First Annual
State of the Agency Report
Fiscal Year 2000

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Chairman

FEDERAL ENERGY REGULATORY COMMISSION

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Federal Energy Regulatory Commission

Vision

Promoting Competitive Markets
Protecting Customers
Respecting the Environment
Serving and Safeguarding the Public

Mission

The Commission regulates key interstate aspects of the electric power, natural gas, oil pipeline, and hydroelectric industries. The Commission chooses regulatory approaches that foster competitive markets whenever possible, assures access to reliable service at a reasonable price, and gives full and fair consideration to environmental and community impacts in assessing the public interest of energy projects.

Values

Employees **– People are our most valued asset. We provide the support needed for all employees to excel.**

Integrity **– We maintain the highest level of professionalism and an environment of fairness, trust, respect, and honesty.**

Diversity **– We value diversity in people and ideas.**

Working Together **– We clearly communicate expectations, encourage cooperation and teamwork, and share responsibility.**

Progress and Innovation **– We are creative and flexible, and seek out opportunities to improve.**

Action **– Prompt and fair resolution of matters before the Commission is essential to our mission.**

Reaching Out **– Two-way communication with the public is key to our effectiveness.**

Public Service **– Our ultimate objective is to provide valued services to the public.**

Contents

Introduction

This report is a portrait of our agency at fiscal year's end. It is the first such report and it is designed to place the Commission today in perspective for the staff and the public. The Commission's resources, its regulatory decisions, and its strategic objectives for the future are critically important to the Nation's energy future. Consequently, the state of the Commission as it enters the new fiscal year is a matter affecting the public interest.

The reader should understand what this report is *not*. Although it may in some ways complement the annual State of the Markets report, this report is neither as technical nor as detailed. It does not replace the Annual Report to Congress. Nor does it reflect the collective opinions of the members of the Commission; this edition, at least, is primarily a report by the Chairman as the agency's administrative head. Finally, anyone seeking to understand fully the Commission's long-term business objectives will want to consult its Strategic Plan.

The purpose of this brief report is simply to elucidate the choices and challenges facing the Commission today, as it enters a new fiscal year and confronts policy, administrative, and communications challenges, many of which are both large and unique. The energy industry and even regulation itself are subject to unprecedented pressures to change. FY 2001 will require of the Commission and its staff not only their customary diligence and craftsmanship but higher levels of innovation and resolve, particularly with respect to electric restructuring. The information in this report reflects both on the task ahead and the Commission's readiness to tackle it.

This is a report in three parts. The first is a snapshot of the agency, its external environment, and the challenges inherent in more competitive energy markets. The second describes the Commission's response to changing markets during FY 2000, including the status of its major internal initiatives. The final section discusses the Commission's priorities for the near future.

The Commission Today

On October 1, 2000 – the beginning of FY 2001 – the Commission has four sitting members. In addition to one current vacancy, the term of the Chairman will expire shortly. With national elections upcoming, the composition of the Commission itself will change fundamentally within the next year, although the terms of Commissioners Breathitt, Massey and Hebert continue until 2002, 2003, and 2004 respectively.

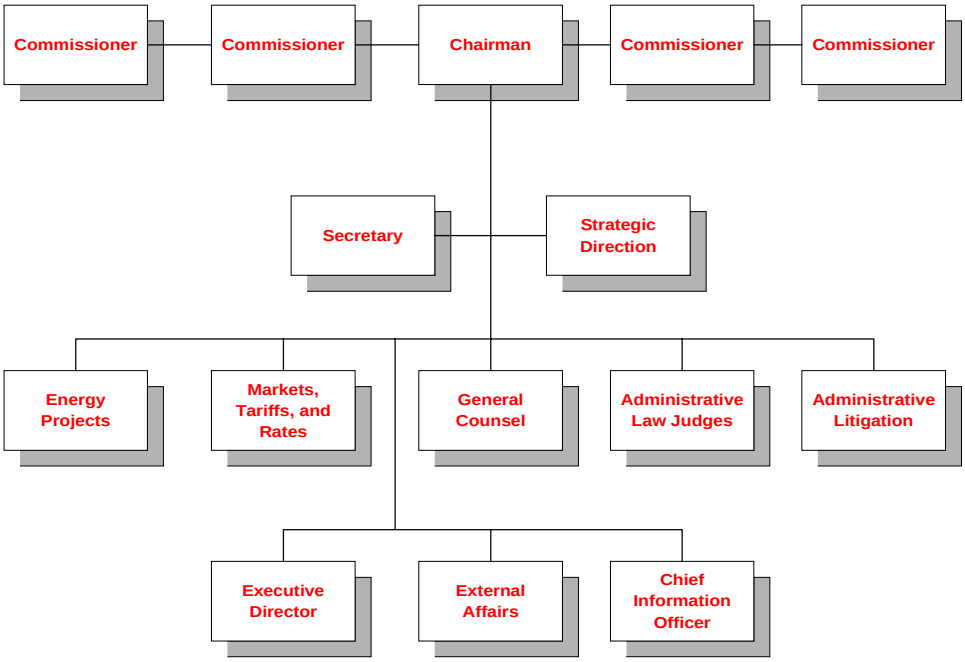
The Commission's statutory responsibility for key aspects of electricity, natural gas, and petroleum markets, as well as for authorizing nonfederal hydroelectric projects and interstate natural gas transportation facilities, remained unchanged during FY 2000. However, while processing a typical array of business, the Commission focused intensively on two crucial business areas:

- electricity markets, which remain far less competitive and less mature than interstate natural gas markets; and

- achieving a workable balance between environmental and landowner interests on one hand and the need for regional additions to natural gas pipeline capacity on the other.

During FY 2000, the Commission completed its restructuring to facilitate the Commission's new ways of doing business. The new organizational structure will assist the modernization of staff processes that were redesigned during the FERC First reengineering program. See the organizational chart below.

FERC Organization 2000



The Commission today employs 1,160 people in its Washington headquarters and in five Regional Offices around the country where about 12 percent of the Commission's employees work (see Table 1). That compares to 1,337 people in 1997 and 1,562 in 1987. The size of the Commission's staff has declined as its jurisdiction has changed (for example, as a result of gas wellhead price decontrol), as information technology allows us to do more with less, and in the context of bipartisan interest in shrinking the size of

government generally. The Commission has responded to these trends by reducing staff 15 percent since 1997, through attrition, buy-outs, and early-out programs. The current workload and potential additional challenges – for instance, if the Congress were to pass major electricity reform legislation – makes continued reduction of this kind unsustainable, however. In fact, the Commission is more than likely to require enhanced resources, including perhaps a more market-oriented skill mix, to meet new and heretofore unanticipated challenges. As a result, resource levels may need to increase somewhat in the foreseeable future.

Table 1: Distribution of Commission Employees by Region

Location	Number
Headquarters	1,051
Regional Offices	109
Atlanta	19
New York	32
Chicago	17
Portland	20
San Francisco	21

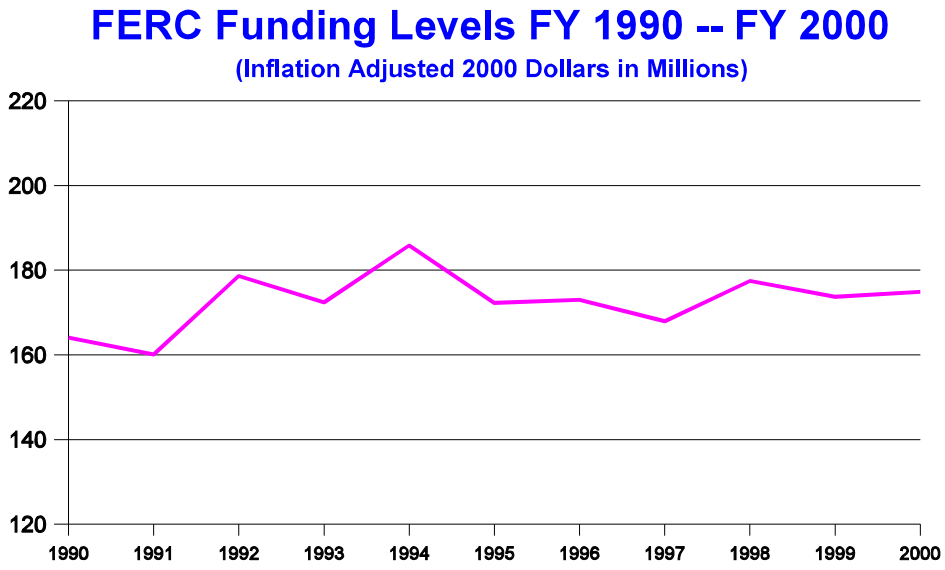
The Commission employs a wide range of technical experts, as might be expected, for the many different kinds of work that it needs to perform (see Table 2). Professional competence and diversity are both important to fulfill the Commission's role in developing and overseeing the future competitive markets in the natural gas and electric power industries.

Table 2: Distribution of Commission Employees by Profession

Profession	Percentage
Energy Industry Analysts	19.2%
Attorneys	15.4%
Engineers	13.4%
Accountants	7.6%
Computer Specialists	2.7%
Economists	2%
Support Staff	10.7%
Other	29%

It is fair to say that the Commission is "graying." One result of this is that the average FERC FTE in FY 2000, measured in terms of his or her average salary cost, is a full grade higher today than in 1990 – at a Grade 14, Step 2. This trend therefore raises concerns about the Commission ensuring a succession of qualified experts with knowledge and judgment. Recruitment, leadership training, and mentoring have therefore become more important.

The Commission's budget request for FY 2001, still pending approval, is $175.2 million. It compares to $174.95 million in the fiscal year just past. In real dollars, the Commission's budget has remained stable over the last decade, however, despite increased costs of operation and growing information technology needs. The Commission continues to be entirely self-funded through industry fees.



FY 2000 Achievements

Summary

FY 2000 was a successful, even an historic, year for the agency. It launched serious structural changes in bulk power markets (Order No. 2000) and further improved competition in interstate natural gas markets (Order No. 637). The Commission implemented a new policy for natural gas pipeline authorizations and encountered facts that made for some unusually difficult decisions in that area. The Commission also completed one of the most ambitious self-assessments and agency reinventions in the federal government.

Like all regulatory agencies, however, the Commission faces uncertainty about its resources and its future mission. The Commission must perform its regulatory duties and further its pro-competitive agenda amid several

contradictory trends that could affect its public policy choices and even its ability to do its job. Consider the following competing demands on the Commission, shown in Table 3:

Table 3: The Regulator's Dilemmas

People Like...		But They Also Want...
Due Process: all affected parties get a fair shake	⟷	**Expedition:** cut red tape and make fast decisions
Smaller Government: budgets and resources must be constrained	⟷	**Government That Is Effective and Up-to-date**
Less Regulation: less intrusion into competitively sensitive areas	⟷	**Assurance of Fair Markets:** the "new economy" requires new market structures, market information, and oversight
Market-dictated Outcomes: bureaucrats should not orchestrate results	⟷	**Protection from Market Dysfunctions, Unexpected Risk, and Unjust Rates**
Protection for the Environment and Property Interests	⟷	**Ample Supplies of Low-cost Energy**

In short, Americans want an array of public goods that ensure their welfare and enhance their lifestyles. Their goals sometimes conflict with one another, pose difficult choices for all Americans, and require public policy-makers to balance often-competing interests. State regulatory agencies may experience these conflicts even more strongly than does the Commission.

These dilemmas underlie a cultural challenge for the Commission. Although technology and changing market dynamics largely drive the emerging competitive energy marketplace, consumer confidence in the benefits of natural gas and electricity competition will depend on how well federal and state regulators lead the way to this new energy economy. Nothing more directly illustrates the key responsibilities of regulators at this moment than the market dysfunctions and price volatility seen recently in some emerging electricity markets. If they do not lead the search for solutions, the risk to regulators is that they too will become "stranded," especially if their traditional regulatory duties are fundamentally altered or marginalized. The Commission must therefore adapt the way it does business to the real-time needs of market players and changing market dynamics, while maintaining the integrity of its regulatory functions.

For several years, the Commission has faced the challenge of updating regulation of the new electric and natural gas industries. By 1998, the changes to the external environment, many induced by the Commission's work in Order Nos. 636 and 888, for example, had become so dynamic and rapid as to call into question the Commission's ability to take action in ways that fit the external environment. This led to the Commission's ambitious project to examine and retool its key processes. It was called FERC First, and it ended one year ago. During FY 2000, the Commission began to see the results of this retooling. To begin with, the Commission's resources were redistributed among three basic programs or processes:

- **energy markets**, including both traditional and market-based economic regulation of the electric, natural gas, and oil pipeline industries;

- **energy projects**, including certification of natural gas pipeline facilities, hydropower licensing and relicensing, and dam safety; and

- **management**, including information technology, human resources, budgeting, and facilities.

Much more has changed than office structure, however. In nearly every aspect of staff's work, there are four very notable new approaches to getting work done. They are:

Teaming is a way to leverage our human resources to gain better results. It replaces multiple office-to-office hand-offs with interdisciplinary coordination, staff empowerment, and less repetitive review. Teaming ultimately knits all staff offices together at all levels of the organization.

Customer focus means we pay attention to and seek to meet the need for service. Making good and timely decisions is a real service to everyone involved in a case and to the public at large. Our service focus can entail outreach, which bridges gaps between the Commission and parties affected by the agency's work, finding solutions to problems through collaboration, consultation, or alternative dispute resolution – outside the context of contested cases, and increasing trust and information sharing which leads to better outcomes.

Faster decision making helps the Commission respond to the pace of change in today's energy industries. Finding efficiencies in workload processing is also essential due to resource constraints and the need to put available effort into the highest-priority areas.

Strategic thinking is now built into the way we do business, organizationally and culturally. The Commission staff has long been accustomed to "fighting fires" – making short-term decisions about Commission policy or the industry. Because of the Government Performance and Results Act (GPRA)

and FERC First, we now will be doing things differently. The new Strategic Plan, submitted to Congress on September 29, 2000, sets a clearer overall direction for the Commission. Yearly performance plans, required under GPRA and based on participation by all parts of the Commission, guide all of the agency's future efforts.

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The New Energy Markets Program

It is important for Commission employees and the Commission's constituents to understand that, building on the four approaches above, the regulation of markets involves not only the Office of Markets, Tariffs and Rates (OMTR), but also the Office of Administrative Litigation (OAL), the Office of Administrative Law Judges (OALJ), and most of the Office of General Counsel (OGC). Promoting competition entails ***providing a fair, open, and efficient foundation for competition***, through the following activities:

- market assessment and oversight;
- traditional rate regulation;
- regulation of tariff terms and conditions;
- compliance and enforcement; and
- dispute resolution.

The energy markets program pursues the following objectives and, during FY 2000, the Commission has made strides in each area.

Tighter Deadlines on Key Cases. The Commission processes highly complex economic regulatory matters which often require considerable time and effort. However, there is a new time-sensitivity in its processes. An initial order is typically issued within 150 days after a completed merger application is filed. The Commission often has beaten this goal. Over the past two years, the Commission has on average issued an initial order within 109 days of the filing of a completed application, even in the midst of internal reorganizations and even though the number of merger applications increased.

The Commission staff devised time standards for litigated cases (see Table 4), aiming to reduce both processing time and resource commitments.

Table 4. Time Standards for Litigated Cases

Case Type	Hearing	Reply Briefs	Initial Decision
Simple Case	19.5 weeks	25.5 weeks	29.5 weeks
Complex Case	32 weeks	40 weeks	47 weeks
Exceedingly Complex Case	42 weeks	53 weeks	63 weeks
Complaint	30 days	45 days	60 days
"Fast-Track" Complaint	3 days	5 days	8 days

Finally, many innovations such as alternative dispute resolution, collaborative process, and outreach are largely designed to avoid or minimize litigation in appropriate circumstances. Although trial work will remain critically important to the Commission's decisionmaking, it is now being supplemented by a portfolio of other decisional techniques.

With growing competition in natural gas and electric power, the Commission's traditional workload of docketed cases remains as challenging as ever. The volume of the Commission's casework remains high. In addition, many cases raise new and difficult questions and generate greater public interest than ever before.

Maintaining and improving the processing of docketed workflow is the single most important task regulatory agencies face. It is in this area that Commission staff shines in mostly unheralded activities of research and analysis. Our notable successes over the past year processing natural gas pipeline certificate and electric merger cases, even during the agency's reengineering, are proud achievements that, among other things, suggest that better processes that combine time-sensitivity and attention to detail help staff excel. From a management perspective, however, the Commission has few ways of documenting its productivity in processing cases. Given the vastly different resource commitments different time frames required for its many tasks, not to mention the unprecedented nature of some cases, it is difficult for the Commission to define how it will measure performance in processing docketed workload.

Bringing Natural Gas and Electric Staff Together. Staff members whose specialties are natural gas or electric issues are working together every day, sharing knowledge and experience, and making regulation more innovative and consistent. Recognizing that natural gas and electric markets are intricately connected, the Commission has combined resources to deepen its understanding of market events. It is also beginning to find that resources can be redeployed more efficiently, and most staff members enjoy the learning and growth opportunities.

Attorneys and Technical Experts Team Up. Although technical and legal staffs and cultures have historically been very separate, they are highly integrated in OAL's trial teams. Meanwhile, OMTR and OGC are developing strong inter-office teams for advisory work. The opportunities are there for savings of time, greater efficiency, and better decisions, and these benefits are now beginning to be obtained.

Explicit Focus on Evolving Energy Markets. The Commission's traditional regulatory activities have focused on the rates and services of specific companies or on specific projects. Markets are broader and more organic subjects of analysis and action. OMTR and OGC have created units that assess and oversee developing markets in natural gas and electric power.

The key to success for these organizations will be their ability to understand markets quickly as they change, identify key problems or opportunities, and help the Commission respond appropriately. These organizations will examine systemic issues far more deeply than has been possible for the Commission to do in the past. Those working to promote competitive markets always implicitly understood the need for this kind of focus; it was only after FERC First, however, that such work was given an explicit place in the organization.

Outreach. Collaborative work and testing ideas with external constituents is now a part of day-to-day operations at the Commission. Order No. 2000, the initiative on regional transmission organizations (RTOs), substituted regional workshops and collaboration with market participants for a regulatory mandate. Order No. 637 requires ongoing consultations about the evolving requirements of the transportation services market. The Chairman has signed protocols with the North American Electric Reliability Council (NERC) to establish better consultative processes on electric reliability. Similarly, Commission staff has initiated bi-annual meetings with every industry segment to discuss issues in a relatively informal setting. Improved outreach will improve the chances for a meeting of minds on regulatory policy. It should also make it possible to handle issues more quickly and less confrontationally.

Alternative Dispute Resolution (ADR). The Commission's recently created Dispute Resolution Service is promoting ADR internally and offering ADR services to outside customers. Over the last year, the number of convening sessions tripled and over 35 disputes using mediation and/or facilitation processes ended in settlement. Moreover, the vast majority of cases set for hearing are resolved through the negotiation and settlement process. In the long run, ADR is likely to prove to be among the most important procedural innovations of the last two years.

In sum, the Commission's new market organization faces major challenges – staffing, access to timely market information, authority to curb market power proactively in contexts other than electric mergers, integrating gas and electric policies – but, where possible, we are developing the tools to address them. The foundation is laid. A new regulatory approach is emerging to complement the Commission's traditional rate regulation. The Commission now needs to fully exploit the potential of these efforts.

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The New Energy Projects Program

Authorization of energy projects is a distinct process that depends mainly on skills and specializations in the biological sciences and engineering. The energy projects program ***fosters economic and environmental benefits through the approval and oversight of hydropower and natural gas pipeline projects that are in the public interest.*** The program was created in 1999 to

obtain additional efficiencies and information from combining hydropower work (licensing, relicensing, and dam safety) with natural gas pipeline certification. The program is housed mainly in the new Office of Energy Projects (OEP) and OGC. Like the energy markets program, it builds on the attributes of teaming, customer focus, faster decisions, and strategic thinking.

The projects program pursued each of the following objectives in FY 2000 and has made dramatic progress in each area.

Case Processing Efficiencies. Perhaps the most immediate goal of the energy projects program has been to maintain or improve case processing times for natural gas certificate applications. Table 5 reflects our success in this effort. Hydropower licensing also has improved its ratio of cases completed to cases received. Because these improvements occurred during a transition to a new organization, these are remarkable achievements.

Table 5. Processing Times for Natural Gas Certificates

Category	Completed October 1998-September 1999		Completed October 1999-September 2000	
	# of Dockets	Days (average)	# of Dockets	Days (average)
No Precedential Issues, Unprotested	174	108	74	95
No Precedential Issues, Protested	31	247	10	169
Precedential Issues	39	300	42	210
Major Environmental Impact	14	438	23*	437*

* Excludes the Independence Project.

Sharing Resources. The common thread woven through energy projects is the National Environmental Policy Act (NEPA) process. Combining the environmental and engineering professionals from the hydropower and natural gas staffs has created a broader and deeper pool of technical expertise for both programs to draw on. For instance, the hydropower program has developed considerable expertise in the use of Geographic Information Systems (GIS) to expedite the processing of certain permits, which enables staff to develop GIS uses to expedite natural gas pipeline cases. OEP can now shift resources to meet changing caseloads in ways it previously could not. It remains to be seen whether the Commission's regional offices, which are now almost entirely dedicated to dam safety, could provide a suitable base of operations for environmental work on hydropower and pipeline projects.

Interagency Cooperation. The need to coordinate the work of several agencies is never greater than for the hydropower program. The Commission

took the lead in promoting interagency efforts to improve the hydropower licensing process. This year, an interagency task force achieved several goals, including agreements on "noticing" procedures and NEPA processes, which were adopted through an unprecedented agreement among the Secretaries of the Interior, Commerce, and Agriculture and the FERC Chairman. *Collaborative Process Guidelines: A Primer on Writing Trackable and Enforceable License Conditions*, a report on improving the process by conducting studies, and a report on improving coordination of the Commission licensing process and Endangered Species Act consultation are scheduled for completion by January 2001.

Outreach. Even more than the energy markets program, the projects-related processes almost always entail extensive outreach to pipeline companies, federal, state, and local agencies, landowners, Indian tribes, and other interested parties. The Commission can expect from these outreach efforts: (1) more complete and less contentious applications as more issues are resolved before filing; (2) development of a toolbox of best practices for pipeline applicants; and (3) a reduction in case processing times.

In sum, the Commission's new energy projects program, and OEP specifically, represent a major new approach to leveraging its engineering, environmental, and legal expertise related to project construction and safety. Its statutory authority is adequate to the task, although greater accountability by resource agencies would be helpful. OEP's resource challenges differ from OMTR's, and its mission today is quite clear. Moreover, its dam safety program has continued to be world-class and well-managed. In FY 2001, however, expectations for more efficient hydropower relicensing and pipeline certificate processes will run high. OEP and its counsel in OGC will meet the challenge of balancing vigorously competing interests in pursuit of the overall public interest.

* * *

The New Management Program

Management and administration at the Commission is now regarded as a program. It is the foundation of more ***efficient, effective, accountable business practices across the Commission.*** Human resources, information technology, and financial management are the core areas in management. While these activities take place to some extent in all offices, the primary management offices are the Office of the Executive Director (OED), Office of the Chief Information Officer (OCIO), Office of the Secretary (OSEC), and Office of External Affairs (OEA). In addition, the Office of Strategic Direction (OSD), helps all three programs develop a coherent overall set of Commission objectives and helps managers place their resource decisions in the context of the Commission's overall goals and the needs of other offices.

Human resources. Personnel costs account for two thirds of the agency's overall costs. Consistent with one of the Commission's primary values –

People are our most valued asset. We provide the support for all employees to excel – FY 2000 was a year spent putting the right people in the right positions under the revised organization and developing new programs to mentor, develop, and better employ members of the staff.

The Commission's mid-level supervisors have both a great opportunity and great challenge in the year to come. The opportunity: to mentor and develop staff talent, and foster creativity and diversity. The challenge: maintaining and improving productivity. This group of leaders is the critical core of the Commission's leadership, and they drive its processes and take responsibility for meeting deadlines.

Supervisors and staff, to be effective, must work together collaboratively. Managers must lead by setting direction, communicating clearly, building trust and commitment, promoting teamwork, and achieving results. Likewise, staff must be able to step up to greater responsibility, exhibit its creativity, and work in interdisciplinary teams. The Commission has focused strongly on leadership over the last two years – and has results to show for it. Two years ago, there was widespread concern about the uneven quality of Commission management. In a recent leadership survey, staff indicated leadership behaviors had improved, often dramatically. Improvement is still needed, however, especially in setting direction.

FERC First resulted in a flattening of the Commission's hierarchy; that is to say, fewer levels of supervision, fewer supervisors, as that term has been understood, and a greater assumption of responsibility by teams and team leaders. This has been a difficult cultural change and, frankly, a disappointment to many staff who had, or aspired to, a particular titled position. It nevertheless holds the promise of sharpening Commission processes and re-energizing the Commission's rank and file.

Some innovations are noteworthy. Supervisors now meet with employees at least four times per year to talk about both performance and growth opportunities. The agency is making judging performance clearer by using fewer rating levels and linking awards directly to specific achievements. The Continuous Learning Program and our participation in the Fellows Program of the Council on Excellence in Government are indicia of our new investments in our people and, ultimately, the Commission's interest in providing better service.

Investing in people must be a priority as the Commission faces new regulatory challenges. That means:

- Further developing the Commission's leadership. The Commission has made a start in improving the way that supervisors and employees work together. We must continue to make progress.

- Improving the Commission's performance on diversity. This is not only the right thing to do; it is a strategic necessity given where technical talent will come from in the future. The Commission's Diversity Council is charged with making the Commission an employer of choice for a diverse workforce.

- Making the Commission a learning organization. Every employee should develop his or her talents in support of the agency's efforts to meet its challenges. The agency must create opportunities for each staff member to broaden and deepen subject matter expertise.

Information Technology. Information technology (IT) will drive many, if not most, of the Commission's future changes. So important is this to effectiveness in government departments and agencies that Chief Information Officers are given enormous discretion to drive processes and fund retraining. Here at the Commission, market oversight and assessment will depend on the ability to identify and use accurate data from all over the country. Customer service will depend on a first-rate system of electronic filing. Teaming will depend on a virtual environment that encourages collaboration among people who are physically separate. The interconnectedness of IT and the Commission's capacity to achieve its policy agenda has become so important that the Commission has appointed a Chief Knowledge Officer to help bridge the wide cultural gap between the Commission's IT professionals and its attorneys and technical experts. In addition, e-commerce in the energy economy must be understood technically and in the context of the Commission's competitive agenda and its regulatory duties. The Office of the Chief Information Officer (OCIO) is re-making the Commission's electronic infrastructure. The primary objectives of that activity include:

- *Electronic Filing.* The Commission has already piloted its new electronic filing capability and is on course for implementing full electronic filing in stages. This year, Form 423, Monthly Report of Cost and Quality of Fuels for Electric Plants, began submission in electronic format. The Commission receives 95 percent of Form 1 submissions electronically. Under the e-filing pilot beginning on November 1, 2000, the Commission will accept certain filings via the Internet in lieu of paper copies. The pilot begins with electronic submission of comments, and will ramp up to include protests and interventions by February 2001. These categories will represent 35 percent of the Commission's total filing volume. Later in FY 2001, the Commission will prototype electronic tariff submissions with electronic signature or authentication and also will prototype e-issuance and e-service. Looking forward, the Commission plans for online electronic mechanisms for more than 97 percent of its submissions by FY 2003. This initiative should give the Commission's customers the full advantages of current technology.

- *FAMIS.* This system will provide the collaborative internal environment that staff need to take full advantage of teaming and that management requires to ensure productivity.

- *RIMS and CIPS.* Public interface with the Commission's data bases must be upgraded.

Overall, the Commission faces the same IT issues that all organizations face: ensuring that this vital and resource-intensive area yields maximum benefits. The OCIO has major responsibilities to ensure this result.

Financial accountability. Fiscal management is vital to any agency. More than two years ago, the Commission committed to its House appropriators that it would reduce its personnel costs by about 2 percent per year (in real terms) over the next 5 years. So far, the Commission has met or exceeded that target. Only greater efficiency and new processes makes this even close to possible, given current and projected workload. The Commission has delegated responsibility for meeting budgets downward through the organization, so that all managers feel accountable for the wise use of resources.

The first step is to implement Manage-to-Budget, a program under which each office is directly accountable for its salary expenditures. This kind of accountability is an important and difficult step in an agency that traditionally has relied on central budgetary controls. Even if the Commission is compelled to abandon its force reduction schedule because of new statutory duties or events in the energy markets, this new fiscal approach will yield savings for years to come.

In sum, most management functions are nearly invisible to the Commission's customers, but they are critical to the quality of service it provides. The new focus of the management program is on serving external as well as internal customers. It has become clear that the management offices which support the Commission's programs and policies cannot work in isolation. They must be centers of change and improvement, leadership training, and our own knowledge economy. These organizations have primarily internal customers, but the success of the Commission relative to the industries it regulates will therefore depend on the analogous relationship between these service groups and the regulatory machinery they support.

Tomorrow's Challenges

Energy Markets

The Commission's biggest challenge over the next year will be to sustain its policy of encouraging competition in the electric power industry. Competition can work in energy as surely and as well as it does in other

industries. Cost savings to American consumers from natural gas wellhead decontrol and open access to natural gas transportation now approach $200 billion. The potential (not yet fully realized) benefits from establishing similar competitive markets for electric power are much greater because the industry is much larger, up to $20 billion per year by some estimates.

During FY 2001, however, competition in energy industries will come under challenge as it has not for a decade and a half. Energy prices are again a major issue for many Americans, as shown by the breakdown of California's electricity market and the rising price of natural gas. Reliable energy service is also a critical concern, as headlines report blackouts in San Francisco and Detroit. More specifically, recent experience in electricity markets tells us that:

- market rules on bidding, congestion management, and other matters can have dramatic effects on prices and require strong independent oversight;

- the timing of investments, barriers to siting, and inflexible demand can lead to shortages and high prices even in well-structured markets; and

- political pressure to roll back competitive reforms can arise rapidly and powerfully, making expedition in achieving market transformations doubly important.

The electricity industry is now at a crucial moment of transition. The benefits of competition are as real as ever. But without strong, focused action, there is a very real chance that the Nation will forego the full benefits of competition in electricity for a generation, at vast cost to citizens and to the economy as a whole.

To make the transition to competition work in electricity will require courage and imagination from state and federal policy-makers and leaders in the private sector. *Most of all, a successful transition requires implementation of the kind of vision offered by this agency in Order No. 2000, just as it did for the natural gas mid-stream markets in Order Nos. 636 and 637.* This Commission is extraordinarily well placed to provide the leadership needed to bring coherence to this national effort.

Leadership in electric competition will require roughly equal parts of remaining true to basic principles and taking on new roles. The three basic conditions needed to realize the full benefits of competition in the electric industry – including adequate supply – remain the same as they have been:

- fair, open access to the transportation grids;
- appropriate regulation of the monopoly aspects of the grids; and
- strong commodity markets that operate both efficiently and fairly.

Addressing these three needs is the bread and butter of the Commission's daily work in markets – from RTOs to rate filings to market oversight. Going forward, the Commission also needs to learn new ways of doing business. To sustain a policy of encouraging competition for consumers' benefit, the Commission must:

- become the watchdog of market integrity;
- be increasingly attuned to the effects of the transportation grids on the commodity markets and vice versa;
- develop the capacity to act much more quickly than ever before; and
- continue adapting its approach to regulation.

Specifically, what important goals should the Commission aim to achieve in its markets program over the next year?

First, the Commission must develop its Market Oversight and Assessment (MOA) function so it can analyze events and act quickly as markets develop in unforeseen ways. This means innovative procedures and a new skill mix for the staff members dedicated to the effort.

Second, the Commission must seek the necessary real-time information that will allow it to monitor market developments. As the Commission's *State of the Markets Report* and its performance plan under GPRA indicate, the agency's success – and its ability to back away from heavy-handed regulation – will henceforth be tied to the success of the competitive markets it oversees.

Third, the Commission and the states must devise more effective ways to work together on electric markets of the future. As is now evident, retail electricity competition (regulated by the states) requires competitive wholesale power markets (regulated by this Commission), and an open transmission network; likewise, wholesale markets will be most efficient only when electricity customers can change their purchasing patterns in response to changing prices. Too much of the current restructuring conversation with states is about jurisdiction and too little is about markets.

Finally, the Commission must make a persuasive case to state and other federal policymakers that the electricity marketplace of the 21st Century, like the interstate natural gas industry, must move toward competition. That case entails three principles:

- The Commission's vision for bulk power markets – more competition among generators and service suppliers, greater ease of market entry and exit, and less government intrusion in the absence of market power – is the right course for the country.

- A key to achieving this vision for competitive wholesale markets is open and accessible regional transmission grids that cover large areas and are independently operated.

- The Commission can be relied on to create and oversee competitive wholesale electricity markets to the extent it has the right set of regulatory tools, including more direct responsibility to curb market power and ensure compliance with industry-set standards of bulk power reliability.

Thanks to both the talent of the Commission's employees and the reengineering of the last three years, the Commission is well-placed to take on these critical challenges in the markets area.

Energy Projects

The Commission also faces challenges in energy projects. The development of adequate, environmentally responsible energy infrastructure is critical to the success of energy markets. Our expanding economy needs more energy. However, increasing demand also is increasing reliability concerns. The current failure of natural gas and electricity supply to keep pace with growth turns out to be as big a threat to reliability and competition as any market design problem. So, facilitating prudent energy infrastructure expansion – especially of natural gas pipelines – becomes more important, visible and controversial than ever. Moreover, the renewed interest in transporting Alaskan natural gas to the lower 48 states could create a task for the energy projects program of historic proportions.

Siting new natural gas pipeline facilities requires adequate and open processes, a depth of technical knowledge, and a willingness to make difficult decisions. Growing environmental awareness and citizen involvement in land use decisions sometimes make these projects controversial. Consideration of the long-term impacts on regional air quality, endangered species, and other aspects of ecological systems generally has magnified the complexity of our analyses. At the same time, the surging demand for natural gas, especially for electric generation, has heightened the immediacy of requests to build new facilities, thus making the time needed to process filings for new facilities a matter of importance in two key energy industries.

In hydropower relicensing, the Commission faces several challenges. It will need to relicense a new class of large projects in the next decade. It will need to respond to calls to expedite the relicensing process, which will be a challenge, given the many agencies involved in the process. Finally, it will need to be attuned to the dynamic nature of relicensing decisions. For example, the 1998 Edwards Dam settlement, in which a dam was dismantled after 160 years, shows how the Commission can encourage a fresh look at existing facilities and support a new balancing of competing interests.

Management

The primary challenge facing the Commission's management program in the next year will be to maintain continuous improvement, building on the improvements already achieved. Improvements in human resources, leadership development, and business practices must continue to move forward. Perhaps the most important of these is information technology, which has become intrinsic to so many facets of modern life that to ignore its benefits for better government administration and for a better energy economy is to commit a grave error. For example, the very ability of this Commission to meet its challenges in overseeing and assessing energy markets hinges on our ability to establish and maintain a robust technology infrastructure. Other potential gains through e-commerce and the move toward paperless processing make technology a key area of challenge in the next year and beyond.

Policy Postscript

In sum, FY 2001 will inevitably be a transitional year, both in terms of the composition of the Commission membership and how it chooses to handle the coming challenges – those rising from possible electricity legislation, developments in the industry's structure, the Commission's relationship with state policymakers, and the demanding choices about priorities and resources. The Commission's major specific challenges for FY 2001 – and perhaps for one or two years hence – involve electric restructuring. They are likely to be: (1) to address the dysfunctional California bulk power market, correct its rules, rid it of market power abuses, and establish long-term objectives and priorities that suit both that state and the West; and (2) to advance implementation of RTOs in conformance with Order No. 2000. These two immediate tasks are interrelated. In fact, the second will be immeasurably more difficult to achieve across the country if the first is not addressed promptly and firmly.

There is no more important moment for the Commission to continue exerting its leadership in electric restructuring. There are no other candidates for that job. The risks to the industry, the economy, and, most of all, to consumers from a prolonged and chaotic transition to bulk power competition are quite real. This critical industry cannot fail to keep pace with other aspects of the "new economy."

The forthcoming RTO proposals under Order No. 2000 will frame the Commission's options and objectives for FY 2001. They may vary dramatically in quality and effectiveness. It remains to be seen whether the industry will be willing to adapt and restructure or whether impediments to viable regional power markets will persist. In either case, the Commission's responses to the filings will be crucial. They may yield a rapid series of seminal orders and basic change in bulk power markets, a prolonged process

of rehabilitating poor regional market plans, or a redetermination of the Commission's course of action. In any event, the RTO model is here to stay. Uncertainty is not an option.

If the transition to operational regional markets is delayed, the Commission will face a pressing need to address separately several key transmission issues: interconnection policy, contract reservation requirements, and how to govern the "seams" between existing systems. In the absence of RTOs, the Commission will decide in FY 2001, one way or the other, its obligation to move ahead in these areas and to alleviate impediments to efficient markets – even though RTOs would otherwise be making many of these decisions.

In the final analysis, the regulator's job is to make the unpopular decisions that other policymakers find too controversial or too technical to tackle. He or she will have to negotiate between competing claims that dislocations in electricity markets can be traced to too much deregulation or too little, or that the Commission should be faulted for authorizing too much project development or has imposed too many environmental constrains on that development. The job is a difficult balancing act that will only become more challenging for this agency in FY 2001. It is a job that the Commission has customarily accomplished incrementally, with due process, by case-by-case litigation, consensus building, or compromise. In the new world of dynamic energy markets, however, such time-tested approaches to dispute resolution can too easily be mistaken for obstructionism or ineffectiveness. Instead, market participants in FY 2001 will be looking to the Commission to call the balls and strikes unequivocally, to eradicate uncertainty, and to provide investors and the market participants the kind of clear direction and keen oversight they require.

If the Commission is to be more aggressive in pursuit of competition, more real-time and market-responsive in its actions, and more capable of monitoring markets on behalf of the public interest as they evolve, the management reforms already begun must be continued. Given the right tools and the resources, the Commission will clearly be up to these tasks.

Do you have comments on:
This year's report? How to make this report better next year? The Commission's future direction? The Strategic Plan?
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