

For Distribution

Remarks of
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Federal Energy Regulatory Commission

"Is the Natural Gas Business Ready for the Information Economy?"

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I.

I am sure that only the most unfortunate souls among you have spent time pouring over my biography, but at least you know that I am a retooled history professor. I still try to extrapolate from the lessons of the past in an effort to ascertain what needs to, or inevitably must, happen next. This habit endured even after I abandoned the classroom for law. I always regarded it as part of my charm. To regulators and even managers of government agencies, a passion for trends is both natural and useful. This is especially the case where people like me, and people in a changing

business like you, are struggling to adapt a fixed asset, natural monopoly (generally speaking) enterprise to a newly competitive, customer-driven, and information-intensive environment.

I am a fan of the Gas Industry Standards Board (GISB). There are many reasons. You have performed services critical to the vitality of the industry and, consequently, to the advancement of pro-competitive public policy. You often did it thanklessly. You brought disparate industry elements together and worked assiduously toward doable if not perfect market solutions once thought impossible. But, most important, you have helped us -- regulators and company managers -- recognize the importance of coming to grips with the information economy. GISB, I contend, operates astride one of the key developments in recent American economic history.

Today's top thinkers about technology, information, or management -- people like Peter Drucker -- would lay it out this way, I suppose.

- Increasingly, the business of business will involve integrating information systems with real-time operating systems.
- The information economy will minimize the importance of time and distance. This means that, as a general matter, information dissemination will tend to minimize competitive advantages. In a more transparent environment, the way we look at market power and old economic assumptions about scarcity necessarily changes.
- The Internet will become the primary medium in which to conduct business.

None of these concepts ought to be alien to this audience.

I could spend my limited time on the Commission's work yesterday where we extended the Order No. 587-G compliance deadline one year but also required pipelines to offer communications on the Internet using both EDI and interactive websites. Let's not dwell on that; you know what that's about, and I think the Commission has helped your process by its new order. GISB still has its work cut out for it. But, Mike Bray's legitimate resource worries notwithstanding, you ought to be contemplating the future requirements for information in this business, not just the medium over which it is conveyed. I hope you are beginning to ask yourselves whether, in light of the dramatic information technology changes headed this way, what role an industry group like GISB can play in readying the gas industry for the information economy. Information technology and communications protocols are

necessary tools in furthering commerce in Btu's.

However, information itself will drive an entirely new kind of marketplace.

Let me appeal to Peter Drucker. In an August 24, 1998, Forbes article, he takes an historical view of information revolutions. Looking at the modern computer revolution, he contends that for 50 years we have focused on the collection, storage, transmission, analysis, and presentation of data. But, says Drucker, business people and their army of IT and MIS experts are missing the point. He puts it like this:

It can be argued that the computer and the data flow it made possible, including the new information concepts [e.g., activity-based accounting and wealth-creating strategies like economic-value-added], actually have done more harm than good to business management. They have aggravated what all along has been management's

degenerative tendency, especially in big corporations: to focus inward on costs and efforts, rather than outward on opportunities, changes and threats.

Drucker finds this tendency of modern business myopic and alarming in the face of business globalization, industry convergence, and rising consumerism -- all trends that challenge North American natural gas companies, I might add.

II.

This may be just too Alvin Toffler for you, especially so early in the morning. My point is not really so obscure, however. GISB has worked long and hard to negotiate a common denominator approach to facilitating gas market operations. The GISB experience nevertheless shows how closely information technology and the operation of the competitive marketplace are already intertwined. Open access to

pipeline transportation under Order No. 636 and competition among sources of supply necessitated quick access to accurate information about available pipeline capacity and the ability to schedule that capacity on relatively short notice. After Order No. 636, the industry acknowledged that real electronic commerce in gas and capacity depends on standardization of electronic bulletin boards (EBBs). EBBs came first. Out of that chaos, GISB was born as a way for the industry to serve its own interest in electric commerce rather than operate in the shadow of Commission-sponsored working groups. We soon clearly understood that standardized information without standardized business practices (e.g., nominations, confirmations, flowing gas, and capacity release) was impossible to collect and otherwise meaningless. Better operations require better utilization of information technology. The difficulty of the GISB process is in part the price of consensus decisionmaking. It may also be an

attestation to the secondary importance which many companies assign to the emerging information economy.

Don't feel alone! Today, electric utilities are proceeding down the same road. OASIS (Open Access Same-Time Information Systems) systems are proving incapable of supporting non-discriminatory transmission open access without greater standardization in business practices. Regulated gas companies may pride themselves on arriving at this conclusion first. Sophisticated electronic commerce, however, has always been a necessity in the power business. Its current efforts in the information arena consequently offer a powerful business and operational challenge to the pipeline industry, in my view.

Let's look at the challenges you face. Today's gas and electric industries require flexibility and speed in the acquisition of gas supplies and the use of capacity, at a pace we barely grasped five or ten years

ago. Gas commodity markets, as well as futures markets, have developed so that market participants can trade gas on a daily or intraday basis and adroitly manage price risk. Market centers have developed in response to the need to trade gas quickly and provide new services. And, new shippers with different competitive needs are entering and exiting the market all the time. Not even GISB could have recognized just how difficult it would be to devise market and technology solutions that would accommodate both commercial flexibility and standardized operations. Remember that the first set of intraday nominations standards provided for just one intraday nomination and did not standardize nominations and confirmations. By the time of Order No. 587-C in 1997, there was a need for even more flexibility and standardization. Intraday nominations increased to three, for example, and more standardization became necessary. Yesterday the Commission's Northwest Pipeline decision, to cite just one case, explained how current conflicts

concerning nomination and confirmation schedules for intraday nominations can be resolved by new GISB standards in the interest of uniform confirmations across multiple pipelines.

More challenges are coming, though. Three intraday nominations may be insufficient, as gas and electric industries become more integrated and need even faster and more frequent nomination changes. In recognition of a similar need in electric transmission markets, the Commission has already approved a four-month experiment to develop a next-hour market. The changing competitive necessities of the information economy will continue to motivate gas companies to install new metering and flow systems that enhance pipeline and shipper control of flows in continuous and contiguous nomination systems.

Pricing certainty is another challenge. Such practices as penalty and imbalance tolerance provisions

affect an energy customer's ability to manage risk, because penalties can make pricing less certain. Pipeline operational flow orders, invoked to protect pipeline systems, are arguably very disruptive. When pipelines file with us to reduce tolerances and increase penalties because neighboring pipelines have done so, they are trying to avoid becoming a parking lot for gas. But higher penalties upset business relationships and make gas a less reliably priced commodity. Other problems arising because of lack of standardization, whether in overrun penalties, delays in executing and performing capacity releases, or making nominations, serve to illustrate the commercial importance of what GISB is doing to tackle operational issues.

What's at stake here, in the larger sense, with respect to both the Commission's job of developing sound policy and your responsibility to incorporate that policy into efficient operations, is the future

competitiveness of natural gas relative to other forms of energy in the market -- a challenging issue to be presented within the age of competition, globalization, and convergence. In a nutshell, the speed of gas transactions places a premium on flexibility, planning, and real-time information.

If pipeline capacity sales and acquisitions are to be made easier and faster and if fair access and protection to all shippers is our mission, the key will be shared information. Information not widely shared has diminishing value (other than to preserve existing competitive advantage). The tools of open access energy markets are access and information. In fact, they are the market. In the highly integrated electricity marketplace, independent system operators or similar regional institutions will in the future govern the geographically large and reliable highways over which commercial information and electrons flow with equal speed. In the less integrated but still-

evolving gas industry, capacity tradeability, pricing transparency, and non-discrimination are no less critical.

Mining the available wealth of information is what ensures that a company has the ability to address (as Drucker put it) the "opportunities, changes, and threats" in its economic surroundings. To be sure, computer technology can be used for vital but limited missions, including cost tracking, billings, and performance measures. But, its proponents and users -- including GISB -- need also to anticipate the needs of evolving markets two to five years in the future, when the standardization of operations has eliminated the distinctions among discrete pipeline markets.

III.

GISB has been instrumental in developing critically important infrastructure. Standards for nominations and confirmations and flowing gas have

helped integrate the gas grid. And, GISB has tackled this job by employing broad representation and consensus decisionmaking. That level of openness and fairness is an example from which the North American Electric Reliability Council could learn a great deal in tackling the commercially sensitive area of electric reliability, just as speed and adaptability in the electric industry could be instructive for you.

When the Commission issued its NOPR in July (Docket No. RM98-10-000) setting forth ambitious proposals for greater industry flexibility in response to the changes in the gas market for short-term gas and capacity, it was in many ways recognizing the importance of the changes that GISB fostered in the marketplace. In the future, the industry, through GISB, can help us anticipate the need for operational improvements and enhancements to electronic commerce by taking the initiative to alert the Commission and then developed the necessary standards.

More importantly, GISB is in an opportune position to help the industry truly become part of the information economy. It can do that by developing operational details, standards, and communication protocols, of course. But, more than that, GISB can organize its work in anticipation of certain market models of the future. To illustrate, there is no better intersection between the need for information and the coming dynamic market for gas and capacity than the Commission's proposal in July to create an auction for capacity in the short-term market. It is clear to me that such a Commission policy will be ineffectual, as a foil for market power and a creator of economic efficiency, unless that auction process can be made to work so that the market participants have ease of access to real-time information. It is here that GISB's knowledge of both technology and gas markets can be employed in new ways. We need to reach out to you for technical advice!

IV.

In the future, energy market information will be a very valuable commodity, at least as valuable as the underlying energy resource itself. Integrating operations and information will ensure that natural gas is well-positioned to participate in the fast-moving energy markets.

GISB can have a new and strategic mission advancing the propagation and dissemination of data. That data will be the backbone of the energy business of tomorrow. As the Internet becomes the medium that sustains market activity in natural gas, the impact of information on business policy, business decisions, and business strategy will become more pronounced. Such a mission for GISB would therefore serve the strategic interests of its members.

If Drucker is right that an "outward" focus on customers, competitors, markets, and other economic and

technological factors that create value and patterns of consumption -- and not technology or information about internal costs and efforts -- will drive the next information revolution, will gas companies be ready? He contends that most of this "outside" information does not yet exist. One must therefore ask who is going to create and organize it and profit from it, and, who will hoard it or inhibit its release and dissemination for short-term competitive reasons. If history teaches us anything, however, it is that information will eventually become more important than the technologies and commercial practices that produce or organize it. Access to, and use of, information for strategic purposes may have as much to do with the vibrance of gas markets of the future as reserve-to-production ratios or pipeline operating protocols.

While I never tire of applauding the efforts of GISB, it is time -- indeed it is always time -- to begin looking ahead to the next challenge. The gas

industry is about to meet the information revolution.
As you grapple with the tasks of the next two years,
outlined in part in Order Nos. 587-G and 587-I,
remember to raise your vision and that of your members
to this challenge.

Thank You