needed*, GAO-03-296, January 2003, Pgs 3-4, <<http://www.gao.gov/audit.htm>>.

seeking to end cash payments for the privilege of drilling on public land altogether, it appears as though the oil companies are attempting to hedge their losses from the embarrassing court decisions.

WHAT WOULD MUSSOLINI DO? ASK A NATURAL GAS LOBBYIST

On March 18, 2001, Kelliher initiated an email correspondence with Dana Contralto, chairman of the energy group at the IBC law firm/lobby shop Crowell & Moring. Kelliher asked: "If you were King, or Il Duce, what would you include in a national energy policy, especially with respect to natural gas issues . . . I am working up the policy elements, and am less confident of my judgment on gas pipeline issues than other areas, and thought I would pick your brain." Mr. Contralto replied, "Of course, if I were King we would already have a national energy policy that would have kept California out of the mess in which it now finds itself . . . so, having said that, what can be done . . . more resources at FERC . . . could expedite pipeline certificates substantially." The Cheney energy task force parroted Contralto's advice: "The NEPD Group recommends that the President direct agencies to . . . expedite pipeline permitting."²³

WHILE CORPORATIONS GET ATTENTION, THE PUBLIC INTEREST
GETS A COLD SHOULDER

Public Citizen's search of released communications involving Kelliher turned up zero contacts with public interest organizations. But correspondence by Kelliher's co-workers indicate that public interest groups were given 48 hours to provide input—compared to private meetings, breakfasts and lunches available to energy company representatives. A March 2, 2001, email sent from Kelliher's co-worker Margot Anderson asked that fellow staffer Peter Karpoff contact public interest groups "and get them to send you any energy policy options they are advocating . . . can you then review the proposals and recommend some we might like to support that are consistent with the Administration's energy statements to date?" The message, which was sent on Wednesday afternoon, concluded "need by Friday noon."

It should come as no surprise that as a result of his advocacy, Kelliher enjoys broad industry support for his nomination to FERC. The Electric Power Supply Association praised Kelliher's as "an excellent choice to round out and complement a newly re-energized FERC." The Edison Electric Institute's Pat McMurray noted Kelliher's "broad and deep" background in energy policy in giving him their support.²⁴ The American Gas Association described Kelliher in an August 16, 2001 letter to President Bush as having the "breadth of experience, judgment and expertise to fulfill the responsibilities" of a FERC commissioner,²⁵ even though he admitted he was "less confident of my judgment on gas pipeline issues."

In addition to asking questions about Kelliher's role in writing the Administration's *National Energy Policy*, the Committee should ask Mr. Kelliher his views on important market issues currently before FERC. A quick analysis of legislation of which Kelliher has had a hand drafting shows an interest in repealing the Public Utility Holding Company Act and providing an increased regulatory role for FERC at the expense of state sovereignty.

The White House first announced its intent to nominate Kelliher in October 2001 and in May 2002 sent his nomination to the Senate, which did not act on it. Kelliher, a Republican, was nominated for a term expiring June 30, 2007, to replace former Commissioner Linda Breathitt, whose term ran out late last year. When Bush first nominated Kelliher in October 2001, he was set to fill former FERC Chairman Curtis Hebert's seat, which is set to expire in June 2004 (Hebert resigned in August 2001).

Sincerely,

JOAN CLAYBROOK,
President, Public Citizen.

WENONAH HAUTER,
Director, Public Citizen's Critical
Mass Energy
and Environment Program.

²³ Page 7-18, <<http://www.whitehouse.gov/energy/Chapter7.pdf>>

²⁴ *The Energy Report*, October 22, 2001, Volume 29, Issue 43.

²⁵ Katharine Fraser and Chris Newkumet, *Inside FERC*, September 3, 2001.

[The following article was submitted for the record by Senator Cantwell:]

Published on *HeraldNet* on Tuesday, February 11, 2003

RATE HIKES WORRY BUSINESS

If PUD raises power rates again, Kimberly-Clark might shut its Everett mill, and other large power users fret about paying their bills.

By Lukas Velush, Herald Writer

EVERETT—If Kimberly-Clark Corp.'s electricity rates go up again, the longtime company will scale back operations and possibly start discussions that could lead to shutting down its 900-employee pulp and tissue mills.

Kimberly-Clark and several other large power users in Snohomish County say they can't afford another PUD rate increase. All said recent spikes in power bills tied to the 2000-01 energy crisis are unacceptable.

If the PUD passes on a Bonneville Power Administration rate increase to its customers, Kimberly-Clark will look at building its own power plant. "If that's not cost-effective, we'll have to take a look at whether it makes sense to continue to do business in this county," said Dave Faddis, general manager of Kimberly-Clark's Everett operations. "We cannot tolerate these kinds of price swings."

The PUD has not announced that it will raise rates, but BPA—the federal energy wholesaler that provides 80 percent of the PUD's power—last week proposed a 15 percent rate increase to cover a massive budget shortfall. If adopted, it would go into effect Oct. 1.

The PUD, which charges residential customers the highest electricity rates in the state, also has some of the highest rates for industrial customers. A 2002 survey of major U.S. public utilities by Weyerhaeuser Co. shows Snohomish County PUD rates for large industrial customers ranks 29th out of 32 surveyed.

Kimberly-Clark's rates are up 85 percent since late 2001, when the PUD raised costs because of a 46 percent Bonneville increase and a similar spike in rates linked to high-priced power contracts signed by the PUD. For residential customers, the two rate increases and one small reduction translated to bills that are 50 percent more than they were two years ago.

"We cannot afford another rate increase," Faddis said. "The cost of power has gotten to the point where it's not supportable."

The Boeing Co. and the Everett School District are among the county's big power users that have complained to Bonneville and the PUD. But Kimberly-Clark's worries are urgent. The company has cut its local workforce by 10 percent over the last two years and projects that the trend will continue if electricity rates go up.

The Everett paper mill is one of Kimberly-Clark's most expensive plants in the country, where two years ago it was in the "middle of the pack." The rising cost of power and the higher cost of fiber, the wood material the company uses to make its paper products, are listed as reasons. Kimberly-Clark uses about 300 million kilowatt-hours of power a year. To compare, the average home uses only about 13,000 kilowatt-hours.

The company has been in Everett since 1927. The Dallas-based corporation is known for making Scott paper towels, Huggies diapers and Kleenex tissues, most of which are made here. Meanwhile, Boeing's Everett assembly plant, which employs about 20,000 people, uses about 360 million kilowatt-hours a year, spokesman Dean Tougas said.

Alan Mulally, president and CEO of Boeing's Commercial Airplanes division, asked Bonneville to avoid another rate hike in a letter sent in October.

"Boeing urges BPA to forgo these rate increases and explore alternative strategies for addressing its potential budget shortfalls that do not impose greater financial burdens on its customers," Mulally said. "As you are aware, the Pacific Northwest is suffering from a significant recession with some of the highest unemployment rates in the nation. Boeing simply cannot absorb more rate increases." School districts that expect the state to slash next year's budgets also want to avoid higher electricity rates.

"There is no extra money," said Sue McCann, a spokeswoman for the Everett School District, which used about 25 million kilowatt-hours to keep the lights on at its 25 schools last year. "When you have an increase, it has to come from somewhere," she said, adding that the district will try to make up for the hike by increas-

ing conservation efforts. “Hopefully it doesn’t touch the classroom, but if it keeps going everything will be hurting.”

The school district has adopted conservation measures that save it about \$200,000 per year. The district spent about \$2 million on power last school year.

Bonneville has started a rate-case proposal to make up for a budget shortfall of about \$500 million. It will take about six months for an increase to be approved. The agency hopes to reduce its budget shortfall, which would lower the proposed rate increase. But a poor year for snow actually looks like it could increase its costs to generate power even more—causing the shortfall to grow even more.

