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Introduction

Thank you, Chairman Bingaman, Ranking Member Domenici, and members of the Committee for your leadership and for the opportunity to update you on the status of the Energy Policy Act of 2005 (EPAct 2005) and the Public Utility Holding Company Act of 2005 (PUHCA 2005) and their implementation.

I also want to extend my gratitude to Senators Feingold and Brownback who, along with Chairman Bingaman, asked the Government Accountability Office (GAO) to look into the progress made on the implementation of EPAct 2005. More specifically, I applaud them all for demanding a close look at what the Commission is doing to prevent cross-subsidization. Cross-subsidization was central to this legislation's enactment, and we – as a Commission – can and must go farther than we have on this most serious issue. As Federal Energy Regulatory Commission (FERC) Chairman Kelliher noted in his testimony, "At heart, the Commission is a consumer protection agency," and the Commission must continue to work closely with this Committee and, more broadly, the Senate and the House to make sure that FERC is protecting the American consumer.

This has never been more the case than today. With the repeal of PUHCA 1935, EPAct 2005 has correctly taken the Securities and Exchange Commission

(SEC) out of the enforcement-picture and has expanded FERC's role considerably. I am proud of the work that the Commission and – notably – our tremendous staff have done to breathe life into this new and evolving role.

Congress was correct to repeal PUHCA 1935, entrusting the regulatory and enforcement roles to the states and to FERC, when it comes to the holding companies that have acquired or seek to acquire public utilities. FERC is equipped to regulate and take enforcement action to enforce that regulation. Under PUHCA 2005, FERC and the states have access to the holding companies' books and records, so that regulators can make fully informed decisions. Congress has also correctly given the Commission the authority it needs to "blow the whistle", as necessary, and assess appropriate penalties.

Permit me to discuss four issues: first, the impact of this new legislation on investment in the energy market; second, the need to build more process into FERC's enforcement authority; third, cross-subsidization; and fourth, the case for compliance.

Impact of EPAct 2005 on the Energy Market – New Investors

To understand the states' and the Commission's regulatory and enforcement roles under this relatively new legislation, it is essential to discuss the very positive impact EPAct 2005 has on the energy market itself.

Born in this Committee, EPAct 2005 has helped the American consumer and the economy by broadening the field of investors in the energy market, which is one of the best ways to spur the improvements and innovations in the market

that we are all so eager to see. The proponents of this legislation saw *new* opportunities for *new* investors with *new* money and *new* ideas to enter the energy market, giving the impetus to push ahead through the beginning of the 21st century. As noted in the GAO report, this objective has been met: new investors have entered the energy marketplace since EPAct 2005 was enacted and specifically *because* it was enacted. That is good news for the American consumer.

Building a Better Enforcement Process

What this also means is that the energy market has welcomed a host of new members and investors who may be, and – in some cases – are, unfamiliar with regulation. It would be irresponsible for all of us to purposefully attract new investors to the energy market and not educate them about the rules that govern it. Therefore, the Commission must – at a *minimum* – develop an enforcement strategy and be transparent in communicating that strategy to market participants. There is a distinct difference between including objectives and scope in an individual audit and setting forth the Commission's objectives, scope, vision, and strategy for enforcement more broadly.

The GAO's thoughtful paper raises issues that this Committee and my fellow Commissioners have and must take seriously. Whether we build strategy risk-based assessments into the Commission's enforcement mandate, as the GAO recommends, or some other methodology that is clear, predictable, fair, and sufficiently straightforward such that market participants can understand it and

know what rules they must follow, it is imperative that the Commission adopt and communicate a clear vision for its enforcement strategy.

A risk-based assessment has considerable merit on the micro-level for individual companies. First, risk is a metric readily identifiable in the business community; market participants and holding companies make decisions each day on the basis of their own risk calculations in a variety of circumstances. Second, risk assessments can lay down clear metrics that will give market participants sufficient predictability concerning what is expected of them. Third, risk also provides the flexibility to not be so prescriptive that the metrics rule out unforeseen or variable circumstances. One size does not fit all, and risk assessments take that reality into account.

For nearly all of the same reasons, a risk-based approach to enforcement also has merit, on the macro-level, of assessing which companies, regions, or problems should cause the Commission the greatest concern, as it develops its enforcement strategy.

The key in all of this is to continue to foster Congress' successful intent behind EPAct 2005 and PUHCA 2005: bringing new investment and new investors into the marketplace, while avoiding another Enron from occurring. With a clearly thought out and communicated enforcement strategy, that marketplace predictability and enhanced certainty will attract even greater investment and further protect the American consumer from exploitation.

Cross-Subsidization

It is no mystery that the provisions on cross-subsidization were central to the passage and enactment of EPAct 2005. Nor was it a mystery in 2005. Cross-subsidization is to be avoided at all costs. Through cross-subsidization, a utility could increase rates to the American consumer not to benefit the consumer but to benefit some business entity held by the utility or its holding company. Or, through cross-subsidization, a utility could allow some unregulated entity held by it or its holding company to use the utility's assets to provide it an unfair competitive advantage and, possibly, harm the utility's financial integrity. That is why the Commission took the steps it did, as laid out in testimony by Chairman Kelliher. However, we can and must do more.

Chairman Kelliher cautions against adopting a uniform and preemptive federal rule on cross-subsidization in the absence of widespread evidence of state regulatory failure. I agree with him that many state regulatory commissions have succeeded, but they have not succeeded across the board. I also agree that there is no one silver bullet for preventing cross-subsidization, and that – to use the example Chairman Kelliher invoked – some states have found ring-fencing to be very successful, even though it can cause problems for other states which have chosen not to accept it. That does not mean the federal government cannot insist that at least one of a suite of mechanisms to prevent cross-subsidization be adopted. Not every one of the 50 states needs to adopt ring-fencing specifically, but they should all adopt some proven mechanism to help them better regulate

these holding companies and guard the American consumer from cross-subsidization.

As a practical matter, the Commission currently relies primarily on self-reported assurances from the market participants it regulates to learn about their cross-subsidization practices and the likelihood of those practices occurring. No amount of conferences, rules, or policy statements will help the Commission obtain better information about cross-subsidization until the Commission's auditing and enforcement arms are given more resources and a clearer mandate to obtain the same information on their own -- *independent* of the information provided directly by the market participants. Enhanced resources would also permit the Commission to obtain better information from state regulators and to meet more frequently with them. Finally, enhanced audit and enforcement resources would build the Commission's capacity to analyze this information so that it can better fulfill its mission to protect the public interest.

Now is not the time to rule out options, but to explore them and adopt one or more of them soon, whether it is through independent risk-based assessments, as GAO recommends; ring-fencing; or some other method. We must make sure we are doing all we can to guard the American consumer from cross-subsidization and other forms of exploitation.

The Case for Compliance

As the enforcement role of the Commission and the states continues to evolve, regulators must work with market participants to ensure that they

understand how to comply with the rules – especially insofar as new investors who are unfamiliar with FERC, state regulators, and the regulated energy marketplace generally are concerned. The Commission has not used its authority to play "gotcha" with holding companies and other market participants. That was not the intent of Congress and this Committee. Still, we must make that abundantly clear to all market participants and, in particular, to the new investors that EPAct 2005 was intended to attract.

With the 2005 enactment, the Commission has entered the enforcement business and has room to grow in this endeavor. The Commission may want to examine the enforcement practices of other government agencies entrusted with similar authority, such as the Federal Trade Commission. There are always ways to improve, and so why not look down the street to agencies that have experience in this business? What are their practices? What are their strategies? How are they staffed? What do their budgets look like?

We may learn from these other agencies that it would be prudent for the Commission to enter the "compliance" business as well. By assisting regulated companies with their compliance on a more consistent basis, they will gain a much better sense of what the rules are, how to comply with them, and what the Commission values. The Commission, in turn, will learn from its regulated companies which rules are clear and effective and which are not. A strong compliance program presumably would provide market participants with greater assurance that the Commission is not out to play "gotcha." To the contrary, a

more productive relationship should emerge. At the end of the day, the American consumer would benefit from a Commission working regularly with market participants to make sure they understand the rules and are playing by them.

Conclusion

This Committee's efforts, under the leadership of Chairman Bingaman and Ranking Member Domenici, cannot go for naught. These new laws can be a boon not only to the energy market and the American economy, but also to the American consumer. This legislation has sent FERC into a new world of enforcement with the authority to impose million dollar per day penalties. With that great power comes great responsibility. We not only need to know where to look, but also what we are looking for. To that end, we must develop a comprehensive enforcement strategy and be clear about it. We must also enlist market participants and the states as allies to protect the American consumer from exploitation. The heavy stick of enforcement cannot – by itself – get the job done. We must require that public utilities have the necessary structures in place to prevent cross-subsidization, and we must work together to make sure everyone plays by the rules. Thank you.