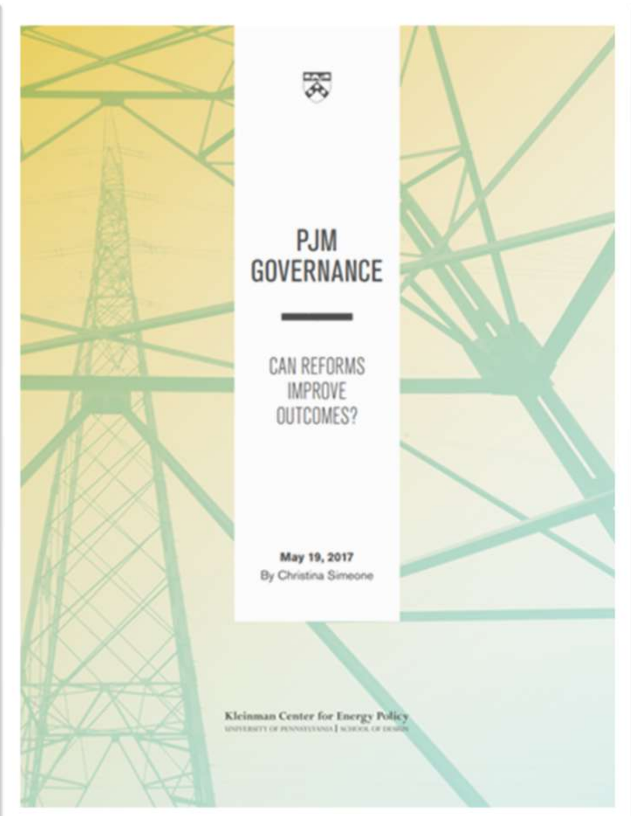
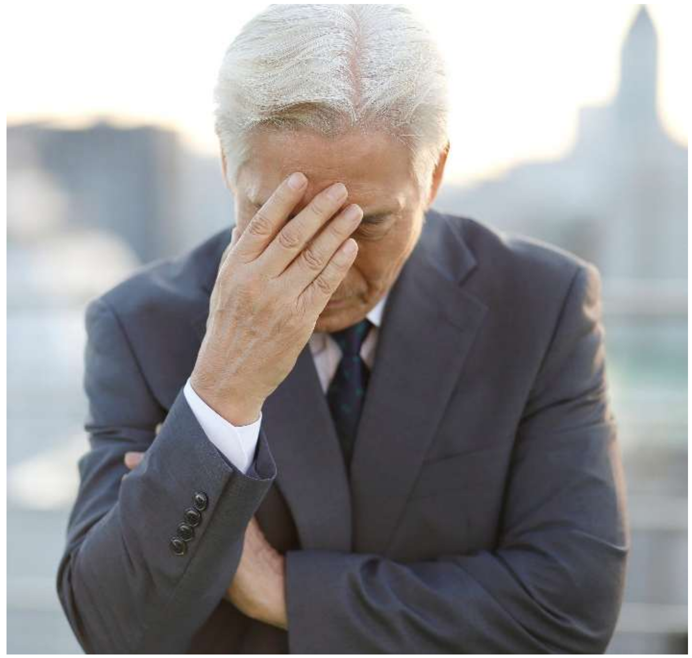
# PJM GOVERNANCE: What is Going on Here?

*"PJM Governance: Can Reforms Improve Outcomes?"* – Kleinman Center for Energy Policy (2017)



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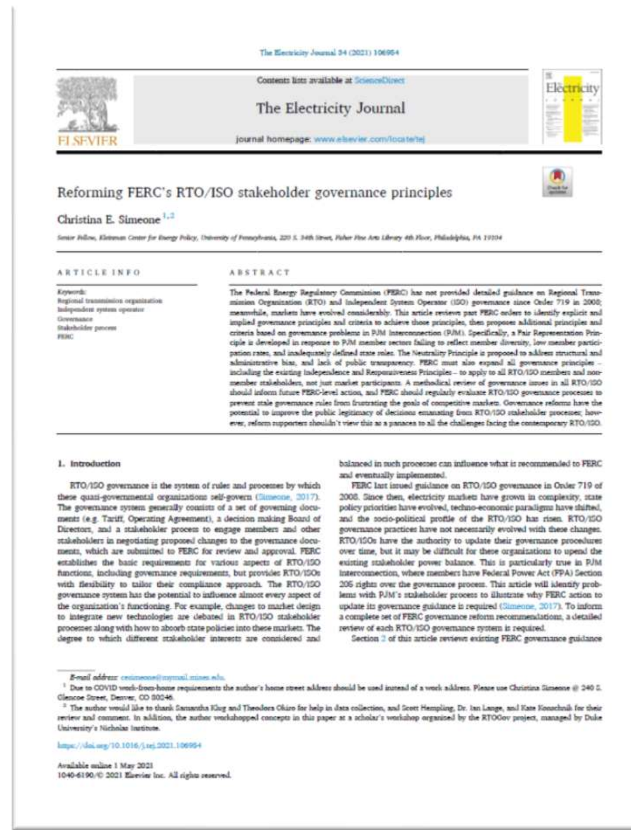
*"Reforming FERC's RTO/ISO Stakeholder Governance Principles"* – The Electricity Journal (2021)



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Reforming FERC's RTO/ISO stakeholder governance principles

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ABSTRACT

The Federal Energy Regulatory Commission (FERC) has not provided detailed guidance on Regional Transmission Organization (RTO) and Independent System Operator (ISO) governance since Order 719 in 2008; meanwhile, markets have evolved considerably. This article reviews past FERC orders to identify explicit and implied governance principles and criteria to achieve those principles, then proposes additional principles and criteria based on governance problems in PJM Interconnection (PJM). Specifically, a Fair Representation Principle is developed in response to PJM member sectors failing to reflect member diversity, low member participation rates, and inadequately defined state roles. The Neutrality Principle is proposed to address structural and administrative bias, and lack of public transparency. FERC must also expand all governance principles – including the existing Independence and Responsiveness Principles – to apply to all RTO/ISO members and non-member stakeholders, not just market participants. A methodical review of governance issues in all RTO/ISO should inform future FERC-level action, and FERC should regularly evaluate RTO/ISO governance processes to prevent stale governance rules from frustrating the goals of competitive markets. Governance reforms have the potential to improve the public legitimacy of decisions emanating from RTO/ISO stakeholder processes; however, reform supporters shouldn't view this as a panacea to all the challenges facing the contemporary RTO/ISO.

1. Introduction

RTO/ISO governance is the system of rules and processes by which these quasi-governmental organizations self-govern (Simeone, 2017). The governance system generally consists of a set of governing documents (e.g. Tariff, Operating Agreement), a decision making Board of Directors, and a stakeholder process to engage members and other stakeholders in negotiating proposed changes to the governance documents, which are submitted to FERC for review and approval. FERC establishes the basic requirements for various aspects of RTO/ISO functions, including governance requirements, but provides RTO/ISOs with flexibility to tailor their compliance approach. The RTO/ISO governance system has the potential to influence almost every aspect of the organization's functioning. For example, changes to market design to integrate new technologies are debated in RTO/ISO stakeholder processes along with how to absorb state policies into these markets. The degree to which different stakeholder interests are considered and balanced in such processes can influence what is recommended to FERC and eventually implemented.

FERC last issued guidance on RTO/ISO governance in Order 719 of 2008. Since then, electricity markets have grown in complexity, state policy priorities have evolved, techno-economic paradigms have shifted, and the socio-political profile of the RTO/ISO has risen. RTO/ISO governance practices have not necessarily evolved with these changes. RTO/ISOs have the authority to update their governance procedures over time, but it may be difficult for these organizations to upend the existing stakeholder power balance. This is particularly true in PJM Interconnection, where members have Federal Power Act (FPA) Section 205 rights over the governance process. This article will identify problems with PJM's stakeholder process to illustrate why FERC action to update its governance guidance is required (Simeone, 2017). To inform a complete set of FERC governance reform recommendations, a detailed review of each RTO/ISO governance system is required.

Section 2 of this article reviews existing FERC governance guidance

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# Disclaimer

- Presenting to PIEOUG in my capacity as an independent researcher, not in my capacity as an employee of the Governor's Office.
- Perspectives and data are from research published in 2017 & 2021 and may require updates.
- Analysis in the research and opinions expressed in the presentation are my own and do no necessarily reflect the views of my employer, Governor Shapiro, or any other individual or office.

# Overview

- PJM stakeholder process basics
  - Quick run through
- Some PJM stakeholder process problems
  - Membership growth, sector stagnation, and vote dilution
  - Structural bias in voting rules
  - Low participation rates
- RTO/ISOs and the public interest
- Thoughts on FERC-level reforms

# Purpose of Stakeholder Process

- PJM is a quasi-governmental organization that has its own set of FERC-overseen rules, referred to as governance documents
  - OATT, OA, RAA, CTOA

- The purpose of the stakeholder process is to negotiate (e.g. educate, develop, endorse) proposed changes to PJM's governance documents, for example:
  - Stakeholder driven - When PJM or stakeholders identify issues
  - Compliance filing - When FERC requires changes based on a rulemaking (e.g., FERC 1920)

- Federal Power Act Section 205/206
  - Open Access Transmission Tariff (The Tariff), RAA
    - Rates, terms of service, capacity market
    - **Board has FPA Section 205** authority over Tariff [STAKEHOLDER VOTE IS ADVISORY]

  - Operating Agreement (OA)
    - Governance, energy markets, RTEP
    - **Members have FPA Section 205** authority over OA [STAKEHOLDER VOTE IS BINDING]

**Members have strong control over changes to stakeholder process**

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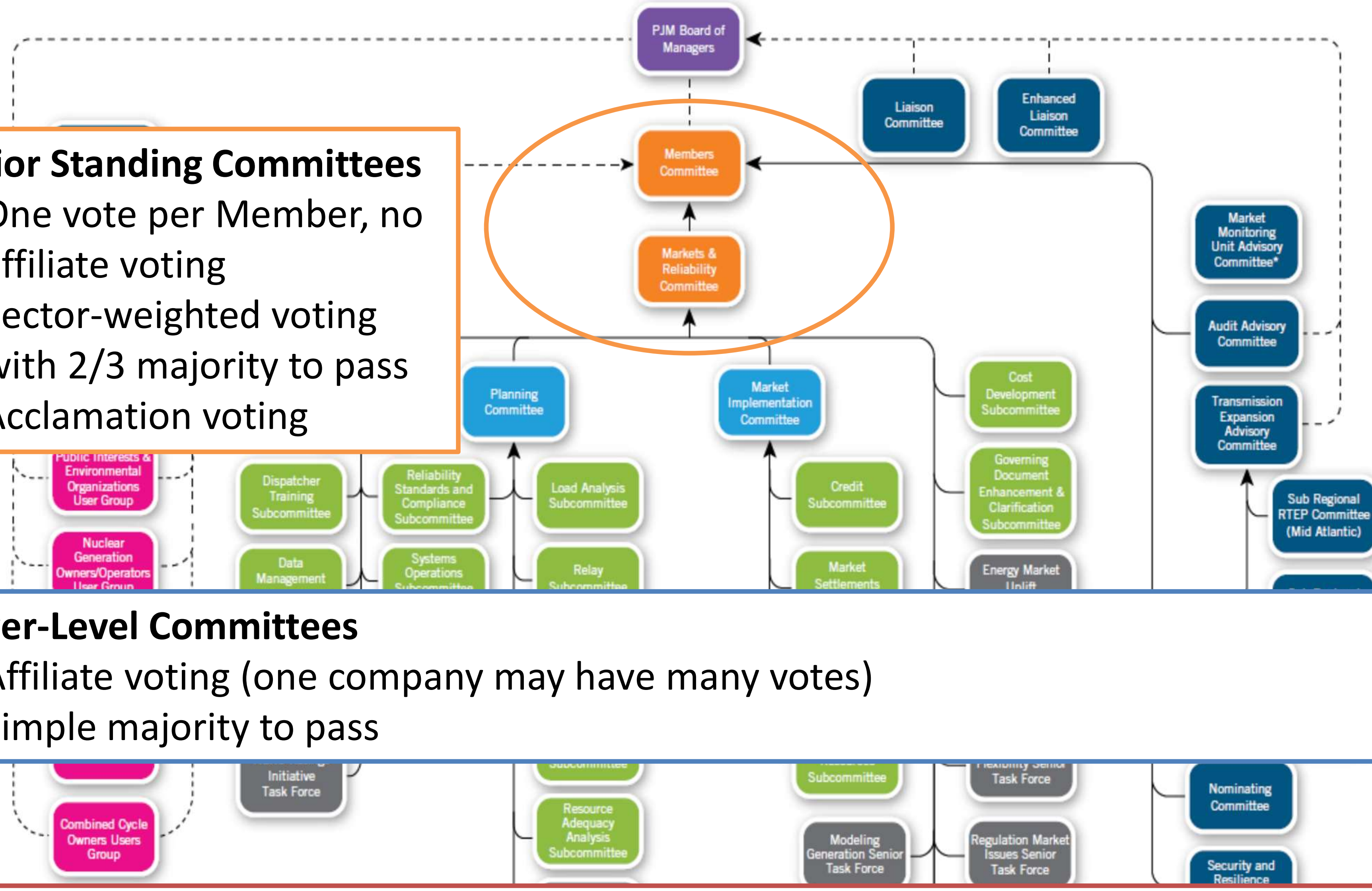


**Senior Standing Committees**

- One vote per Member, no affiliate voting
- Sector-weighted voting with 2/3 majority to pass
- Acclamation voting

**Lower-Level Committees**

- Affiliate voting (one company may have many votes)
- Simple majority to pass

**Five Member Sectors:**

- Generation Owner
- Other Supplier
- Transmission Owner
- End Users
- Electric Distributor

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# Exploring Issues and Solutions

- **Identify Issue -** via drafting "Problem Statement"
- **Set Issue Agenda** - "Problem Statement" and related docs must be approved by higher level committee first through sector weighted (or acclamation) vote limited to voting members

**Develop Solutions** – Then, solutions are explored at lower level committees and advanced to higher level committees via simple majority vote that includes voting members and affiliates.

- **Endorse/Reject Solution**– supermajority vote at Senior Standing Committees

★ **PJM Files with FERC** – (need board approval if a Tariff/RAA change)

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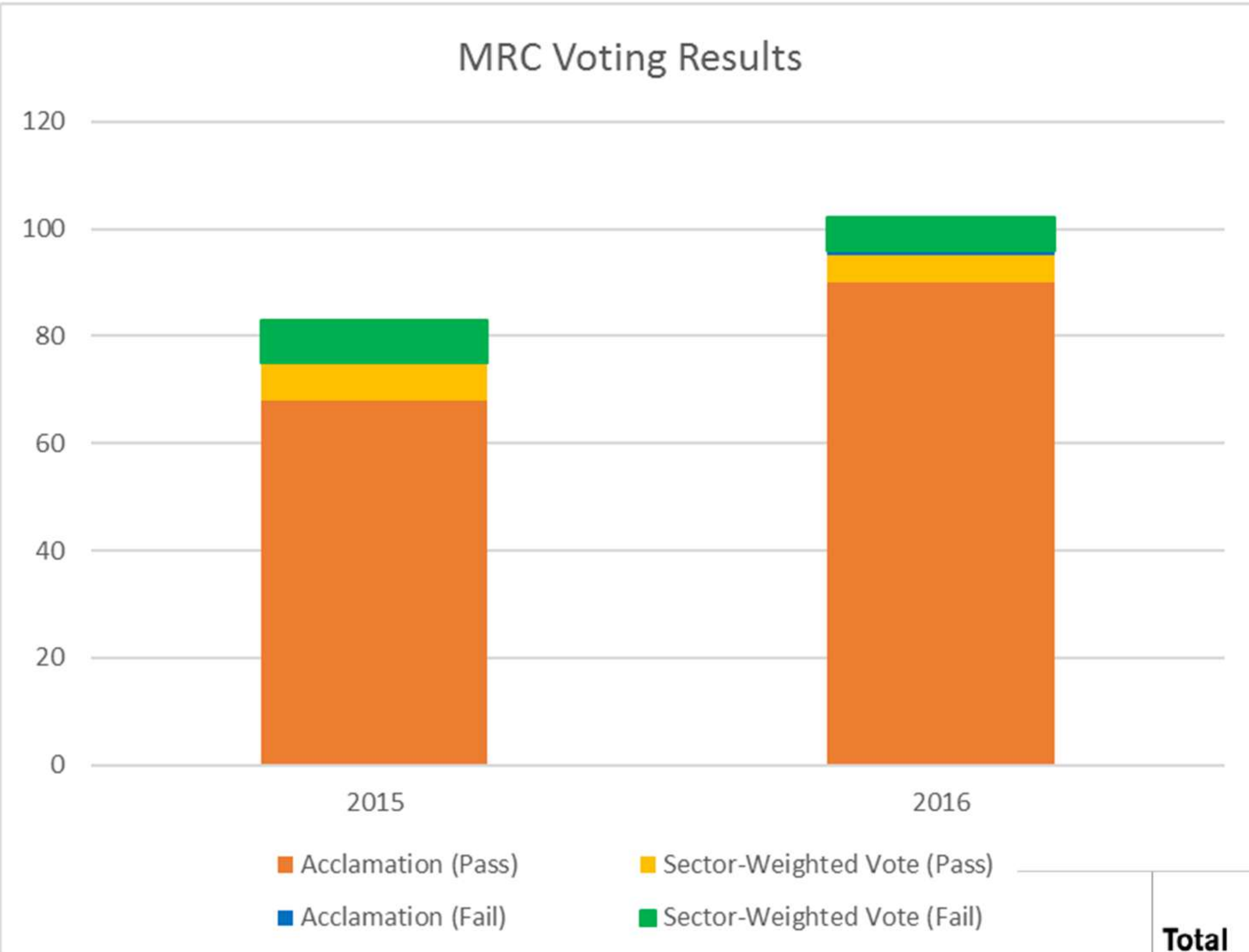
# Stakeholder Process Remarkably Effective When Issues Less Contentious




Acclamation vote = less contentious

Sector-weighted vote = more contentious

Not a remarkable conclusion, and typical of multi-stakeholder processes.

| | Total Votes | Acclamation (Pass) | Acclamation (Fail) | Sector-Weighted Vote (Pass) | Sector-Weighted Vote (Fail) |
|---|---|---|---|---|---|
| **2015** | 83 | 68 | 0 | 7 | 8 |
| **2016** | 102 | 90 | 1 | 5 | 6 |

# PJM STAKEHOLDER PROCESS ISSUES

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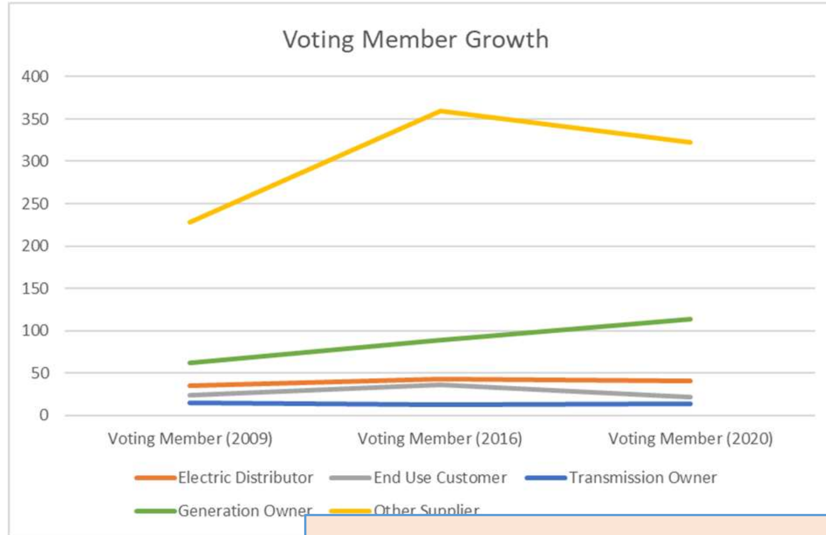
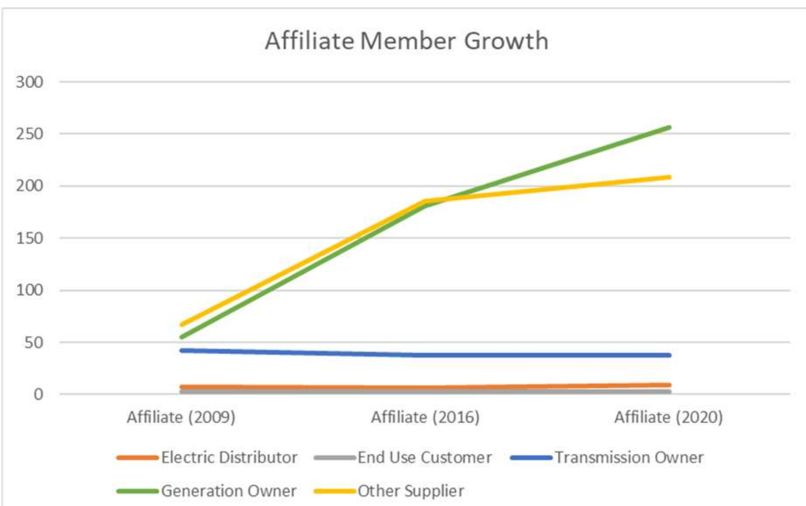
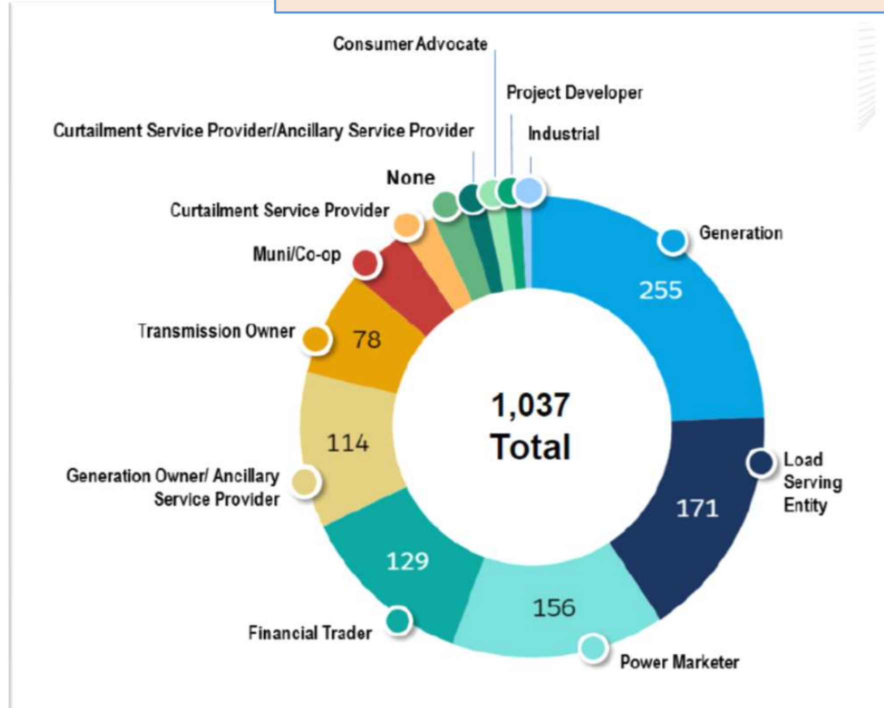
# Existing Member Sector Growth

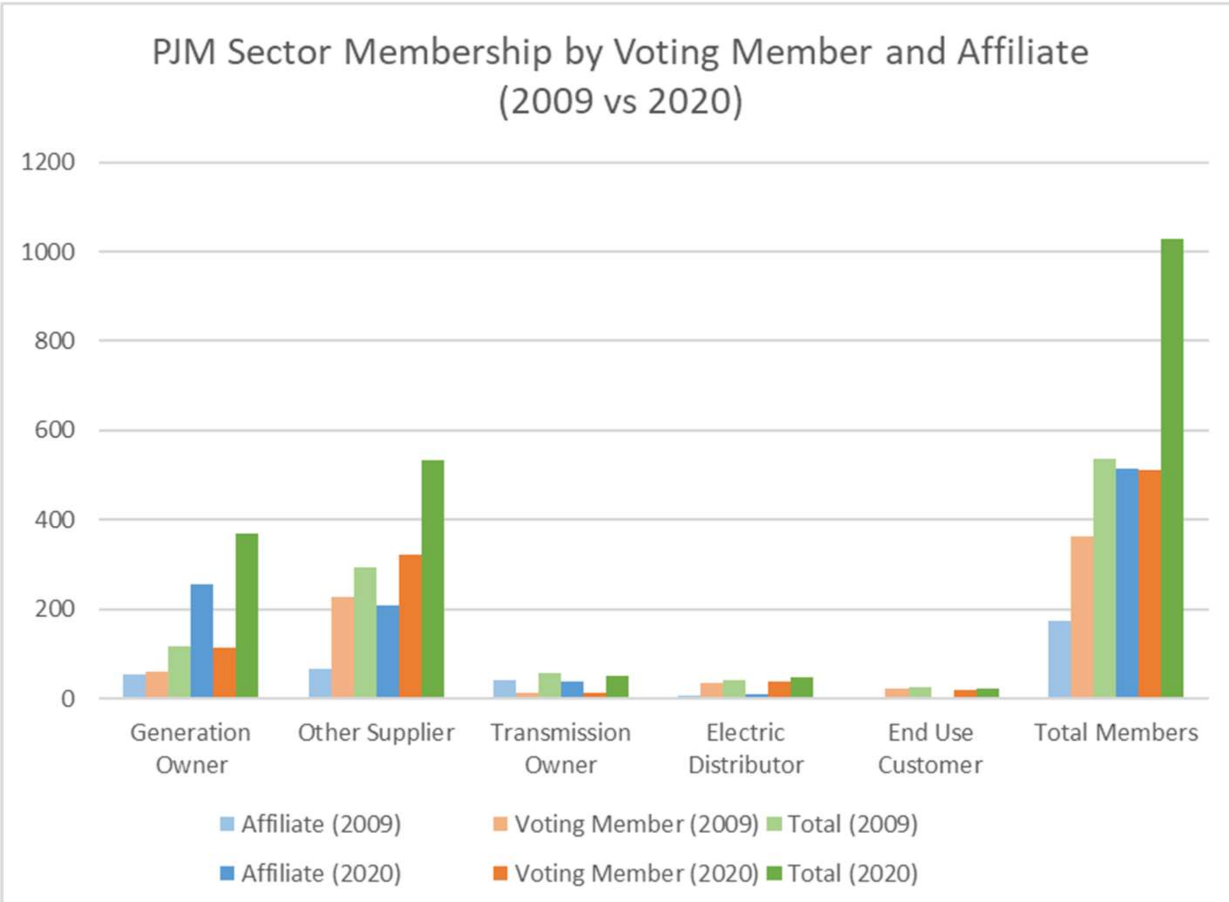




Diversity of PJM Lines of Business



# Do Sectors Still Represent Stakeholders?




New Market Entrants in growth sectors:

- Renewable Energy (G.O.)
- EE (E.D./T.O./O.S.)
- DR (O.S.)
- Marketers/Traders (O.S.)

**Some Key Issues**

- Same 5 sectors since ~2000
- **GO and OS -** vote dilution, complicates caucusing, reduces the impact of each firm
- **OS** – not pure "supply", financials, broker/marketers, curtailment
- **ED** – not pure load due to muni/coop generation interests

| Sector Weighted Voting Power by Voting Member (2020) | | | | | |
|---|---|---|---|---|---|
| | **Electric Distributor** | **End Use Customer** | **Transmission Owner** | **Generation Owner** | **Other Supplier** |
| Sector Vote Weighting | 1 | 1 | 1 | 1 | 1 |
| Total Voting Members per Sector | 40 | 21 | 14 | 114 | 323 |
| Sector Share of Vote per Voting Member | 2.5% | 4.8% | 7.1% | 0.9% | 0.3% |

# Structural Bias as Inefficiency

- Higher and lower-level Committees use different voting rules
  - Higher level – SWV, no affiliates, supermajority, transparency
  - Lower level – No SWV, affiliates allowed, simple majority, no transparency

Based on July 3, 2020 membership numbers, the introduction of affiliate voting results in 88 % of total lower-level votes being from supply-side sectors.

“Legacy Deals” split structural advantage in decision making process. This enabled agreement on process, but did it compromise long-term viability of process outcomes?

# Existing "Legacy Deal" Structure

**Splitting Power** - Supply-side bias at lower-level committees leads to supply-biased solutions advancing to higher-level committees, only to be blocked by load-side interests.

**Affiliate Votes at Lower-Level Committees**

- Historic example: Top 15 companies control <u>198 affiliate votes (41% of total affiliate votes)</u>.
  - 9 GOs (121 votes); 4 TOs (60 votes); 2 OS (17 votes)

**Buy-Side Voting Blocking Power at Higher Level Committees**

- Empirical measurement of buy-side vote blocking power at higher level committees on capacity market issues.
- *"Can Capacity Markets Be Designed by Democracy?"* Blumsack, Yoo & Johnson, Penn State University.

| PJM Affiliate Votes by Affiliate Sector (2020) | | | | |
|---|---|---|---|---|
| Electric Distributor | End-Use Customer | Transmission Owner | Generation Owner | Other Supplier |
| 9 | 3 | 38 | 256 | 209 |
| **PJM Affiliate Votes by Parent Company's Sector (2020)** | | | | |
| 5 | 2 | 90 | 228 | 166 |

| Parent Company | Parent Voting Sector | Total Affiliates | Generation Owner | Transmission Owner | Electric Distributor | End User | Other Supplier | Total MW (non-renewable) w/Access to PJM as of 2015 |
|---|---|---|---|---|---|---|---|---|
| Appalachian Power Company | Transmission Owner | 17 | 1 | 12 | | | 4 | 6,167 |
| Dayton Power and Light | Transmission Owner | 6 | 5 | | | 1 | | 2,690 |
| Exelon Business Services | Transmission Owner | 14 | 5 | 3 | 3 | | 3 | 20,580 |
| FirstEnergy Solutions Corp. | Transmission Owner | 15 | | 15 | | | | 14,975 |
| Public Service Gas and Electric | Transmission Owner | 6 | 4 | | | | 2 | 9,790 |
| Virginia Electric Power Company | Transmission Owner | 4 | 4 | | | | | 18,644 |
| | | | | | | | | |
| Calpine Energy Service, L.P. | Generation Owner | 6 | 2 | | | | 4 | 5,036 |
| Dynegy Marketing and Trade LLC | Generation Owner | 9 | 8 | | | | 1 | 10,546 |
| NRG Power Marketing, LLC | Generation Owner | 12 | 6 | | | | 6 | 15,250 |
| Talen Energy Marketing, LLC | Generation Owner | 19 | 18 | | | | 1 | 7,187 |
| | | | | | | | | 110,864 |
| | | | | PJM Regional Summer Peak Capacity (2015) | | | | 143,698 |

***Table 6**: Sample of PJM Members, Affiliates and MWs, by Sector*[48]

**Hypothetical Example**: SCRSTF (2016-2017) proposal voting had 190 votes through 34 unique respondents, where 10 companies could have prevented anything from passing the lower level.

# Existing Participation Rates

- Stakeholder process participation is part of member responsibilities in OA, but participation is very low in some sectors…why?
- Are participation rates (17% - 28%) reasonable and appropriate?
- Here, participation means Members that attend and vote.

**Table 2**
Average PJM Member Voting Participation at the Higher-Level Committees.

| Average Voting Participation in PJM Senior Standing Committees | | | | |
|---|---|---|---|---|
| | Total Votes | Sector Weighted Votes | Average Total Voting Members | Voting % |
| **Members Committee (MC)** | | | | |
| 2018 | 38 | 16 | 544 | 18% |
| 2017 | 25 | 4 | 534 | 17% |
| 2016 | 26 | 0 | – | |
| 2015 | 21 | 2 | 528 | 25% |
| 2014 | 26 | 3 | 455 | 18% |
| 2013 | 13 | 8 | 455 | 28% |
| **Markets and Reliability Committee (MRC)** | | | | |
| 2018 | 105 | 36 | 544 | 20 % |
| 2017 | 80 | 18 | 534 | 18% |
| 2016 | 81 | 11 | 528 | 18% |
| 2015 | 70 | 12 | 528 | 20 % |
| 2014 | 105 | 32 | 455 | 23% |
| 2013 | 11 | 1 | 455 | |

Source: Voting data was taken from meeting minutes and voting reports for the respective committees from PJM's website. Total votes include sector-weighted and acclamation votes.

# Existing Participation Rates

**Table 3**
Average PJM Member Voting Participation by Sector and Committee.

| Average Voter Participation by Sector at the Members Committee | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Ave. Eligible Members (2018) | Generation Owner | | Other Supplier | | Trans. Owner | | End User | | Electric Dist. | |
| | 101 | | 354 | | 15 | | 31 | | 43 | |
| | Ave. Votes Cast | Participation % | Ave. Votes Cast | % | Ave. Votes Cast | % | Ave. Votes Cast | % | Ave. Votes Cast | % |
| 2018 | 18 | 19% | 32 | 9% | 11 | 76% | 15 | 45% | 22 | 52% |
| 2017 | 16 | 17% | 33 | 9% | 10 | 70% | 12 | 43% | 17 | 40% |
| 2016 | 0 | 0% | 0 | 0% | 0 | 0% | 0 | 0% | 0 | 0% |
| 2015 | 18 | 22 % | 55 | 15% | 12 | 88 % | 18 | 57% | 28 | 61 % |
| 2014 | 14 | 20 % | 22 | 7% | 11 | 75% | 12 | 43% | 24 | 64% |
| 2013 | 18 | 26% | 54 | 18% | 13 | 93% | 15 | 54 % | 31 | 81% |
| 5-Year Ave. | 21 % | | 12 % | | 80 % | | 48 % | | 60 % | |

| Average Voter Participation by Sector at the Markets and Reliability Committee | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Generation Owner | | Other Supplier | | Trans. Owner | | End User | | Electric Dist. | |
| | Ave. Votes Cast | Participation % | Ave. Votes Cast | % | Ave. Votes Cast | % | Ave. Votes Cast | % | Ave. Votes Cast | % |
| 2018 | 22 | 22 % | 33 | 9% | 12 | 81% | 17 | 55% | 28 | 65% |
| 2017 | 22 | 24% | 37 | 10% | 13 | 90% | 15 | 52% | 25 | 59% |
| 2016 | 18 | 23% | 29 | 8% | 12 | 93% | 16 | 53 % | 21 | 45% |
| 2015 | 17 | 21 % | 33 | 9% | 11 | 86% | 16 | 52% | 29 | 62 % |
| 2014 | 16 | 23% | 32 | 10% | 13 | 86% | 14 | 52% | 27 | 72% |
| 2013 | 0 | 0% | 0 | 0% | 0 | 0% | 0 | 0% | 0 | 0% |
| 5-Year Ave. | 22 % | | 9% | | 87 % | | 53 % | | 61 % | |

Source: Voting data was taken from meeting minutes and voting reports for the respective committees from PJM's website. Average per sector votes cast is the average number of votes cast per issue per year, divided by the average number of eligible members per sector per year. Years with zeros indicate no sector weighted votes occurred.

# RTO/ISOs and the Public Interest

# Quasi-Governmental Organizations

## Have legal characteristics of both government and private sectors

**Benefits**

- Avoids expanding federal bureaucracy
- Develops new revenue sources to fund operations
- Exempt from federal central management laws (e.g. compensation limits)
- Economic-focused values (e.g. use of markets)
- Entity-specific laws and regulations for flexibility

**Drawbacks**

- Accountability?
  - More difficult to control, less responsive to preferences of political superiors (compared to traditional government agencies)
  - To whom are these orgs accountable?
- How is the public interest being protected over private interests?

# Quasi-Governmental Organizations: Accountability and Public Interest

- **Political Accountability** – Compared to traditional government agency
  - Unlike FERC leadership, RTO/ISO leadership is not politically appointed.
  - FERC cannot appoint board members to RTO/ISOs.

- **Stakeholder Accountability**
  - Stronger Accountabiliity over RTO/ISOs
    - Transmission Owners – participation in RTO/ISO is voluntary but foundational.
    - Members – have 205 rights over the Operating Agreement, but must reach supermajority
    - States – can implement legally acceptable policies that impact RTO/ISO markets

  - Weak Accountability over RTO/ISOs
    - All other stakeholders, unless they are a T.O. affiliate

- Reduced political accountability enables pursuit of organizational interest, which may or may not be consistent with public interest.

# Theory of Potential RTO/ISO Bias

- **Organizational Bias** - Self-interested behavior not associated with profit motivation.
  - Reliability bias – pursuit of reliability at any cost

- **Cultural Bias** – Impact of workforce beliefs

- **Principal-Agent Problem** – Agent advantage
  - Principals (i.e., stakeholders, ratepayers) rely upon Agent (i.e., PJM) to act on their behalf.
  - Problem exists when priorities of the agent and the principles begin to conflict.
  - Agent has information advantage, different incentives, etc.

- **Moral Hazard** – Party managing financial risk (PJM) does not bear financial risk

# Greater Participation of States

- **When?** Specifically, on high-controversy issues
  - Including some method of voting where non-conflicted, elected representative of state (e.g. governor's office) participates.

- **Why?** States help define and represent public interest
  - Definition is Dynamic – different over time, location.
    - Lowest cost? Price stability? Reliability? Environmental? Jobs?
  - Elections and political accountability.

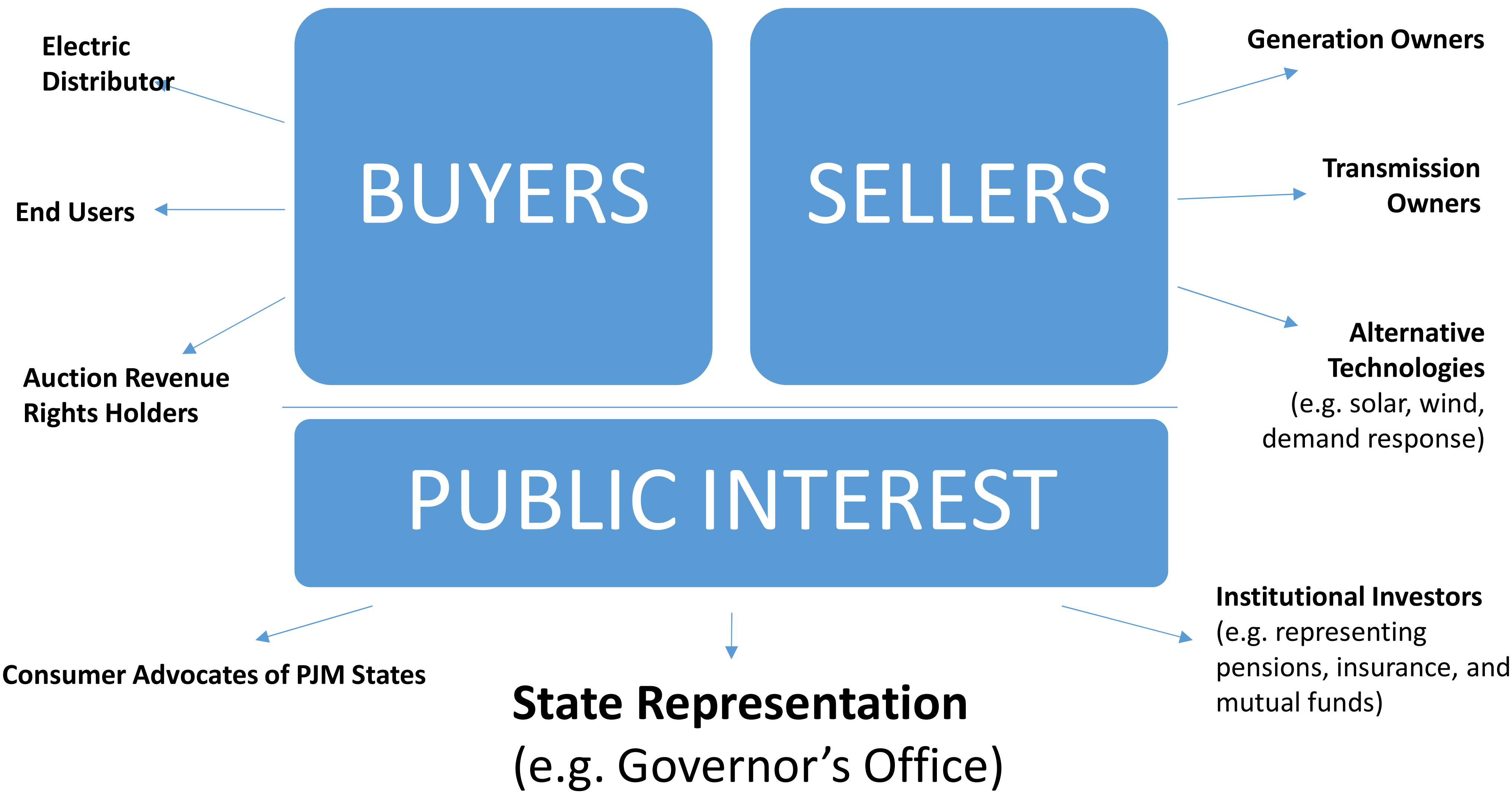
- **How?** The questions isn't "whether" increased state involvement is needed, rather what is the best "method" to enhance state involvement?

***Theory** – will greater involvement increase state understanding of issues, reduce impacts of political offensive, and reduce distortionary state policy?*

# Idea: Public interest can be buy and sell side balanced

**Exploring an Enhanced Stakeholder Construct**

Realigned Sectors and Enhanced Public Interest and Accountability Mechanisms



# Concepts for FERC-Level Reforms

# Top Issues of Concern

- **Stakeholder Process Issues**
  - **Fair Representation**
    - Voting sector do not reflect stakeholder diversity
    - Low participation rates a reflection of high participation cost and vote dilution?
  - **Neutrality**
    - Structural bias – rule changes between lower and higher-level committees afford advantage to large, incumbent firms.
      - Setting the solution agenda
    - Lack of lower-level transparency
- **Public Interest Protection and the Role of States**
  - this issue also goes beyond stakeholder process reform and to broader governance issues.

**Table 5**
Framework for Existing and Proposed FERC Guidance for RTO/ISO Governance Principles and Criteria.

| FERC RTO/ISO Governance Principles and Criteria | | | |
|---|---|---|---|
| The Independence Principle | The Fair Representation Principle | The Neutrality Principle | The Responsiveness Principle |
| ISO should be [operationally and financially] independent of any individual market participant or any one class of participants **(Order 888)** | "A governance structure that includes fair representation of all types of users of the system would help ensure that the ISO formulates policies, operates the system, and resolves disputes in a fair and non-discriminatory manner." **(Order 888)** | Governance should be structured in a fair and non-discriminatory manner. The ISO's rules of governance…should prevent control, and appearance of control, of decision-making by any class of participants. **(Order 888)** | RTOs and ISOs must provide an avenue for customers and other stakeholders to present their views on decision-making to the board, and to have those views considered. **(Order 719)** |
| | | Criteria | |
| RTO/employees/directors - no financial interest in market participants **(Order 2000)** | *Voting Sectors Should Reflect Stakeholder Diversity* | "The business practices and procedures must ensure that the interests of customers or other stakeholders are equitably considered and that deliberation and consideration of RTO and ISO issues are not dominated by any single stakeholder category." **(Order 719**, *originally referred to as criteria #2 for responsiveness*) | "The business practices and procedures must ensure that any customer or other stakeholder affected by the operation of the RTO or ISO, or its representative, is permitted to communicate its views to the RTO's or ISO's board of directors.'" **(Order 719)** |
| Decision-making [Board] process that is independent of control of market participants or class of market participants **(Order 2000)** | *Participation Rates Should be Monitored and Per Sector Minimums Achieved* | *Enhance Public Transparency* | "The business practices and procedures must provide for stakeholder input into the RTO's or ISO's decisions as well as mechanisms to provide feedback to stakeholders to ensure that information exchange and communication continue over time." **(Order 719)** |
| RTO must have exclusive Federal Power Act 205 rights over tariff **(Order 2000)** | *Greater Clarity Provided About the Role of the States (i.e. who speaks for the state, how to give the state a unique voice, how often to consult with the state, when to relay perspectives to the Board).* | *Structurally Neutral Process Design* | "The business practices and procedures must ensure that, in instances where stakeholders are not in total agreement on a particular issue, minority positions are communicated to the RTO's or ISO's board of directors at the same time as majority positions." **(Order 719)** |
| | | *Monitor Administrative Neutrality* | Post mission statement and charter on website **(Order 719)** |
| | | | *Establish Issue Prioritization Procedures* |
| Regular = Explicit | Underlined = Implied | *Italicized* = Proposed | *Establish Issue Expedition Procedures* |

# Areas of Improvement in FERC Regulation

| FERC ISO/RTO Governance Principles | | | |
|---|---|---|---|
| **Independence** | **Fair Representation** | **Neutrality** | **Responsiveness** |
| Principle - Financially and operationally independent from market participants. ***(Order 888)*** | Governance structure must include fair representation of all types of users of the system. ***(Order 888)*** | Governance structure should be fair and non-discriminatory, prevent control or appearance of control over decisions by any class of market participants. ***(Order 888)*** | RTOs and ISOs must provide an avenue for customers and other stakeholders to present their views, and to have those views considered. ***(Order 719)*** |
| (1) RTO/employees/directors - no financial interest in market participants ***(Order 2000)*** | SECTORS REFLECT STAKEHOLDER DIVERSITY | Fairness in balancing diverse interests ***(Order 719)*** | Consumer and Stakeholder Inclusiveness ***(Order 719)*** |
| (2) Decision-making process that is independent of control of market participants or class of MPs ***(Order 2000)*** | PARTICIPATION RATES | Publicly post mission/charter, guiding principles, and commitment to consumers/stakeholder responsiveness ***(Order 719)*** | Ongoing responsiveness ***(Order 719)*** |
| (3) RTO must have exclusive 205 rights over tariff ***(Order 2000)*** | ROLE OF THE STATES | TRANSPARENCY | Representing Minority Positions ***(Order 719)*** |
| | | STRUCTURALLY NEUTRAL | PRIORITIZATION |
| | | ADMINISTRATIVELY NEUTRAL | EXPEDITION |

# Rational actions, but not likely…

- **FERC unlikely to reform governance rules that apply to all RTO/ISOs.**

- **PJM could launch an evaluation and reform process**
  - Also, PJM user group could recommend development of a “special team” on governance
  - Highly unlikely to lead to significant reforms unless PJM is prepared to file FPA section 206.

- **FERC should require** PJM (& other RTO/ISOs) to review and evaluate governance process, implement beneficial changes.
  - Should require future evaluations at regular intervals.
  - Refine rules - “ongoing responsiveness” principle of FERC Order 719

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# QUESTIONS