

STRATEGIC PLAN FOR FISCAL YEARS 2003 - 2008



**FEDERAL ENERGY REGULATORY COMMISSION
SEPTEMBER 2003**

Pat Wood, III
Chairman

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Message from the Chairman

To the Speaker of the House of Representatives, the President of the Senate, the President pro tempore of the Senate and the Director of the Office of Management and Budget:

I am pleased to submit the Federal Energy Regulatory Commission's Strategic Plan for Fiscal Years FY 2003 - FY 2008. This plan describes how we intend to accomplish our mission: To regulate and oversee energy industries in the economic and environmental interest of the American public. In particular, it discusses the objectives and strategies we will follow to meet our three mission-oriented goals, and sets out performance goals and measures to gauge our progress. In addition, it discusses the primary management initiatives that support all three goals and their underlying objectives.

Our Strategic Plan responds to the needs of the times, charting a course to achieve dependable, affordable energy through sustained competitive markets. The plan reflects ongoing dialog with customers, industry, tribes and states; however, the plan is our own. It is a living document, which we will adapt as necessary as circumstances change.

Pat Wood, III
Chairman
Federal Energy Regulatory Commission

Regulatory Responsibilities

The Federal Energy Regulatory Commission (FERC) is an independent regulatory commission within the Department of Energy (DOE). Its function is to oversee America's electric utilities, natural gas industry, hydroelectric projects and oil pipeline transportation system.

Mission

The Federal Energy Regulatory Commission regulates and oversees energy industries in the economic and environmental interest of the American public.

The Commission was created through the Department of Energy Organization Act on October 1, 1977. At that time, the Federal Power Commission (FPC), the Commission's predecessor which was established in 1920, was abolished and the Commission inherited most of the FPC's regulatory mission.

The Commission has five members who are appointed by the President with the advice and consent of the Senate to five-year staggered terms. Each Commissioner has an equal vote on regulatory matters and no more than three Commissioners may belong to the same political party. One member is designated by the President to serve as Chair and is the Commission's administrative head.

Hydropower is the oldest area of Commission jurisdiction. The Commission's predecessor began federal regulation of non-federal hydroelectric generation in 1920, authorizing the construction of projects in interstate commerce and overseeing their operation and safety.

Since 1935, the Commission has regulated certain electric utility activities under the Federal Power Act (FPA). Under FPA Sections 205 and 206, the Commission oversees the rates, terms and conditions of sales for resale of electric energy and transmission service in interstate commerce by public utilities. The Commission must ensure that those rates, terms and conditions are just and reasonable, and not unduly discriminatory or preferential. Under FPA Section 203, the Commission reviews mergers and other asset transfers involving public utilities. The utilities regulated under FPA sections 203, 205 and 206 are primarily investor-owned utilities; government-owned utilities (such as the Tennessee Valley Authority, the federal power marketing agencies, and municipal utilities) and most cooperatively-owned utilities are not subject to the Commission's regulation, with certain exceptions.

The Commission may not regulate retail sales or local distribution of

electricity. These are matters left to the states by the FPA. Nor does the Commission have a role in authorizing the construction of new generation facilities (other than non-federal hydroelectric facilities) or transmission facilities. These too are state or local responsibilities.

The Commission's role in the natural gas industry is largely defined by the Natural Gas Act of 1938 (NGA). Under NGA, the Commission regulates the construction of new natural gas pipelines and related facilities and oversees the rates, terms and conditions of sales for resale and transportation of natural gas in interstate commerce. Pipeline siting and construction is authorized by the Commission if found to be required by the public convenience and necessity. As with hydropower licensing, the Commission's actions on pipeline projects typically require consideration of factors under the National Environmental Policy Act (NEPA), the Endangered Species Act, the Fish and Wildlife Coordination Act, the Coastal Zone Management Act and other such legislation. Regulation of retail sales and local distribution of natural gas are matters left to the states.

Finally, the Interstate Commerce Act (ICA) gives the Commission jurisdiction over the rates, terms and conditions of transportation services provided by interstate oil pipelines. The Commission has no authority over the construction of new oil pipelines, or over other aspects of the industry such as production, refining or wholesale or retail sales of oil.

Goal 1: Promote a Secure, High Quality, Environmentally Responsible Infrastructure through Consistent Policies

Natural gas and electric markets need adequate capacity. When supply, delivery capability, or demand flexibility to respond to high prices is insufficient, either market can experience significant and rapid price increases. In these circumstances, market power abuses also become more likely.

Adequate energy infrastructure helps make competitive markets work by:

- Reducing barriers to entry;
- Allowing choice and competition between multiple supply sources;
- Better matching demand and supply;
- Improving customer access to low-cost resources;
- Encouraging price-responsive markets; and
- Improving reliability.

Objective 1.1: Expedite Appropriate Infrastructure Development to Ensure Sufficient Energy Supplies

Sufficient supplies of energy and a reliable way to transport those supplies to customers are necessary to assure reliable energy availability and to enable competitive markets. Reasonable supply relative to demand is essential for competitive markets to work. Without sufficient delivery infrastructure, some suppliers will not be able to enter the market, customer choices will be limited, and prices will be needlessly volatile.

For the nation to continue enjoying affordable, reliable electric and gas service, we will need significant investment in new electricity transmission and generation (in specific areas), and continued gas pipeline, storage, and LNG terminal investment to link gas producing and consuming regions.

Since November 2001, FERC has developed assessments of the energy infrastructure in each of the nation's regions. These assessments report and analyze the adequacy of electric, gas, hydro, and other fuels, spanning generation, transmission, delivery, and environmental issues. Each regional assessment has been presented in a public infrastructure conference in the region, with expert speakers and public discussion. These regional conferences have been very useful in focusing attention and common effort to important infrastructure issues for each region.

Some ways to expedite appropriate infrastructure development are to standardize the rules for interconnection of power generation plants;

identify transmission and pipeline projects with high public interest benefits and facilitate their speedy completion; and strengthen inter-agency coordination related to hydropower licensing and gas pipeline certification to expedite processing.

Means and Strategies

Appropriate Transmission and Pipeline Projects

For competitive markets to develop, adequate transportation is necessary to deliver the supply to where demand exists. Inadequate transportation creates artificial geographic price differences, price volatility, and barriers to market entry and can undermine reliability. Adequate transportation allows a choice of suppliers, allowing the market to compete on customer service, price, and new services and features.

We authorize the construction of natural gas pipelines, storage facilities and liquefied natural gas (LNG) import terminals. The market, through investors, decides where and what to build. We make sure the proposed projects meet all statutory requirements concerning routing, including landowner and environmental concerns, without excessive delay. We will expedite review of projects during the next few years that will provide additional transportation capacity out of the Rocky Mountain region to help alleviate the current gas supply shortage, and stand ready to handle the permitting of a pipeline for Alaska natural gas if Congress and the market deem it desirable.

In FY 2003, the natural gas industry filed an increased number of new LNG import terminals along with expansions at existing terminals. This trend is expected to continue as companies are planning additional LNG projects to increase the gas supply from offshore sources over the next few years.

Although we have no authority over the siting of electric transmission lines (except for those to licensed hydroelectric projects), we are working with state regulators to establish regional state committee groups to identify needed transmission and do regional system expansion planning.

Power Plant Interconnection

One major potential barrier to obtaining adequate generation supplies is the lack of a standard, expeditious way to connect to the transmission grid. Standardized interconnection procedures and agreements for electric generators will encourage needed investment, remove incentives for transmission owners to favor affiliated generation, and encourage efficient generation and transmission siting decisions. In the summer of 2003, following a year of discussion and comment, we issued a final rule covering interconnections for large (20 megawatts and above) generators and issued a notice of proposed rulemaking to standardize interconnection procedures for smaller generators. The next order of business is to implement the new large generation interconnection rule and complete action on the small generation interconnection rulemaking.

Regional Transmission Planning

The nation's transmission grid has experienced a decade of under-investment. Electric load has grown markedly but the grid has not, and the result is increasingly costly congestion and, occasionally, reduced reliability of service. Fully competitive markets will require extensive regional planning to guide new investments in generation, transmission and demand resources. Transmission constraints in one area can have wide-ranging effects for customers throughout a region, including the negative effects that transmission upgrades in one place can sometimes have on other parts of the grid. New generation construction can also have significant regional impacts beyond its immediate location.

For regional planning, regional transmission organizations (RTOs) will serve as objective experts and support for local siting authorities. Because they will operate the transmission system and oversee the market, RTOs will be in a unique position to understand the grid's technical requirements and market needs, and integrate them into a long-term regional plan that reflects regional needs and values. Full participation from state officials and stakeholders will be crucial for effective, meaningful regional plans.

Hydropower Licensing and Pipeline Certification

Hydropower Licensing. Hydropower provides low cost energy reserves and ancillary services that support markets (in addition to other benefits such as water supply, recreation, economic development, and flood control). However, the potential for adverse impacts on environmental resources requires the involvement of many other entities which may lead to a lengthy licensing process. Citizen groups, environmental organizations, tribal interests, and state and federal resource agencies may seek adjustments to project licenses to mitigate, protect and enhance impacted resources. In the interest of meeting statutory mandates, court decisions, and the mandatory conditioning authority of other resource agencies, the licensing process has become a multiyear effort. For a traditionally prepared relicense application, the median process time is 47 months.

The Commission has been working to expedite the licensing process. Notably, the Alternative Licensing Process (ALP), which has become an increasingly popular method for preparing relicense applications over the past 5 years, has a median processing time of 18 months. Building on the successes of the ALP, the Commission has issued new licensing regulations. The new Integrated Licensing Process (ILP), based in large part on input from all stakeholder groups, will integrate the resource agency, Indian tribe, and public pre-filing consultations with the Commission's National Environmental Policy Act scoping. To reduce delays resulting from study requests, the ILP provides for early resolution of the scope and nature of data collection efforts and establishes informal and formal forums for resolving study disputes. Furthermore, the ILP, unlike both the traditional process and the ALP, will ensure Commission staff involvement at all stages, deadlines for all stakeholders, and, most

importantly, better integrate the Commission’s actions with the actions of other Federal Agencies with roles under the FPA. In 2005, the ILP becomes the default process, but applicants can still propose the traditional or alternative process.

These means of streamlining the process will be particularly important to meet the increased workload through calendar year 2008. Over this time we anticipate the filing of 218 relicense applications. These applications are for projects that are among the largest under the Commission’s jurisdiction.

Gas Pipeline Certificates. A robust natural gas pipeline infrastructure is critical for the reliability of the Nation’s energy supply and for competitive market development. In light of the need to expand and construct pipelines and related facilities to meet growing demand, we have several approaches to expedite our response to certificate applications:

- We are gradually expanding the number of certificate applications bound by tight processing schedules, and are clearly defining our expectations of applicants and other parties.
- We encourage the use of the new NEPA Pre-filing Process as a means to address stakeholders’ concerns prior to filing, improve the quality of applications, and improve the likelihood of regulatory approval.
- We partner with other federal and state agencies to streamline the application process.

***Relationship to
Performance
Plan***

For Objective 1.1, our long range performance goals 1.1A – 1.1E, long range measures, and sample annual performance measures follow:

Long Range Performance Goal 1.1A: Easier entry to the transmission grid for new generators	
<p><i>Long Term Measure:</i> Average time for new generators to become interconnected.</p> <p><i>Target:</i> Reduced</p>	<p><i>Sample Annual Measure:</i> Average times for new generators to become interconnected under the Commission’s standard procedures and standard agreement.</p> <p><u>For large generators:</u> <i>Baseline:</i> TBD in FY 2004 <i>Target:</i> Decreased by 5%</p> <p><u>For small generators:</u> <i>Baseline:</i> TBD in FY 2005 <i>Target:</i> Decreased</p>

Long Range Performance Goal 1.1B: In every region, have Regional State Committees (RSCs) in place, approving annual regional system transmission plans produced by RTOs/ISOs, that shape long-term infrastructure growth	
<p>Long Term Measure: Number of regions of the country with operating RSCs and annual transmission plans by FY 2008.</p> <p><i>Target:</i> All</p>	<p>Sample Annual Measures:</p> <ul style="list-style-type: none"> Percentage of the state commissions that join an RSC each year. <p><i>Target:</i> Additional 20% of state commissions</p> <ul style="list-style-type: none"> Percentage of the nation's transmission infrastructure covered by RTO/ISO-prepared and RSC-sponsored transmission expansion plans. <p><i>Baseline:</i> FY 2003 <i>Target:</i> Additional 20%</p>

Long Range Performance Goal 1.1C: Increased investment in electric transmission	
<p>Long Term Measure: Amount of transmission investment in the United States by FY 2008.</p> <p><i>Target:</i> Actual increase</p>	<p>Sample Annual Measure: Amount of increase in transmission investment over previous year.</p> <p><i>Baseline:</i> Year that annual transmission plan is produced <i>Target:</i> 5%</p>

Long Range Performance Goal 1.1D: Decreasing price differentials between locations for gas	
<p>Long Term Measure: No price differentials between locations, large enough to justify investing in new capacity, will remain in place for longer than 5 years. (Excessive price differentials may indicate that there is not enough infrastructure to deliver gas to the location where the price is higher. In such a case, we expect that complete market response to meet infrastructure needs could take up to 5 years.)</p>	<p>Sample Annual Measures: Reason for excessive differential discovered and resolution underway.</p>

Long Range Performance Goal 1.1E: Quicker processing of hydropower cases	
Long Term Measure: Average processing times for hydropower relicensing. <i>Baseline:</i> 4.1 years in FY 2002 <i>Target:</i> 25% reduction	Sample Annual Measure: Average processing times for hydropower relicensing. <i>Target:</i> Additional 5% reduction each year

Objective 1.2: Provide for Timely Cost Recovery to Infrastructure Investors

Competitive energy markets depend on the services provided by the underlying transportation infrastructure – natural gas pipelines and electric power transmission lines. These are regulated monopoly services. To support competitive energy markets, our policies concerning regulated monopoly services must:

- Give transportation infrastructure investors confidence that they have the opportunity to recover their costs and make a fair return on their investment;
- Give transportation customers (generators, gas producers, local distribution companies, demand aggregators) reasonable certainty about the costs they will bear for transportation and about future terms and conditions that affect access to transportation; and
- Give transportation owners the right incentives to provide customers with better services, lower costs, or both.

Means and Strategies

Clear Cost-Recovery Process

To invest in facilities that provide regulated monopoly services, such as natural gas pipelines and electric transmission, investors need to know how and when they will have the opportunity to recover their costs. Thus we must establish clearly understood cost recovery processes and act quickly and with certainty on rate proposals, especially for new construction.

Pipeline and power line cost recovery and rates are set in tariffs filed at, and usually litigated before, the Commission. Most power line cost recovery is in retail rates. These cases are processed and settled or litigated as quickly as due process allows. The resulting tariffs must be clear and meet both business needs and the public interest.

Rate Design for Long-term Competitive Markets

Just as investors in regulated monopoly infrastructure need to know the rules for cost recovery, customers of transportation (electric generation, gas production, local distribution companies, and demand-side measures) need reasonable assurance of what transportation costs they can expect to

face and that they will continue to have nondiscriminatory access to transportation services. Without such assurances, transportation providers will find it more difficult to obtain financing, and invest in fewer projects. That in turn could undermine the adequacy of supply and management of demand that are prerequisites for competitive energy markets.

The same measures we are undertaking to provide cost recovery assurance for infrastructure investors lowers the cost of new infrastructure, thus lowering costs and providing greater rate certainty for customers.

Innovative Rate of Return Proposals

Traditional cost-of-service rate regulation provides few incentives for regulated companies to lower their costs, to provide better service or to remove barriers to open commodity trading. Such regulation is not necessarily the best way to set rates for regulated services that support an overarching competitive energy market. Therefore, we welcome innovative rate proposals that promise reduced costs, improve service or remove trade barriers. The Commission encourages formula rates or rates set through other efficiently administered means.

Relationship to Performance Plan

For Objective 1.2, the following long range performance goal, long range measure, and sample annual performance measure applies:

Long Range Performance Goal 1.2A (same as 1.1C): Increased investment in electric transmission	
<i>Long Term Measure:</i> Amount of transmission investment in the United States by FY 2008. <i>Target:</i> Actual increase	<i>Sample Annual Measure:</i> Amount of increase in transmission investment over previous year. <i>Baseline:</i> Year that annual transmission plan is produced <i>Target:</i> 5%

Objective 1.3: Address Landowner and Environmental Concerns Fairly

Infrastructure projects inevitably involve competing economic, environmental and landowner interests. We are continuing to improve our processes to reconcile these interests.

Means and Strategies

Pre-filing Collaboration Among Affected Parties

While competing interests are never easy to reconcile, we believe they are best addressed openly and early in the process. For pipeline certificates, our new NEPA Pre-filing Process is an outgrowth of the stakeholder involvement workshops. This process is specifically designed to address landowner and other environmental concerns well before an application is filed. It provides a framework for constructive discussions among Commission staff and stakeholders - natural gas transmission project

proponents, potentially affected landowners, Indian tribes, federal, state, and local agencies - before the selection of a final pipeline route and the submission of a formal application. Use of the NEPA Pre-filing Process is voluntary, and natural gas companies can use it to expedite our NEPA review of their proposals. We are conducting outreach meetings to encourage and explain the program to the public and industry. To date, one project has used it, resulting in a 40% reduction in time to prepare an FEIS after the application was filed. We believe that company use of the NEPA Pre-filing process will result in better applications, and project approvals by the Commission that are more responsive to market needs.

For hydropower licensing, the ALP and ILP allow stakeholder groups, including resource agencies that have mandatory conditioning authority, to have more involvement during the preparation of the license application. When parties clarify and narrow the issues and data needs with effective communication before they file with the Commission, we can act more expeditiously in case litigation and approval.

Environmental Conditions and Related Compliance

Natural gas pipeline construction and hydropower projects have environmental impacts that can be mitigated with appropriate measures. For pipelines, we impose environmental measures in certificates and inspect natural gas facilities to verify compliance. For hydropower projects, most licenses contain needed environmental resource protection measures. The Commission monitors each project to ensure that these measures are providing the appropriate levels of protection, mitigation and enhancement.

For Objective 1.3, our long range performance goals 1.3A and 1.3B, long range measures, and sample annual performance measures follow:

Relationship to Performance Plan

Long Range Performance Goal 1.3A: Maintained environmental quality at hydropower projects	
<i>Long Term Measure:</i> Resource protection measures constructed and implemented according to license requirements.	<i>Sample Annual Measure:</i> Resource protection measures constructed and implemented according to license requirements.

Long Range Performance Goal 1.3B: Reconciliation of competing interests through streamlined collaborative processes	
<p>Long Term Measures:</p> <ul style="list-style-type: none"> • Increase in the number of major federal-action gas pipeline and LNG projects using the NEPA Pre-filing Process. <p><i>Baseline:</i> One project completed in FY 2003 <i>Target:</i> Increase in number of projects using and successfully completing the process</p> <ul style="list-style-type: none"> • Percentage of projects using the ILP pre-filing process. <p><i>Baseline:</i> FY 2003 – 20% of cases using pre-filing process</p>	<p>Sample Annual Measures:</p> <ul style="list-style-type: none"> • Time to complete NEPA Pre-filing Process. <p><i>Target:</i> 8 months after a complete application is filed</p> <ul style="list-style-type: none"> • Yearly increase in the percentage of hydropower projects using the ILP pre-filing process. <p><i>Target:</i> FY 2004 – 20% FY 2005 – 25% FY 2006 – 60% FY 2007 – 70% FY 2008 – 85%</p>

Objective 1.4: Promote Measures to Improve the Security and Safety of the Energy Infrastructure

For customers to enjoy the benefits of competitive energy markets, the Nation’s energy infrastructure must be adequate and secure. Adequacy is the ability of the electric and natural gas systems to supply the aggregate requirements of all consumers most of the time. Security is the ability of the system to withstand sudden disturbances for a short time, and to be safe from attack or sabotage.

Means and Strategies

Prudent Dam Safety Practices

To protect life, health, and property, FERC focuses on the safety of approximately 2,600 non-federal hydropower dams we license. Many of these dams were constructed more than 100 years ago. We will continue to inspect about 1,000 high- and significant-hazard –potential dams once a year and the remaining dams (low-hazard-potential dams) once every three years. We work with licensees, dam safety experts, and other federal and state agencies to develop and apply state-of-the-art safety and security guidelines and practices.

Infrastructure Security

Electric, gas, and oil companies may need to adopt new procedures, update existing procedures, and install facilities to further safeguard their electric power transmission grid and gas and oil pipeline systems.

Although the security of gas and oil pipeline and storage facilities is not under the Commission's purview, we do support the activities of the agencies with regulatory responsibility for security. With regard to LNG facilities, the Commission supports the U.S. Coast Guard, which has jurisdiction over off-shore facilities, and DOT, which has jurisdiction over on-shore facilities. Both of these agencies have recently issued new guidelines that significantly expand security requirements. We are working with the U.S. Coast Guard and the DOT to address the public's concerns regarding LNG shipping and pipeline safety. We have also entered into a joint partnership with DOT and the National Association of State Fire Marshals to address security and response initiatives. Four factors are under examination to enhance operations of the natural gas industry: training, education, accident prevention, and accident response.

The Commission has adopted a rule on the identification and handling of critical energy infrastructure information for entities filing this type of information with the Commission, to keep information on energy facility structure and vulnerabilities out of public and internet access without compromising the availability of information needed for public participation. This rule appears to be compatible with the Department of Homeland Security's critical infrastructure information rule.

Security Issues

In the electric industry, we expect the North American Electric Reliability Council (NERC), independent system operators (ISOs), and RTOs to address security and reliability concerns. We are working to reduce the vulnerability of the Nation's electric grid and market operations to physical and computer failures. The bulk electric system is complex and highly interdependent; a failure of its computer or communications systems could cause widespread harm to both electric service and facilities. Thus, we are facilitating (through the NERC Critical Infrastructure Protection Advisory Group) cyber-security standards for electric system participants.

In the gas industry, we are partnering with gas industry groups and state regulators to better understand natural gas needs by region and how to allocate available gas in the event of a major emergency. We have already issued a rule to expedite gas pipeline reconstruction following an emergency disruption.

Recovery of Security and Safety Expenses

The Commission is supporting industry efforts to improve security by promptly allowing recovery of prudently incurred related costs as security issues and needs are identified. The Commission gives high priority to processing any filing made for the recovery of extraordinary expenditures

to safeguard the reliability of our energy transportation systems and energy supply infrastructure. The Commission will approve reasonable proposals, such as a separate rate recovery mechanism, for security and safety related costs.

***Relationship to
Performance
Plan***

For Objective 1.4, our long range performance goals 1.4A – 1.4C, long range measures, and sample annual performance measures follow:

Long Range Performance Goal 1.4A: Maintained safety of regulated hydropower facilities through FERC policies and procedures	
<p><i>Long Term Measures:</i></p> <ul style="list-style-type: none"> • Uniformly high percentage of high- and significant-hazard-potential dams that meet all current structural safety standards. • 100% of qualifying dams in compliance with EAP requirements. 	<p><i>Sample Annual Measures:</i></p> <ul style="list-style-type: none"> • Uniformly high percentage of high- and significant-hazard-potential dams that meet all current structural safety standards. • 100% of qualifying dams in compliance with EAP requirements.

Long Range Performance Goal 1.4B: Enhanced security of regulated energy facilities through FERC policies and procedures	
<p><i>Long Term Measure:</i> Assured recovery of companies’ prudently incurred costs to safeguard the reliability and security of energy transportation and supply infrastructure.</p> <p><i>Target:</i> 100% of prudently incurred costs can be recovered in rates</p>	<p><i>Sample Annual Measure:</i> Timely processing of filings seeking recovery of security and safety expenses in jurisdictional rates:</p> <ul style="list-style-type: none"> • Process gas and oil rate filings within 30 days • Process electric filings within 60 days

Long Range Performance Goal 1.4C: Reduction in regulated facilities vulnerability to attack

<p>Long Term Measures:</p> <ul style="list-style-type: none"> • Number of industry developments and observances of security best practices and standards. <p><i>Baseline:</i> Number of industry best practices for security and industry security standards in FY 2003 <i>Target:</i> Increase</p> <ul style="list-style-type: none"> • Number of instances of improved regulation to facilitate security and emergency response <p><i>Metric:</i> Number of specific measures (e.g., number of security surcharge requests approved, gas allocation principles set)</p> <ul style="list-style-type: none"> • No instances of unauthorized access to security-related documents held by FERC. 	<p>Sample Annual Measures:</p> <ul style="list-style-type: none"> • Number of industry developments and observances of security best practices and standards. <p><i>Baseline:</i> Number of industry best practices for security and industry security standards in FY 2003 <i>Target:</i> Increase</p> <ul style="list-style-type: none"> • Number of instances of improved regulation to facilitate security and emergency response <p><i>Metric:</i> Number of specific measures (e.g., number of security surcharge requests approved, gas allocation principles set)</p> <ul style="list-style-type: none"> • No instances of unauthorized access to security-related documents held by FERC.
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Goal 2: Foster Nationwide Competitive Energy Markets as a Substitute for Traditional Regulation

In the years since Congress enacted the Energy Policy Act of 1992, competition among power plants for wholesale customers' business has largely replaced traditional cost-of-service regulation of wholesale power sales. Our primary focus is creating fully-functioning, nationwide wholesale electricity markets. In accomplishing this, we hope to gain the benefits of competition as soon as practical. However, progress in opening electricity markets has been uneven in different parts of the country and has been considerably slower than it was for natural gas. The process has required an extended transition period, with unanticipated market disruptions. Only when market institutions are strong and stable, and market rules are sensible, clear, accepted, and enforced, will the electricity market transition be complete.

Although we don't have jurisdiction over the development of electric generation capacity or natural gas reserves, we do have jurisdiction over how the wholesale markets operate. We try to design market rules and policies that promote infrastructure development.

Objective 2.1: Advance Competitive Market Institutions Across the Entire Country

Open access to transmission is the underpinning for competitive regional electricity markets. This avoids several obstacles to competitive power markets caused by traditional approaches. For example:

- The existence of many transmission owners with differing rules and practices within a region makes it cumbersome and costly for customers to do business over a wider area. This can balkanize markets, raise the cost of business for all, prevent trade, and often limit the number of competitors who can offer service to customers.
- The lack of regional planning means that both transmission providers and generators act parochially, and transmission bottlenecks are difficult to remedy, perpetuating congestion that raises costs for all customers.

We believe that the best sustainable path to competitive power markets is to establish regional transmission organizations (RTOs) that implement fair market rules consistent across the nation's bulk power markets. RTOs will operate the transmission system and competitive markets across very large geographic areas, operating independently of all other market participants. Therefore, the most immediate task is to complete development of RTOs and independent electric wholesale markets. We

are aiming for:

- Sound wholesale market competition in regional markets, improving grid reliability and reducing delivered electricity costs;
- Markets serving legitimate interests at both the local and regional levels; and
- RTOs stimulating the use of new technologies.

Means and Strategies

Wholesale Market Platform

Absent consistent, non-discriminatory rules for all transmission customers, there are substantial competitive consequences and higher costs to all customers. Therefore, the Commission has proposed a common set of principles for the design of electric transmission markets, based on an extensive discussion about the best practices for wholesale electric markets. The eight elements of the wholesale market platform are:

- Regional independent grid operation
- Regional transmission planning process
- Fair cost allocation for existing and new transmission
- Market monitoring and market power mitigation
- Spot markets to meet customers' real-time energy needs
- Transparency and efficiency in congestion management
- Firm transmission rights
- Resource adequacy approaches.

The wholesale market platform will address persistent and costly problems in the nation's wholesale electric power markets. These include a decade of under-investment in needed transmission, which raises energy costs by billions of dollars across the grid and exacerbates reliability problems; generation siting in locations far from customers; unduly discriminatory behavior by transmission providers against independent generators; and fundamental design flaws in certain existing electricity markets. Our goals are to:

- Remedy remaining undue discrimination in transmission service;
- Provide more choices and improved services to all wholesale market participants;
- Reduce delivered wholesale electricity prices through lower transaction costs and wider trade opportunities;
- Improve reliability through better grid operations and expedited infrastructure improvements; and
- Increase certainty about market rules and cost recovery for greater investor confidence to facilitate much-needed investments.

Sound market rules and fair and open transmission access, as implemented under these principles, should cure many of these problems. The wholesale market platform proposal contains flexibility so that regions need only implement the elements that are cost-justified for that region.

Further Development of RTOs

Today, proposals for RTOs are in various stages of completion in all regions of the United States. Existing Independent System Operators (ISOs) and RTOs under development are incorporating cost effective market principles and practices into their formation.

Overseeing Regional Power Markets

The state-federal split of jurisdiction is defined in the Federal Power Act. While states have strong, long-standing legal responsibilities for how the electric power industry operates, particularly in relation to end-use customers and the utilities that serve them, the transmission of electric power is inherently an interstate business in almost all areas of the country. As a result, the Commission and states must work together to adapt the traditional regulatory models to new market realities.

We have established extensive communications and outreach efforts to assure input from every sector and stakeholder group affected by wholesale electric markets. In particular, we have worked, and will continue to work, closely with states at every stage of market design and RTO development, and now are working with them to build multi-state regional organizations - Regional State Committees (RSC) - to make important regional policy and planning decisions.

Relationship to Performance Plan

For Objective 2.1, our long range performance goals 2.1A – 2.1C, long range measures, and sample annual performance measures follow:

Long Range Performance Goal 2.1A: Have RTOs and ISOs operating transmission grids across every region of the nation, as soon as possible	
Long Term Measure: Operation of transmission assets in each region by FERC-approved RTOs or ISOs.	Sample Annual Measure: Additional 20% of transmission assets participating in a FERC approved RTO or ISO. <i>Baseline:</i> TBD in FY 2004.

Long Range Performance Goal 2.1B: Regional wholesale market platforms established	
Long Term Measure: For each RTO or ISO approved by the Commission, establishment of cost effective elements of the wholesale market platform within 3 years of RTO/ISO approval.	Sample Annual Measure: For each RTO or ISO, cumulative number of wholesale market platform elements adopted. <i>Target:</i> Increase 20% per year

Long Range Performance Goal 2.1C: Lower costs to customers

Long Term Measure:

In regions with functioning RTO markets, comparison of wholesale prices to what they would have been otherwise; that is, after controlling for factors not related to the electric markets themselves, such as inflation, fuel costs and weather.

Target: Wholesale prices are lower than they would have been

Sample Annual Measure:

Over the first 5 years of wholesale market platform operation, comparison of wholesale prices to our estimate of what they would have been without good wholesale markets.

Target: Average of 2% lower than they would have been otherwise each year; that is, after controlling for factors not related to the electric markets themselves, such as inflation, fuel costs and weather

Objective 2.2: Establish Balanced, Self-Enforcing Market Rules

A market can only be as good as the rules that govern it. Therefore, rules for regional electricity markets must balance the interests of all market participants – ensuring they are fair and equitable, prevent abuse, and build the market’s credibility. The best rules are clear and proactive, requiring a minimum of regulatory intervention.

Means and Strategies

Market-based Rate Authority

Unless there is evidence that companies have the ability to exercise market power or engage in anticompetitive behavior, we allow the use of market-based rates for wholesale sales of electric power. In practice, however, our traditional test for market power led to approval of market-based rates for most generators who requested them. The crisis in California made clear that the traditional definition of market power did not always prevent markets from developing problems. In particular, when demand nearly reaches supply, markets become unbalanced and scarcity exacerbates opportunities to exercise market power. In such situations, even an otherwise well functioning market may no longer deliver the full benefits of competition that justify market-based pricing. We intend to complete revisions to our market-based ratemaking policy and implement the policy through triennial rate reviews.

Demand-side Participation

Energy markets must allow response from both the supply and the demand side of the industry. Historically, the industry has assumed most demand is fixed, and has priced power to most customers at constant rates during fairly long periods such as a month. The result is that customers have seldom seen prices change in the short run and have had little if any incentive to change their usage to meet the true costs of producing power at any given time. The lack of short-term demand response was a major

contributing factor to the problems in western electricity markets, just as individual customer decisions to conserve electricity were a significant part of the solution. In the future, wholesale electricity markets will require a fuller demand response, informed by wholesale price signals, to better balance supply with demand, improve reliability, moderate price volatility, and reduce supplier market power.

States have direct jurisdictional authority over many demand-side measures. However, our efforts to encourage more demand response include:

- Ensuring that wholesale markets facilitate equal participation by demand-side and supply-side resources;
- Encouraging States to adopt programs that let customers respond to changing prices; and
- Helping to remove any impediments that prevent full demand-side participation in electricity markets.

FERC efforts to support demand response have included supporting the six-State New England Demand Response Initiative, developing region-wide demand response programs that link retail and wholesale demand response and that work effectively in both competitive retail markets and traditionally regulated markets; frequent outreach on demand response and advance metering; and working with DOE to develop and implement a demand response research program.

Business Rules and Practices

As competitive electricity markets grow, we need to ensure that business is being conducted consistently. This will prevent customers from having to deal with many different approaches, reducing the cost of doing business while improving reliability. Reliability concerns both the physical infrastructure and market functionality. The best way to develop reliability and business practice standards is to use groups of experts drawn from all parts of the industry, so we are working closely with the North American Energy Standards Board (NAESB), the North American Electric Reliability Council (NERC), and the RTOs and ISOs to coordinate the development of business practice and reliability standards for gas and electricity markets. The appropriate standards-setting board will be established and will recommend market and business rule changes to FERC for consideration.

**Relationship to
Performance
Plan**

For Objective 2.2, our long range performance goals 2.2A and 2.2B, long range measures, and sample annual performance measures follow.

<p>Long Range Performance Goal 2.2A: Increased consistency of rules in all RTO- and ISO-managed markets</p>	
<p>Long Term Measure: Number of inconsistencies in rules across RTO- and ISO-managed markets.</p> <p><i>Baseline:</i> All significant market design differences in neighboring markets at commencement of RTO/ISO <i>Target:</i> 100% of all cost effective baseline differences eliminated</p>	<p>Sample Annual Measure:</p> <ul style="list-style-type: none"> • Within 1 year of commencing operations, all RTOs and ISOs would have identified all seams-related issues. • Within 2 years, neighboring RTOs or ISOs would have in place an agreement, including milestones, on eliminating seams that can be resolved in a cost-effective manner. • In each of the subsequent 2 years, each RTO and ISO would resolve half of the seams issues that can be done in a cost-effective manner.

<p>Long Range Performance Goal 2.2B: Wholesale market design allows for meaningful demand response participation and load reduction in every regional market</p>	
<p>Long Term Measure: All markets have in place rules that permit and encourage qualified demand response participation on an equal basis with supply.</p>	<p>Sample Annual Measure: All RTOs and ISOs have rules, permitting demand response participation in RTO/ISO-control markets, in place and approved by the Commission within 1 year of commencing day-ahead markets.</p>

Goal 3: Protect Customers and Market Participants through Vigilant and Fair Oversight of the Transitioning Energy Markets

The need for market oversight and investigation is both crucial and urgent. We must offer the public credible assurance that we can and will identify and remedy energy market problems to maintain justness and reasonableness. Such assurances will contribute to stable, competitive electric markets over the long run.

Objective 3.1: Assure Pro-competitive Market Structures and Operations

Competition is changing the dynamics of the electric and natural gas industries. We must ensure that the market structures and rules we help put in place work well and provide a framework that will serve evolving markets in the future. To do so, we need to track market behavior and evaluate market performance so that we can understand and discern:

- Which market problems (such as high prices or limited supplies) reflect scarcity, problems in market rules or structure, or market manipulation;
- The difference between superficial and significant market problems;
- Which market problems require regulatory intervention and which require only patience and oversight; and
- When mitigation is helping or harming markets.

Means and Strategies

Market Information and Commission Findings

Market oversight and investigation must provide trustworthy analyses based on strong empirical evidence, so that the Commission can make fair and farsighted decisions and the public can have confidence in American energy markets. This requires having full sets of information about electric and natural gas markets.

To do this we will maintain our current data systems, largely consisting of the resources in our state-of-the-art Market Monitoring Center (MMC). We will supplement those resources by continuing to develop the Electric Quarterly Report. This report provides a more comprehensive view of physical electric markets than we have ever had before. It equalizes reporting requirements for traditional utilities and power marketers, and makes information more easily available to the public. It will provide greater price transparency and enhance confidence in the fairness of the markets. Going forward, we will continue to analyze our further information requirements and develop new information systems as needed.

Benchmarking Market Conditions and Infrastructure

It is important that the nation have clear, systematic benchmarks that assess the performance of energy markets and identify infrastructure issues that could hurt market operations. We will present these benchmarks in scorecards detailing how well the industry is operating, as part of an annual State of the Markets Report. We will use the benchmarks to guide our own efforts to address identified trouble spots and to focus the attention of all industry players on problems that need solutions.

Going forward, we will continue to refine our benchmarks and report them in the State of the Markets Report. This will provide measures of market performance and give a comprehensive review of the year, with prospective analysis, policy implications and recommendations.

Market Monitoring Units

Each RTO/ISO will have a Market Monitoring Unit (MMU). There are five MMUs in place today. The MMUs will have detailed knowledge of the markets they monitor and will be able to tailor their monitoring programs to meet the specific characteristics of their own markets as well as to meet the generic issues that affect all markets. As a result, they will be able to identify rapidly developing problems and will be the first line of defense against market problems.

FERC's market oversight function should provide the broader view of how markets interact (for example, how gas, electric and financial markets affect each other), spot patterns emerging across RTOs, inform MMUs and be informed by them. We are developing a close partnership with the MMUs in each market. This effort includes:

- Developing clear lines of communication with each MMU;
- Developing agreed-upon roles and responsibilities between MMUs and FERC;
- Standardizing, to the degree possible, the way that MMUs report on their own markets, to facilitate comparisons among markets and to establish best practices; and
- Stationing Commission staff onsite at some RTOs/ISOs.

Identifying and Rectifying Problems

The key function of our overall market oversight program is to identify market problems as they develop so that the Commission can rectify them quickly. The market benchmarks and the State of the Markets Report mentioned earlier provide a yearly overview of the markets. However, our oversight program continually observes market developments, both small and large, and reports to the Commission as new issues develop.

During the year, the market oversight program will report market developments, including problems, in three major ways:

- During periods of acute market stress, we will follow the markets in real-time, giving bulletins to the Commission as needed and flagging items that need rapid attention.
- Twice a month, our market oversight function briefs the Commission through Market Surveillance Reports. These include both background information and new developments in energy markets. The Surveillance Report may indicate options for addressing identified problems.
- Some issues identified in the Surveillance Reports (or the State of the Markets Report) require in-depth work. We prepare ad hoc reports to explain these problems more fully, often noting possible ways to address them. We often hold technical conferences of knowledgeable experts to assist us in developing these detailed reports.

One of the most important aspects of market oversight is to analyze apparent market anomalies such as high prices or abnormal volumes in unexpected places. Such anomalies can indicate problems with data, new patterns of market trading, or gaming. Information for these reports will come largely from our Market Monitoring Center, which lets us follow market activities as they happen. We will supplement these data with information from significantly improved industry contacts, including close coordination with RTO and other market monitors.

The reports and insights arising from market oversight will identify key problems for the Commission to consider, inform the Commission’s decision-making process about how to respond, and, in the case of apparent behavioral problems, lead to further investigations and audits.

Our long range performance goal 3.1A, long range measure and annual performance measure for Objective 3.1 follow:

***Relationship to
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Long Range Performance Goal 3.1A: Establishment of market monitoring units in all RTO/ISO markets	
Long Term Measure: Areas of the country with established market monitoring units and RTO/ISO markets by FY 2008. <i>Target:</i> All.	Sample Annual Measure: Number of transmission assets participating in a FERC approved RTO or ISO with established market monitoring units. <i>Target:</i> Increase of 20% over prior year.

Objective 3.2: Remedy Individual Market Participant Behavior as Needed to Ensure Just and Reasonable Market Outcomes

We continue to develop a market investigation program that polices energy wholesale markets. Establishing the credibility of this program, our most urgent task in protecting customers and market participants, can be accomplished through the following means and strategies.

Means and Strategies

Investigations and Remedies

In highly dynamic industries, market participants constantly seek new profit opportunities, including new ways to use market power. To protect customers, we will detect any significant abuses of market power quickly. We will also develop our own analytic capabilities, such as automated audits that flag potential abuses. Remedies that mitigate the effects of market power, prohibit abusive actions, and/or impose penalties that deter future abuses will match the specific facts of individual cases.

To make our oversight and investigation more effective in promoting compliance with Commission rules, we are exploring ways to work with the corporate boards of energy companies. We will discuss with other regulatory agencies, such as the Office of the Controller of the Currency, what the best ways are to interact with corporate boards. We will then institute a program to make sure that the boards are aware of what compliance requires and how well their companies are complying with Commission regulation.

Our enforcement activities depend on the timeliness and quality of our investigations. We will prioritize enforcement and investigations by level of impact on the market, and manage investigations to be timely and effective.

Measuring the effectiveness of our enforcement programs is very important. The goal of the program is to discourage companies from violating Commission rules. Clearly, simply measuring the number of investigations undertaken says little about the behavior of the many companies not investigated. Instead, we will institute a random audit process that will systematically assess the degree to which companies are complying with Commission regulation. Each year, we will choose one key aspect of Commission regulation – for example, affiliate abuse in the natural gas industry. Focusing on one major area each year will let us complete a full, in-depth review of that part of the rules. We will audit a representative sample of companies to whom the rule applies and assess compliance with our regulations. We will report the results of our audits as part of our performance measures. We will judge our investigation program to be a success if the audits find few or no violations.

Dispute Resolution

Experience has taught us that, even after competitive power markets are established, there will continue to be disputes among sellers and buyers of power. The Commission encourages parties to use alternative dispute resolution (ADR), whenever appropriate to resolve conflicts faster, less expensively and more satisfactorily, with fewer resources expended. The Commission offers to individuals and organizations with whom it does business, its Dispute Resolution Service for facilitation and mediation consultation and training in effective negotiation skills. The Commission's Hotline is a quick and effective resource for addressing informal disputes. In addition, the Commission's administrative law judges may serve as settlement judges or mediators, thereby offering another alternative to litigation that allow the parties to exercise greater control over the outcomes.

Litigation

In some cases, the best approach to a possible abuse of market power is through our formal litigation process. This is especially true when it is important to establish, in open proceedings, the exact facts of a case. All disputes are processed and settled or litigated as quickly as due process allows. A centralized litigation staff facilitates efficient handling of the unique, complex issues.

We seek to streamline the process as much as possible; however, litigation can still be costly and time-consuming. To accelerate resolution of cases set for hearing, authority has been delegated to the Chief Administrative Law Judge to designate each case to one of several timetables. These timetables indicate various mandatory deadlines for hearing, briefing and the initial decision, for simple, complex, and exceptionally complex cases. These deadlines can be changed only by the Chief Judge.

Relationship to Performance Plan

For Objective 3.2, our long range performance goal 3.2A, long range measure and annual performance measure follow:

Long Range Performance Goal 3.2A: Improved industry compliance with Commission orders, statutes and regulations	
<i>Long Term Measure:</i> <ul style="list-style-type: none">• Few or no major rules violations across a range of market behavior over a period of years.• Resolution of allegations of market misconduct within established timeframes for FERC investigations and litigation, as posted on the Commission's internet site.	<i>Sample Annual Measure:</i> <ul style="list-style-type: none">• Few or no major rules violations for a particular set of business practices.• Resolution of allegations of market misconduct within established timeframes for FERC investigations and litigation, as posted on the Commission's internet site.

Commission Initiatives Supporting All Programs

In support of the Commission's three mission-oriented goals as discussed in this document, and the President's Management Agenda, the Commission has initiatives underway in the areas of human capital management and electronic government. These initiatives help us work more effectively both within and across program areas.

Human Capital Management

We are focusing our human capital activities on targeted recruiting, training, and the rightsizing and reallocation of staff based on our Human Capital Plan. These critical areas will determine how efficiently and effectively we meet current objectives and prepare for future ones.

We face significant challenges in adapting our workforce's skills to meet two major changes. First, as our regulatory approach shifts to making markets work, we must develop a new and different mix of talent and skills. Second, over 25 percent of our workforce, made up mostly of experienced and highly trained employees, is eligible for retirement by 2005. By 2007, over half of our workforce will be eligible for retirement through either voluntary or "early out" retirement. We will need to ensure that this potential rapid turnover of experienced employees does not compromise our skill and knowledge base.

Staffing and building the capabilities for market oversight and investigation is a prime focus of our efforts. Our market oversight and investigative function requires increased skills in market investigations, markets operations, risk management and derivatives, investment in unregulated industries, analysis of overall market information, and the effect of energy transportation systems on commodity pricing.

As we develop our market oversight capability, we also are ensuring the continuance of high-quality regulatory work in performing such traditional functions as ratemaking and licensing. These factors are priorities as we face the rapid turnover of skilled employees due to pending retirements.

Electronic Government

In November 2000, we implemented eFiling, and in April 2002 we initiated the FERC On-Line project. We developed these two initiatives to achieve the President's Management Agenda initiative of expanding electronic government. Citizens and businesses can make electronic submissions of comments, motions, briefs, and other documents related to proceedings before the Commission. We are extending eFiling to all documents submitted in Commission proceedings, reducing our customers' costs and time to make filings, while reducing our own costs and handling time to receive and process the documents. Since November 2000, we have received 22,000 documents electronically. Companies regulated by the Commission have also filed 15,000 forms and reports electronically. More than half of the documents received annually can be

filed electronically.

We expect to provide an electronic filing option for most high volume documents submitted to the Commission by the end of October 2003. By early 2004, the Commission and those who do business with it will take advantage of a huge reduction in paper flow.

We have completed a comprehensive redesign of our internet web site, FERC.gov, making it more useable for: energy practitioners; landowners and citizens affected by natural gas and hydroelectric projects; and the press, financial community, and Commission staff. The new site is a fundamental component of our objective to provide open and effective communication with the public.

