

APPENDIX A TO REPORT OF INVESTIGATION BY THE SPECIAL INVESTIGATIVE COMMITTEE OF THE PJM BOM

HISTORICAL DEVELOPMENT OF THE MMU

A. The Development of Competitive Wholesale Power Markets and Market Monitoring in general and with respect to PJM in particular

In order to provide context to the dispute between Dr. Bowring and PJM Management, this Appendix by Duane Morris sets forth a brief history of FERC orders and regulations regarding competitive wholesale power markets and a more detailed discussion of the contours of the requirements for establishing a market monitor for a given RTO.

In 1996, FERC took the first formal step to permit competitive wholesale power markets throughout the United States by requiring open access to transmission lines.¹ With open access, new strains were placed on the transmission systems, from the increased number of independent power suppliers, as well as, from the new operations dynamics of the transmission lines. The competitive wholesale power market has been refined considerably since then, most markedly in

¹ *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, (“Order No. 888”), 61 Fed. Reg. 21,540 (May 10, 1996), FERC Stats. & Regs. ¶ 31,036 (1996), *order on reh’g*, Order No. 888-A, 62 Fed. Reg. 12,274 (March 14, 1997), FERC Stats. & Regs. ¶ 31,048 (1997), *order on reh’g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh’g*, Order No. 888-C, 82 FERC ¶61,046 (1998), *aff’d in relevant part, remanded in part on other grounds sub nom. Transmission Access Policy Study Group, et al. v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), *aff’d sub nom. New York v. FERC*, 122 S. Ct. 1012 (2002).

response to a FERC order issued in early 2000, designed to advance the formation of RTOs and setting forth the minimum requirements for an entity to qualify as an RTO.²

Along with a number of requirements that make up the minimum functions of an RTO – including the requirement to manage congestion and structure Tariffs – RTOs are required to establish some form of “market monitoring” mechanism. That is, in order to ensure a “reliable, efficient and not unduly discriminatory transmission service, the Regional Transmission Organization must provide for objective monitoring of markets it operates or administers to identify market design flaws, market power abuses and opportunities for efficiency improvements, and propose appropriate actions.”³ Although the mechanism has a set purpose, and sets forth general standards for market monitoring, implementation of market monitoring was left to the particular RTO and there are few concrete requirements. Rather, if a RTO can demonstrate that its plan meets the market monitoring criteria set forth in Order No. 2000, it can structure such market monitoring as it sees fit. Although most RTOs have hired outside consultants to serve the market monitoring capacity, PJM has kept its MMU in-house.

With the implementation of Order No. 888 and related orders governing and permitting the recovery of stranded utility costs, and with Order No. 889,⁴ creating the “Open Access Same-

² See *Regional Transmission Organizations* (“Order No. 2000”), 65 Fed. Reg. 809 (January 6, 2000), FERC Stats. & Regs. ¶ 31,089 (1999), *order on reh’g*, Order No. 2000-A, 65 Fed. Reg. 12,088 (February 25, 2000), FERC Stats. & Regs ¶ 31,092 (2000), *petitions for review dismissed*, *Public Utility District No. 1 of Snohomish County, Washington v. FERC*, 272 F.3d 607 (D.C. Cir. 2001).

³ 18 C.F.R. § 35.34(k)(6) (2006).

⁴ Open Access Same-Time Information System and Standards of Conduct (“Order No. 889”), 61 Fed. Reg. 21,737 (1996), FERC Stats. & Regs. ¶ 31,035 (1996), *order on reh’g*, Order No. 889-A, 62 Fed. Reg. 12,484 (1997), FERC Stats. & Regs. ¶ 31,049 (1997), *reh’g denied*, Order No. 889-B, 81 FERC ¶ 61,253 (1997).

Time Information Systems (“OASIS”), federal regulation opened up a new structure for power transmission. Based on these initial orders, the rules for the open market require all public utilities that own, control, or operate transmission facilities to provide operational access to the transmission system by providing: (a) open-access non-discriminatory transmission tariffs (“OATTs”), (b) transmission and ancillary services for both their own wholesale power sales and purchases of electricity under the OATTs, and (c) real-time information to other transmission users. In addition, these orders permit the owners of transmission assets to recover – typically through consumer surcharges – the stranded costs associated with providing broad access to their transmission assets.

This system was well received by utilities at the time and broadly expanded the opportunities available for independent power producers. By 1999, FERC had come to believe that “traditional management of the transmission grid by vertically integrated electric utilities was inadequate to support the efficient and reliable operation that is needed for the continued development of competitive electricity markets.”⁵ FERC was concerned that such vertical management would limit competitiveness, efficiency, and reliability. It set forth to provide appropriate regulatory mechanisms to improve upon Order Nos. 888 and 889. Although new power capacity came on-line at a prodigious rate, little was done to improve transmission capacity. Because of the new stresses on the transmission grid, occasional price spikes drove spot prices as high as \$7500 per MWh. This suggested the presence of market chokepoints, if not outright market failures. Rather than succumb to a call for more regulation, FERC revisited the structure of the deregulated wholesale power system and the requirements that the new wholesale market placed on the transmission grid. FERC noted that both “engineering and

⁵ Order No. 2000, FERC Stats. & Regs. ¶ 31,089 at 30,992-93.

economic inefficiencies identified . . . are present in the operation, planning and expansion of regional transmission grids, and that they may affect electric system reliability and impede the growth of fully competitive bulk power markets.”⁶

In order to address these issues and to promote the wholesale power market, Order No. 2000 directed the creation of RTOs and set forth both “minimum characteristics” and “minimum functions” to qualify as an RTO.

The minimum characteristics included:

- Independence – RTOs must be financially and operationally independent from the market participants themselves and have an independent decision-making process.⁷
- Scope and Regional Configuration – RTOs must serve a sufficiently large region as to permit the support of an efficient and nondiscriminatory power market.⁸
- Operational Authority – RTOs must have operational authority over the transmission facilities.⁹
- Short-Term Reliability – RTOs must have exclusive authority for maintaining reliability of the transmission grid under its control, both in real-time and on a short-term horizon.¹⁰

In addition, an RTO must provide eight “minimum functions”:

- **Tariff Administration** – RTOs must be the sole administrator of the transmission tariff, including decisions regarding new interconnections.¹¹
- **Congestion Management** – RTOs must ensure the development and operation of market mechanisms to manage transmission congestion.¹²

⁶ *Id.* at 31,014.

⁷ *Id.* at 31,046-76.

⁸ *Id.* at 31,076-86.

⁹ *Id.* at 31,086-92.

¹⁰ *Id.* at 31,092-106.

¹¹ *Id.* at 31,106-08.

¹² *Id.* at 31,108-28.

- **Parallel Path Flow** – RTOs must make allowances for “parallel path flow” – that is, for unscheduled electricity flow on adjoining power systems; this operational function is closely related to Congestion Management.¹³
- **Ancillary Services** – RTOs must be a “supplier of last resort for all ancillary services” required by Order No. 888.¹⁴
- **OASIS and Total Transmission Capability and Available Transmission Capacity** – RTOs must be the administrators of the required OASIS information system to calculate available transmission capacity.
- **Market Monitoring** – as discussed in detail below, RTOs are required to maintain an independent market monitor that serves a specific goal, although the implementation of the market monitoring is largely left up to the RTO itself.¹⁵
- **Planning and Expansion** – the RTO must have authority for transmission planning and expansion within its region.¹⁶
- **Interregional Coordination** – the RTO must ensure the integration of its reliability practices with interconnected facilities and other market participants.¹⁷

FERC directs each RTO to provide a market monitoring function. The relevant regulation provides:

(6) *Market monitoring.* To ensure that the Regional Transmission Organization provides reliable, efficient and not unduly discriminatory transmission service, the Regional Transmission Organization must provide for objective monitoring of markets it operates or administers to identify market design flaws, market power abuses and opportunities for efficiency improvements, and propose appropriate actions. As part of its demonstration with respect to market monitoring, the Regional Transmission Organization must satisfy the standards listed in paragraphs (k)(6)(i) through (k)(6)(iii) of this section, or demonstrate that an alternative proposal is consistent with or superior to satisfying such standards.

(i) Market monitoring must include monitoring the behavior of market participants in the region, including transmission owners other than the Regional Transmission Organization, if any, to determine if their actions hinder the

¹³ *Id.* at 31,128-30.

¹⁴ *Id.* at 31,130-46.

¹⁵ *Id.* at 31,146-57.

¹⁶ *Id.* at 31,157-66.

¹⁷ *Id.* at 31,166-68.

Regional Transmission Organization in providing reliable, efficient and not unduly discriminatory transmission service.

(ii) With respect to markets the Regional Transmission Organization operates or administers, there must be a periodic assessment of how behavior in markets operated by others (*e.g.*, bilateral power sales markets and power markets operated by unaffiliated power exchanges) affects Regional Transmission Organization operations and how Regional Transmission Organization operations affect the efficiency of power markets operated by others.

(iii) Reports on opportunities for efficiency improvement, market power abuses and market design flaws must be filed with the Commission and affected regulatory authorities.¹⁸

These regulatory requirements for the implementation of a market monitoring plan do not address whether, or how, an RTO should structure its market monitoring program as an internal (albeit independent) unit or as an external monitor. Subsequent FERC orders do not meaningfully expand or interpret the market monitoring function. Nevertheless, discussion in Order No. 2000 demonstrates that this silence is by design.

The issue of permitting internal market monitors – rather than requiring market monitoring to be carried out by an external consultant or other outside source – was well-vetted by the FERC.¹⁹ It understood that in some cases an independent monitor would be required, but noted that a market monitoring plan should identify “what the RTO participants believe are the appropriate monitoring activities the RTO, or an independent monitor, if appropriate, will perform.”²⁰ If anything, Order No. 2000 tended to favor internal market monitors rather than outside entities. The FERC specifically declined “at this time to prescribe a particular market monitoring plan or the specific elements of such a plan, [rather] the RTO must propose a

¹⁸ 18 C.F.R. §35.34(k)(6).

¹⁹ Order No. 2000, FERC Stats. & Regs. ¶ 31,089 at 31,148-57.

²⁰ *Id.* at 31,155.

monitoring plan” that meets the minimum standards.²¹ Indeed, the mechanism was designed to work within the framework of the RTO’s ordinary operations, rather than creating a separate operating entity, noting that “in light of our requirements that the RTO have operational control over the transmission facilities transferred to it . . .the RTO will be in the best position to perform (or provide information to another entity, if appropriate, for it to perform) objective monitoring functions for the [relevant] market.”²²

B. PJM’s Market Monitoring Plan

On July 24, 1996, proposals were filed to restructure the PJM power pool (“PJM Pool”) into an Independent System Operator (“ISO”) under a proposed OATT based on Order No. 888. The FERC rejected these original restructuring proposals, and directed that a new OATT and ISO proposal be filed in accordance with guidance provided by FERC’s order.²³ On December 31, 1996, PJM submitted another proposed OATT under Order No. 888 (with two options for allocation of the costs of congestion relief) as an interim step while preparing a filing to finally restructure the PJM Pool into an ISO. The FERC accepted the interim compliance filing on February 28, 1997, and directed adoption of the proposal to allocate the cost of congestion relief to all pool users.²⁴

²¹ *Id.* at 31,156.

²² *Id.*

²³ *Atlantic City Elec. Co.*, 77 FERC ¶ 61,148 (1996).

²⁴ *MidContinent Area Power Pool*, 78 FERC ¶ 61,203 (1997).

On June 2, 1997, PJM submitted a comprehensive filing to restructure the PJM Pool and establish an ISO pursuant to Order No. 888. On November 25, 1997, the Commission accepted PJM's ISO proposal,²⁵ and directed PJM to submit a market monitoring plan addressing:

- Scope and information requirements of market monitoring;
- Market evaluation to detect design flaws or structural problems; enforcement mechanisms; and
- Provisions to ensure the monitoring program “will be conducted in an independent and objective manner.”²⁶

On June 29, 1998, PJM submitted a new Attachment M to its OATT, setting forth a Market Monitoring Plan that established a MMU in PJM. Some PJM members initially had requested that the Market Monitoring Plan be submitted as an amendment to PJM's Operating Agreement so that any further changes to the Market Monitoring Plan would be subject to the approval of the PJM members.²⁷ PJM's BOM, however, decided to file the Market Monitoring Plan as an amendment to the OATT because it would have been inconsistent with the MMU's independence to allow the monitored entities (*i.e.*, the PJM members) to control the plan for monitoring them.²⁸

PJM's Market Monitoring Plan included the following features:

- **Objectives:** That the MMU independently and objectively monitor, report on, and take remedial actions with respect to the PJM Market to ensure: safe and reliable operations; robust, competitive and non-discriminatory market operation; and preclusion of PJM members' undue influence over market.

²⁵ *Pennsylvania-New Jersey-Maryland Interconnection*, 81 FERC ¶ 61,257 (1997) (“ISO Order”).

²⁶ ISO Order, 81 FERC at 62,282.

²⁷ PJM's Filing of Market Monitoring Plan dated June 29, 1998 at 3-4.

²⁸ *Id.* at 4-5.

- **Scope of PJM Market:** PJM’s Interchange Energy Market; bilateral and other energy and transmission transactions, including those involving ancillary services, in PJM’s Control Area.
- **Matters Monitored and Reported On:** Market operation; congestion pricing; exercise of market power; structural problems; design flaws in operating rules; compliance with, and enforcement of, standards, procedures or practices in OATT, agreements and manuals.
- **Accountability:** The MMU is accountable to the PJM BOM and President, not to PJM Members.
- **Investigation:** The MMU is authorized to investigate complaints of interested parties, including confidential complaints.
- **Data Collection:** In connection with investigations, general monitoring, and refinement of standards, the MMU shall have the authority to collect necessary data, including: information customarily available to PJM; and any other information that needs to be requested from market participants. The MMU may enforce its information requests by petitioning FERC for a directive to produce the required data.
- **Corrective Actions of MMU:** Discuss matters with market participants; recommend changes to principal documents (OATT, agreements, etc.); send demand letters telling market participants to discontinue violations; file reports and complaints with state and federal agencies; pursue other remedial measures with BOM approval; recommend other actions to BOM and other groups; and evaluate other enforcement mechanisms. The MMU, however, has no authority to impose sanctions, although it will evaluate the need for further enforcement mechanisms.
- **Reports:** The MMU shall submit periodic reports to PJM’s BOM regarding the market’s competitiveness and efficiency. The MMU may also submit reports upon the request of state and federal agencies, or as approved by PJM’s Board.
- **Composition:** The MMU consists of full-time employees to be provided by PJM’s President, and may retain consultants and experts as needed.
- **Liability Limitation:** PJM’s MMU, BOM, officers, employees, representatives, advisors and consultants (collectively referred to in the Market Monitoring Plan as “PJM Entities”) shall not be liable to market participants, parties to the Operating Agreement, customers, and other persons subject to the Market Monitoring Plan in connection with any matters described or contemplated by the Market Monitoring Plan. This limitation covers any financial loss, loss of economic advantage, opportunity costs, and actual or consequential damages.

On March 10, 1999, the FERC accepted PJM’s Market Monitoring Plan,²⁹ subject to certain changes. The Commission ruled that the Market Monitoring Plan was properly filed as an amendment to PJM’s OATT, rather than to the Operating Agreement, because PJM may file

²⁹ *PJM Interconnection, L.L.C.*, 86 FERC ¶ 61,247 (1999) (“Market Monitoring Plan Order”).

amendments to the OATT without the prior approval of the PJM Members' Committee – whereas such approval is necessary for amendments to the Operating Agreement. The FERC found that since the MMU is required to be independent and objective, the process for changing the MMU's rules should be under the control of PJM's BOM– not the PJM members that are subject to the MMU's monitoring and investigation.³⁰ The FERC also noted that PJM's choice to submit the Market Monitoring Plan as an amendment to PJM's OATT was discussed openly and thoroughly among stakeholders.³¹ In addition, the FERC indicated that the MMU may report directly to the FERC at the MMU's discretion, consistent with the importance of the MMU's independence and objectivity.³²

The FERC conditioned its approval on the following revisions and requirements, with which PJM complied:

- The MMU's reports to PJM's BOM should also be provided to Authorized Government Agencies (*i.e.*, federal, state and other regulatory bodies).³³
- Authorized Government Agencies should be provided an opportunity to comment on proposed indices, standards and evaluation criteria.³⁴
- The MMU should submit detailed, public annual reports, subject to confidentiality requirements.³⁵
- Bid and other related data should be made available to the public after six (6) months.³⁶
- The MMU's demand letters should be provided to relevant state utility commissions and other Authorized Government Agencies, subject to confidentiality requirements.³⁷

³⁰ *Id.* at 61,890.

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

- The MMU should submit within one year a report on whether the MMU needs self-enforcement authority for its data requests.³⁸
- The MMU should submit to FERC within two (2) years, and copy-furnish PJM’s BOM and the state commissions, the MMU’s evaluation of: (1) a broad range of other enforcement mechanisms; and (2) the standards, indices, and criteria for assessing collected data.³⁹

On October 11, 2000, PJM and its Transmission Owners jointly submitted a proposal that the ISO be deemed to satisfy the characteristics and functions of an RTO under Order No. 2000. With regard to market monitoring (RTO Function 6), PJM argued that its previously-approved Market Monitoring Plan also satisfied Order No. 2000’s market monitoring requirements.⁴⁰ PJM essentially repeated portions of the Market Monitoring Plan Order’s description of the main features of the Market Monitoring Plan (*i.e.*, subject matters monitored and reported; authority to recommend tariff and other rule changes; enforcement authority; reporting functions; indices and standards for evaluating information; and sources of data).⁴¹

On November 20, 2000, two intervenors argued that PJM’s Market Monitor should be an outside entity independent of PJM. Southern Energy contended that an outside entity would be “truly independent” from PJM, and “more likely to be objective in evaluating the causes of problems in a market.”⁴² Southern Energy also claimed that in-house market monitors “may feel

(Continued...)

³⁷ *Id.*

³⁸ *Id.* at 61,891.

³⁹ *Id.*

⁴⁰ October 11, 2000 Compliance Filing re Order No. 2000 at 49-52.

⁴¹ *Id.* at 50-52.

⁴² Southern Energy’s Joint Motion to Intervene, Protest and Comments dated November 20, 2000 at 18-19.

less inclined to identify flaws in market rules or structure, or internal RTO operational problems, than an outside advisor, who is not employed directly by the RTO.”⁴³ As an example of an objective assessment of market problems, Southern Energy cited the October 17, 2000 *Preliminary Market Assessment of the New York Electric Markets* by the New York ISO’s independent market monitor.⁴⁴

Delaware Municipal Electric Corporation (“DMEC”) also commented, without elaboration, that: “One suggestion for improvement of the MMU and its effectiveness might be to make the MMU more independent not only of the PJM Members, but of PJM itself.”⁴⁵ In addition, although Shell Energy Services Company (“Shell Energy”) did not argue for making the market monitor an outside entity, Shell Energy’s criticism of the MMU’s failure to address market design and efficiency improvements included the following comment: “It appears, however, that the MMU is somewhat unwilling to comment on existing flaws or concerns such as ICAP [installed capacity] and bid cap elimination”⁴⁶

On December 5, 2000, in response to arguments that the MMU should be an outside entity, PJM answered that no evidence had been presented that the MMU’s staffing with PJM employees created any problems or affected market monitoring. PJM asserted that, on the contrary, the MMU had been effective and independent, having submitted comprehensive reports that provided valuable information, that led to changes in market rules to address identified

⁴³ *Id.* at 19.

⁴⁴ *Id.*

⁴⁵ Delaware Municipal Electric Corp.’s Comments and Motion to Intervene dated November 20, 2000 at 7.

⁴⁶ Shell Energy’s Comments dated November 20, 2000 at 24.

market defects and abusive conduct.⁴⁷ As an example of such a rule change, PJM cited an order with which it had complied that had directed PJM to revise bid cap rules when its MMU “became concerned that market sellers had found a way to evade the bid cap during maximum generation emergencies.”⁴⁸ PJM also contended that it is more cost-effective for PJM ratepayers to have an MMU that is part of PJM.⁴⁹

On July 12, 2001, the FERC granted PJM provisional RTO status.⁵⁰ FERC accepted PJM’s Market Monitoring Plan, subject to one change (which PJM duly made) that would require the MMU’s reports to PJM to be submitted contemporaneously to the FERC.⁵¹ The FERC rejected arguments that the Market Monitor should be an outside entity. First, the FERC pointed out that Order No. 2000 “permits, but does not require, the market monitor to be outside of the RTO.”⁵² Second, the FERC assured that it would work with the MMU to ensure markets are functional and free from design flaws.⁵³ Third, the FERC reiterated Order No. 2000’s statement that the FERC would periodically assess the need for, and appropriate degree of, market monitoring, and the FERC reserved its authority to issue supplemental directives on the subject.⁵⁴ Fourth, although not in connection with the independence issue, the FERC accepted

⁴⁷ PJM’s Answer dated December 5, 2000 at 10.

⁴⁸ *PJM Interconnection, L.L.C.*, 92 FERC ¶ 61,013 at 61,026 (2000).

⁴⁹ *Id.*

⁵⁰ *PJM Interconnection, L.L.C.*, 96 FERC ¶ 61,061 (2001) (“Provisional RTO Order”).

⁵¹ *Id.* at 61,239.

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

PJM’s argument that the MMU’s effectiveness had been demonstrated by the fact that “the MMU has identified market flaws leading to remedies approved by the Commission.”⁵⁵

With respect to the Market Monitoring Plan in general, the FERC explained that Order No. 2000 required market monitoring plans to ensure the availability of objective information about the markets and a vehicle to propose appropriate action on necessary improvements, market design flaws or market power.⁵⁶ The FERC summarized the responsibilities of PJM’s MMU as follows: (1) investigates and monitors activities of market participants, including PJM members; (2) addresses issues relating to congestion pricing, exercise of market power, design flaws and structural problems; (3) submits periodic reports on competition and efficiency in the energy and other markets; (4) relies primarily on data customarily gathered in the normal course of PJM’s business, as well as public information; (5) has authority to recommend changes to PJM’s OATT and Operating Agreement; (6) has authority to issue demand letters requesting discontinuance of activities that violate PJM’s market rules, OATT and agreements.⁵⁷

On December 20, 2002, the Commission granted PJM final RTO status.⁵⁸

C. FERC Action Following RTO Formation

Following formation of the PJM RTO, PJM’s MMU proceeded to execute its duties and responsibilities without incident, and the FERC continued to encourage and refine the details of

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *Id.* at 61,238-39.

⁵⁸ *PJM Interconnection, L.L.C.*, 101 FERC ¶ 61,345 (2002) (“Final RTO Order”).

effective and non-discriminatory competitive wholesale power markets within the umbrella of RTOs.

In Spring 2005, the FERC issued its FERC MMU Policy Statement, with the stated purpose of providing guidance on the role of MMUs associated with ISOs and RTOs.⁵⁹ The FERC noted that MMUs perform valuable tasks in order to achieve the purpose of enhancing the competitive structure of ISO and RTO markets, including:

- Identifying ineffective market rules and tariff provisions and recommending proposed rule and tariff changes to the ISO/RTO that promote wholesale competition and efficient market behavior.
- Reviewing and reporting on the performance of wholesale markets in achieving customer benefits.
- Providing support to the ISO/RTO in the administration of Commission-approved tariff provisions related to markets administered by the ISO/RTO (e.g., day-ahead and real-time markets).
- Identifying instances in which a market participant's behavior may require investigation and evaluation to determine whether a tariff violation has occurred, or may be a potential Market Behavior Rule violation, and immediately notify appropriate Commission staff for possible investigation.⁶⁰

The FERC also noted that MMUs should have access to data to evaluate market participant behavior and market-specific responses, especially responses to existing or proposed market rules and tariff provisions, and that it is crucial that the MMU consistently and impartially evaluate the existing ISO or RTO rules and tariff provisions, including their effects on the economic signals sent to market participants.⁶¹ The FERC also emphasized that the MMU

⁵⁹ *Market Monitoring Units In Regional Transmission Organizations and Independent System Operators*, 111 FERC ¶ 61,267 (2005) (“FERC MMU Policy Statement”).

⁶⁰ FERC MMU Policy Statement at p. 2.

⁶¹ *Id.* at P 3.

should work proactively to identify market design flaws.⁶² However, other than the references to impartiality and proactivity, neither the FERC MMU Policy Statement or the attached Protocols made reference to a MMU's independence.

In early 2006, in response to specific anti-market-manipulation authority granted to the Commission by the Energy Policy Act of 2005 ("EPAct 2005"),⁶³ the FERC issued its Order Revising Market-Based Rate Tariffs and Authorizations,⁶⁴ which revised the FERC's ongoing Market Behavior Rules, and Order No. 670,⁶⁵ which made it unlawful for any entity to engage in "fraudulent or deceptive" conduct in connection with the purchase or sale of electric energy, natural gas, or transmission or transportation services subject to the jurisdiction of the FERC. Among other things, the Market Behavior Rules Order clarified that Market Behavior Rule 3, which requires accurate and factual communications with the FERC, RTOs/ISOs, transmission providers, and market monitors, applies to *all* communications, not just those that are material in furtherance of a "fraudulent or deceptive" scheme.⁶⁶

In Spring 2006, almost a year after the issuance of the FERC MMU Policy Statement, PJM filed to amend Attachment M of its Tariff to conform its market monitoring function to the general principles set forth in the FERC MMU Policy Statement ("Attachment M Filing"). Among other things, the Attachment M Filing limited the PJM MMU's ability to question

⁶² *Id.* at P 4.

⁶³ Energy Policy Act of 2005, Pub. L. No. 109-58, 119 Stat. 594 (2005).

⁶⁴ *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 114 FERC ¶ 61,165 (2006) ("Market Behavior Rules Order").

⁶⁵ *Prohibition of Energy Market Manipulation*, Order No. 670, 114 FERC ¶ 61,047 (2006).

⁶⁶ Market Behavior Rules Order, P 43.

market participants after it had referred the matter to the FERC, and required approval of the PJM BOM before the MMU filed any statements in a docketed and contested proceeding.

PJM did not propose any Tariff revisions regarding the independence of the MMU, but nevertheless several parties filed protests on the issue of independence. The Joint Protestors⁶⁷ argued that the MMU will only be able to provide consistent and impartial evaluations of existing RTO rules and tariff provisions if it is independent of the PJM BOM and management.⁶⁸ The Joint Consumer Advocates⁶⁹ and the Organization of PJM States, Inc. (“OPSI”) disputed the requirement that the MMU have permission from the PJM BOM prior to making filings at the FERC, arguing that the MMU must be able to bring its concerns directly to the FERC in order to maintain independence.⁷⁰ The Maryland Commission endorsed increased MMU independence, and OPSI also proposed a series of changes (which were supported by the Pennsylvania Commission and the Joint State Commissions) intended to provide the MMU with greater independence, arguing that the MMU staff should report exclusively to the Market Monitor, and that the Market Monitor himself should have substantial job security and should only be removed for “just cause.”⁷¹ Several protestors also argued that the MMU should report only to the PJM BOM, rather than to the PJM BOM and the President of PJM, as proposed.⁷²

⁶⁷ Old Dominion Electric Cooperative, the Borough of Chambersburg, Pennsylvania, DMEC, and Electricities of North Carolina.

⁶⁸ *PJM Interconnection, L.L.C.*, 116 FERC ¶ 61,038, P 31 (2006) (“Attachment M Order”).

⁶⁹ Representing Pennsylvania, Maryland, Ohio, the District of Columbia, Illinois, and Indiana.

⁷⁰ Attachment M Order at P 32.

⁷¹ *Id.* at P 33.

⁷² *Id.* at P 36.

In the Attachment M Order, the FERC accepted PJM's Attachment M Filing subject to minor revisions, and flatly rejected the aforementioned protests and proposed changes, stating that the independence issues were not raised in PJM's Attachment M Filing and "are therefore beyond the scope of this proceeding,"⁷³ and that the protesters "have offered no convincing reason for finding that PJM's proposal to have the MMU report to the PJM President, as well as the PJM Board, is unjust and unreasonable."⁷⁴

Several of the parties that protested the Attachment M Filing filed requests for rehearing of the Attachment M Order. OPSI and others argued that the FERC erred by not requiring PJM to show that its revised Attachment M is consistent with the FERC policy on MMU independence, and is just and reasonable. They also argued that the MMU was not given sufficient independence from PJM's Management to ensure proper functioning.⁷⁵ All parties requesting rehearing contended that the MMU should report solely to the PJM BOM, and not the PJM President, and certain parties argued that the MMU's inquiries and findings should not be subject to influence by PJM Management.⁷⁶

PJM answered the requests for rehearing (an answer that the Commission permitted⁷⁷), stating that the requests amounted to challenges to the FERC's generic policies on market monitoring as set forth in Order No. 2000, and that the concerns would be better raised in a

⁷³ *Id.* at P 35.

⁷⁴ *Id.* at P 38.

⁷⁵ *PJM Interconnection, L.L.C.*, 117 FERC ¶ 61,263, at P 12 (2006) ("Attachment M Rehearing Order").

⁷⁶ *Id.* at P 13.

⁷⁷ *Id.* at P 8.

generic rulemaking applicable to all RTOs.⁷⁸ In its December 5, 2006 order on rehearing, the FERC accepted the revised Tariff language, and dismissed the requests for rehearing, holding that it was not persuaded that it had erred by failing to expand the scope of the proceeding to include discussion of the MMU's independence, an issue which was not proposed in the Attachment M Filing.⁷⁹ It reiterated its finding in the Attachment M Order that the parties had failed to offer sufficient evidence to support their concerns that the MMU "lacks adequate independence and authority to carry out its responsibilities."⁸⁰

However, the FERC noted that it had received many comments in this proceeding about the need to safeguard and advance the independence of the MMU and the importance of assuring transparency and clarity to its functions:

In addition, all the parties on rehearing argue that the PJM tariff should contain a clear statement of the MMU's independence, and that it should include all rules relevant to the responsibilities and functions of the MMU, possibly modeled upon the MISO tariff. These issues are of a generic nature, and are not necessarily limited to the MMU within any one RTO or independent system operator (ISO).

Further, the comments received in this docket, while originating from PJM's filing to comply with the Policy Statement, indicate that entities who are regularly involved with or affected by the functions of MMUs are concerned about a range of issues and policies arising from the functions of MMUs. Therefore, the Commission intends to initiate a review of its MMU policies and hold a Commission technical conference, currently planned for early next year, to explore these and other generic issues.⁸¹

In early 2007, the FERC held a number of conferences on competition in organized wholesale electric markets, including topics such as market monitoring. On January 25, 2007,

⁷⁸ *Id.* at P 7.

⁷⁹ *Id.* at PP 16, 18.

⁸⁰ *Id.*

⁸¹ *Id.* at PP 19-20.

the FERC issued a Notice of an April 5, 2007 Technical Conference to review the FERC's general policies regarding market monitoring. On March 9, 2007, the FERC issued a Second Notice of Technical Conference, including a list of topics to be discussed, and on March 30, 2007, the FERC issued a Notice of Agenda for the Conference. Dr. Bowring and Mr. Mark Christie, President of OPSI, were scheduled to speak.

Based on comments received at the conferences, including the April 5, 2007 conference on market monitoring at which Dr. Bowring and Mr. Christie spoke, the FERC identified certain issues pertaining to organized markets that could be appropriate for a generic proceeding. On June 22, 2007, the FERC issued its Advance Notice of Proposed Rulemaking ("ANOPR") on wholesale competition in regions with organized electric markets, which focused on certain issues raised at the conferences, including market monitoring.⁸²

In the ANOPR, the Commission noted that two principal issues had received the bulk of attention from the commenters at the technical conference on market monitoring: the need for independence on the part of MMUs, and the content and proper recipients of the market data and analysis developed by the MMUs.⁸³ Based on these comments, the ANOPR covered several topics related to market monitoring and MMUs, including structure and tools, oversight, functions, mitigation and operations, ethics, MMU provisions in RTOs' and ISOs' tariffs, information sharing, and the MMU provisions in the FERC's *pro forma* tariff.

The FERC noted that it had observed no appreciable difference among the performance of the market monitors that could be attributed to whether they are external or internal to their

⁸² *Advance Notice of Proposed Rulemaking: Wholesale Competition in Regions With Organized Electric Markets*, 119 FERC ¶ 61,306 (2007).

⁸³ *Id.* at P 106.

RTO or ISO, and therefore declined to impose a “one size fits all” approach toward the structure of MMUs.⁸⁴ The ANOPR proposed to require each RTO or ISO to include in its tariff a provision imposing upon itself the obligation to provide its MMU with access to market data, resources, and personnel sufficient to enable the MMU to carry out its functions. The ANOPR further provided that the RTO or ISO tariff should include a provision directing the MMU to report to the FERC any concerns it may have with inadequate access to market data, resources, or personnel, and also describe the steps it has taken with the RTO or ISO to resolve these concerns.⁸⁵

The ANOPR proposed to require each RTO or ISO to have its MMU – whether internal, external or a hybrid combination of the two – report either directly to that RTO’s or ISO’s board of directors or to a committee of independent board directors.⁸⁶ The FERC noted that this policy would mark a departure from the holding in *PJM Interconnection, L.L.C.*,⁸⁷ but that after considering the comments submitted at the technical conference, and considering that it believes that it has the authority to impose this type of requirement on RTOs and ISOs, “the Commission believes that a generic change in policy may be appropriate” and therefore sought comment on the issue.⁸⁸

The ANOPR proposed requiring MMUs to advise the FERC and other interested entities of any recommendations for rule or tariff changes, and to refer to the FERC any suspected rule or

⁸⁴ *Id.* at P 110.

⁸⁵ *Id.* at P 111.

⁸⁶ *Id.* at P 113.

⁸⁷ 116 FERC ¶ 61,038, at P 38, *order on reh’g*, 117 FERC ¶ 61,263 (2006).

⁸⁸ ANOPR 119 FERC ¶ 61,306 at P 113.

tariff violation (including Codes of Conduct and Standards of Conduct) committed by their RTO or ISO, or by market participants.⁸⁹ The ANOPR proposed to retain the Protocols governing referral of potential market violations to the Commission.⁹⁰

The FERC stated that “operational activities affecting the market, including mitigation, are more properly performed by the RTOs and ISOs themselves as part of their responsibility to administer their Commission-approved tariffs.”⁹¹ Accordingly, the ANOPR proposed to require MMUs to refrain from assisting their RTOs or ISOs in tariff administration, from participating in RTO or ISO market operations (including mitigation), and from taking direct actions to influence the market, and instead to concentrate on their role of providing market evaluation, reports, and advice.⁹²

The ANOPR proposed to subject MMU personnel to standards of conduct, to standardize RTO or ISO conflicts of interest or standards of conduct provisions, and to require their inclusion in the RTO or ISO tariff.⁹³ The ANOPR also proposed that each RTO and ISO set forth all its provisions involving market monitoring in one section of its tariff.⁹⁴

The ANOPR included a number of proposals to improve “information sharing,” including the proposal that MMUs be required to report comprehensively on aggregate market and RTO or

⁸⁹ *Id.* at PP 115-16.

⁹⁰ *Id.* The Protocols are included as an Appendix to the FERC Policy Statement on Market Monitoring Units. *See Market Monitoring Units in Regional Transmission Organizations and Independent System Operators*, 111 FERC ¶ 61,267 (2005).

⁹¹ ANOPR, 119 FERC ¶ 61,306 at P 119.

⁹² *Id.*

⁹³ *Id.* at P 120.

⁹⁴ *Id.* at P 121.

ISO performance on a regular basis to the FERC staff, to staff of interested state commissions, and to the management and board of directors of the RTOs and ISOs.⁹⁵ The FERC further proposed that offer and bid data be posted on the RTO's or ISO's website after three months, without identification of the market participants.⁹⁶ The FERC proposed that state commissions be permitted to make "tailored" requests for additional information from the MMUs, but that information should be "regarding general market trends and performance, not information designed to aid state enforcement or related actions against individual companies."⁹⁷ The FERC also proposed to continue confidentiality of MMU referrals of suspected tariff and rule violations to the FERC.

Finally, the FERC stated that it would include in a subsequent NOPR a proposed *pro forma* MMU section for the RTOs' and ISOs' tariffs. The FERC noted that each RTO and ISO may wish to modify or add certain provisions to such *pro forma* tariff to suit its particular needs, but stated that it would be useful to develop specific core provisions that are standardized across the various RTOs and ISOs, particularly in the areas of independence, MMU functions, and information sharing. The FERC anticipated including in the *pro forma* tariff protocols for the referral of tariff and market manipulation violations to the Office of Enforcement, as well as protocols for the referral of perceived market design flaws and recommended tariff changes to the Office of Energy Markets and Reliability.⁹⁸

⁹⁵ *Id.* at P 126.

⁹⁶ *Id.* at P 127.

⁹⁷ *Id.* at P 128.

⁹⁸ *Id.* at P 131.

Comments on the ANOPR were filed on September 14, 2007. The FERC will review those comments and determine whether to initiate a formal rulemaking proceeding.