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BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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IN THE MATTER OF: : Docket Numbers:
REVIEW OF MARKET MONITORING POLICIES : AD07-8-000
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Hearing Room 2C
Federal Energy Regulatory
Commission
888 First Street, NE
Washington, DC

Thursday, April 5, 2007

The above-entitled matter came on for technical
conference, pursuant to notice, at 9:10 a.m.

BEFORE:
JOSEPH T. KELLIHER, Chairman
FERC COMMISSIONER

1 APPEARANCES :

2 COMMISSIONERS PRESENT :

3 CHAIRMAN JOSEPH T. KELLIHER

4 COMMISSIONER SUEDEEN G. KELLY

5 COMMISSIONER MARC SPITZER

6 COMMISSIONER PHILIP MOELLER

7 COMMISSIONER JON WELLINGHOFF

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P R O C E E D I N G S

(9:10 a.m.)

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3 CHAIRMAN KELLIHER: This technical conference is
4 on Market Monitors in the organized markets. I believe this
5 is an important conference, and it's my hope that we can
6 help further clarify the role of market monitors, both what
7 they can do and what they cannot do.

8 The concept of market monitoring was initially
9 addressed -- well, was addressed in Order No. 2000, which
10 set the framework for the establishment of the organized
11 markets.

12 The basic approach towards market monitoring was
13 to let a thousand flowers bloom. Market monitoring was a
14 new concept, and the Commission recognized that regional
15 transmission organizations and independent system operators,
16 may develop along different lines.

17 Now, since Order No. 2000, about a dozen flowers
18 have bloomed. There are more than a dozen market monitoring
19 positions in the country, counting both the market monitors
20 in the organized markets and a handful of market monitors
21 that review the operation of individual utility systems in
22 the bilateral markets.

23 There is variety in the manner in which market
24 monitors operate and in the roles that they perform.

25 Now, two years ago, the Commission acted to

1 clarify the role of market monitors, by issuing the Policy
2 Statement on Market Monitoring Units.

3 We did so because we had developed some
4 experience with market monitoring. We also acted because we
5 were more mindful of the legal limits on the role of market
6 monitors.

7 Court decisions in the Electric Power Supply
8 Association decision, as well as U.S. Telecom, had raised
9 very legitimate questions about the relationship between the
10 Commission and market monitors.

11 Now, I believe the Policy Statement was an
12 important Order that provide more guidance on the role of
13 market monitors, however, the Policy Statement may have
14 provided more clarity on what market monitors cannot do,
15 than what they can or should do.

16 In light of the U.S. Telecom decision, I think
17 it's clear that market monitors cannot be enforcers in the
18 traditional sense. The Commission has no express authority
19 to delegate enforcement power to a market monitor or to an
20 RTO or ISO, for that matter.

21 I think the Commission is now more careful about
22 the limits on delegation, than previously.

23 Now, under some circumstances, a market monitor
24 can help an RTO or ISO administer its tariff, although that
25 role may vary, depending on whether the market monitor is

1 internal or external.

2 Now, frankly, I would have preferred that the
3 Commission define the role of market monitors by rulemaking,
4 rather than a Policy Statement two years ago, but that was
5 not the will of the Commission.

6 However, a policy statement does not impose an
7 obligation on the part of RTOs to act to conform their
8 market monitoring policies with Commission policy.

9 Initially, only PJM filed to conform its policies
10 with our Policy Statement. Recently, MISO has made a
11 filing.

12 However, market monitoring policies in a number
13 of regions, may actually be inconsistent with the
14 Commission's 2005 Policy Statement.

15 Now, there are a number of policy questions
16 before the Commission: One is whether the Commission should
17 initiate a rulemaking to establish the role of market
18 monitors.

19 If so, should we adopt the role defined in the
20 Policy Statement, or go beyond the Policy Statement and
21 provide even more clarity?

22 Now, in any proceeding to define the role of
23 market monitors, I think we should ask two fundamental
24 questions: First, what should the role of market monitors
25 be; and second, what can the role of market monitors be?

1 Now, in a perfect world, the answer to both of
2 these questions would be the same, but they may not, given
3 the legal limits on the relationship between the Commission
4 and market monitors.

5 If these questions elicit different answers, then
6 I think we must respect the legal limits. Now, as someone
7 who likes history, I'm tempted to assume that there's
8 nothing new under the sun, however, it does seem that market
9 monitoring is something new.

10 I've searched for a regulatory model for market
11 monitors and have been unable to find a satisfactory model.

12 The organized markets have some attributes of
13 securities and commodities exchanges, but the exchanges are
14 self-regulating organizations that have legal authority to
15 set and enforce rules.

16 Neither RTOs nor market monitors, have that
17 authority.

18 Analogies have been drawn to inspectors general
19 at federal agencies, but that analogy also fails, because
20 inspectors general, unlike market monitors, are government
21 officials entrusted with governmental responsibility and
22 authority.

23 Now, if we were to reach the conclusion that it
24 is necessary that market monitors have a robust enforcement
25 role, a traditional enforcement role, then it is possible

1 that the only way to reconcile that conclusion with the
2 legal limits on our relationship with market monitors, is if
3 market monitoring becomes a Commission function performed by
4 Commission Staff.

5 That may be the only way to avoid an improper
6 delegation of enforcement authority. Market monitoring
7 performed by the Commission, however, would be subject to
8 due process rules governing our decisionmaking, which do
9 take time.

10 Now, to be clear, I do not start from a premise
11 that it is necessary that market monitors have a robust
12 enforcement role.

13 I believe their greatest contribution can be in
14 improving the performance of the organized markets --
15 identifying possible market manipulation and exercise of
16 market power; making referrals to the Commission for
17 enforcement action; analyzing the operation of RTO markets,
18 and identifying possible market rule changes.

19 Earlier this year, the Commission initiated an
20 effort to improve the competitiveness of wholesale power
21 markets, both the bilateral markets and the organized
22 markets.

23 I believe that the technical conference today is
24 part of this effort, since, to the extent we strengthen our
25 market monitoring policies, we can improve the

1 competitiveness of the organized markets.

2 I look forward to hearing the views of my
3 colleagues, as well as the panelists. Colleagues? Jon?

4 COMMISSIONER WELLINGHOFF: Thank you, Joe. I
5 think this is a very important conference and I'm glad that
6 you called us together.

7 And just to respond to some of your comments in
8 your opening statement, I think that the Commission
9 definitely should look at the issue of a rulemaking or
10 clarifying our policy.

11 I think that it is time, certainly, to look at it
12 from the standpoint of the role of the market monitor, to
13 this issue of the enforcement rule.

14 I am very interested in exploring the possibility
15 of different alternatives, which would include one
16 alternative that you mentioned, which would be actually
17 institutionalizing it in Commission Staff. I think that's
18 something that we definitely should explore. I'd be very
19 interested in exploring that.

20 I think, to go to your flower analogy, perhaps
21 it's time to pick the roses and discard some of the wilted
22 daisies. With that, I'm very anxious to hear from our
23 panelists, thank you.

24 CHAIRMAN KELLIHER: Commissioner Spitzer?

25 COMMISSIONER SPITZER: Thank you, Mr. Chairman.

1 The U.S. Telecom decision posed some significant analytical
2 issues for me with regard to enforcement.

3 With hindsight being 20/20, I probably spent too
4 much time analyzing the enforcement and the question posed
5 as to how government imposes sanctions.

6 I do believe there is a lot of sound advice we
7 can receive from the panel and from my colleagues on the
8 technical and economic aspects of RTO management, and I
9 think the -- as the Chairman pointed out, if we divide
10 economic and operational issues from enforcement issues, we
11 can get a lot of benefit out of today's conference, and
12 leave for rulemaking, which I think is appropriate, the
13 question as to FERC enforcement issues that are ultimately -
14 - that are initially raised by market monitors, but
15 ultimately enforcement resides with the United States
16 Government.

17 So I look forward to the conference, and
18 particularly elaboration on some of the improvements to the
19 economic functioning of these markets.

20 You've got a wide variety of RTO functions, a
21 wide variety of monitoring functions, and this may be an
22 opportunity to analyze some of the best practices, so I'm
23 very attentive and look forward to the discussion today.

24 CHAIRMAN KELLIHER: Thank you. Commissioner
25 Kelly?

1 COMMISSIONER KELLY: Thank you. First of all, I
2 want to ask what happened to spring?

3 (Laughter.)

4 COMMISSIONER KELLY: Yesterday was wonderful,
5 today or winter coats are out, and I personally think that
6 it is the statement from the gods that they are displeased
7 with the fact that our local teams and your local teams lost
8 in the NCAA finals.

9 (Laughter and discussion off the record.)

10 COMMISSIONER KELLY: I think that what we are
11 doing today, is one of the most important thing that FERC
12 will do all year, because what we're talking about is the
13 efficient and fair functioning of the electric utility
14 market.

15 And that is one of our three key and chief
16 objectives under the Federal Power Act, the functioning of
17 markets, the transmission of electricity, and reliability
18 standards.

19 Key to the efficient and fair functioning of
20 markets, is the market monitoring unit, so I thank you all
21 for coming here today. It's very valuable to have you all
22 together and have you give us your advice.

23 Market monitoring has evolved from a mere task,
24 as it was envisioned in Order 2000, which was issued shortly
25 before 2000, to a profession, a profession of great

1 importance to the electric industry and to the public.

2 It's a profession because it has a hallmarks of
3 profession. A profession is the organization of a body of
4 information and knowledge that's difficult to acquire and
5 that is very important to the public, and that's what we're
6 talking about here.

7 Market monitors acquire information that only
8 market monitors can acquire by being on the ground and on
9 the place the market.

10 That information is very difficult to acquire,
11 and we depend on it to ensure the integrity and appropriate
12 functioning of our markets.

13 While the market monitoring has evolved into a
14 profession, our policies, our tariffs, our regulations, have
15 lagged a bit behind, and it's time for them to evolve, too.

16 I think our goal here today is to determine what
17 the objectives of market monitoring are. Our Staff has done
18 a review of what market monitors do across the country --
19 not necessarily because it's in the tariff or in the
20 regulations, but it's what they do.

21 And that's very instructive. I think that what
22 they do, is what they should do, and I think that we should
23 be here today to get a consensus on that.

24 So, what do they do? They enforce; the detect
25 and respond to questionable actions by market participants;

1 the mitigate; they take action designed to change market
2 behavior that appears to be problematic and that needs to be
3 done immediately.

4 They provide advice, both real-time advice and
5 strategic advice. They are neutral actors who recommend
6 actions and policy changes based on immediate observations
7 and/or based on market research.

8 These are important tasks and I think we should
9 enshrine them, not only in policies, but in tariffs and in
10 regulations.

11 In general, delegation of decisionmaking
12 authority from Congress to the Executive, is permissible, as
13 long as the delegation is accompanied by the intelligible
14 principle.

15 Although it's not exactly the same, the
16 Congressional delegation cases form the predicate for
17 evaluating sub-delegations. That's the legal branch given
18 to executive agency delegation to a subordinate agency or a
19 non-federal entity.

20 The recent decision out of the United States
21 Court of Appeals for the D.C. Circuit, United States Telecom
22 vs. FCC, examines this sub-delegation doctrine in a
23 situation like that found in the Federal Power Act, in which
24 the agency statute is silent about permissible delegations
25 to non-federal entities.

1 The Court, in U.S. Telecom, held that executive
2 agencies are prohibited from sub-delegating their
3 decisionmaking authority to non-federal entities, when the
4 agency's enabling statute does not specifically provide for
5 sub-delegation, except -- and this is an important exception
6 -- in three limited circumstances:

7 The one exception to the sub-delegation rule
8 established in U.S. Telecom, which is relevant here, allows
9 for permissible delegations where agencies provide a
10 reasonable basis for granting limited discretion to a non-
11 federal entity.

12 Another decision in the D.C. Circuit, in Perot
13 vs. FEC, set the standard for evaluating agency sub-
14 delegations to regulated entities charged with
15 implementation of agency regulations and tariffs.

16 In Perot, the Court found that agencies regularly
17 leave some discretion to those entities regulated by the
18 agency, and that as long as the agency's regulations
19 establish objective criteria for application of discretion
20 and there is review by the agency of a regulated entity's
21 compliance with the agency's regulation, the agency has not
22 impermissibly sub-delegated its authority.

23 That's a valuable lesson for us here. To the
24 extent that market monitors are necessary to ensure that the
25 market behaves efficiently in the real time, and to the

1 extent that that requires them to do some, quote/unquote
2 enforcement, it is not only permissible, but, in my view,
3 very important to give them the ability to do that.

4 The law supports it. My experience in
5 California, being at the California ISO in 2000, also drives
6 me to this conclusion. Being there and watching the
7 inability of the market monitors to do anything to stop the
8 decline of the market, was exceedingly frustrating.

9 Those market monitors had no authority to do
10 anything.

11 In allowing market monitors to exercise
12 discretion, it is important, however, to ensure that the
13 Commission has provided objective criteria in the tariff for
14 implementation of the tariff provision; that the tariff or
15 the Commission has provided a reasonable basis for giving
16 the entity discretion in applying the tariff provisions; and
17 that discretionary actions by non-federal entities, are
18 subject to review by the Commission.

19 I'm not here to be a proponent for massive sub-
20 delegation of authority to market monitors, but I am here to
21 be an advocate for -- if we call it delegation, then so be
22 it -- giving market monitors the authority to nip in the
23 bud, behavior that's necessary to keep -- to be stopped to
24 keep the market functioning.

25 Having to delay and call FERC, sometimes presents

1 a problem, and in those emergency situations, I think that
2 we should set up tariffs, policies, and rules that allow
3 market monitors to do what we need them to do.

4 The other actions that market monitors have
5 taken, providing advice in real-time and providing strategic
6 advice, is also important.

7 The kind of knowledge that market monitors obtain
8 because of their day-to-day activities, is knowledge that no
9 one else can obtain.

10 And that expertise shouldn't go to waste; it
11 should be used to help the public and help us ensure that
12 the markets stay functioning fairly and efficiently.

13 So, how do we achieve these objectives? Well, I
14 think that a model -- as Joe has also looked for models, I
15 have also looked for models, and one model that seems likely
16 to be helpful to me, is codes of professional
17 responsibility.

18 Those codes of professional responsibility, spell
19 out the job responsibilities of the professional and how the
20 professional deals with potential conflicts between his
21 responsibility to his client, his responsibility to non-
22 clients, his responsibility to the public, and his
23 responsibility to the institution.

24 I think that we can do that. We can talk about
25 the market monitor's responsibility to his employer, the RTO

1 or the ISO, but also talk about the responsibility to the
2 management of the RTO, to FERC, as the enforcer and primary
3 enforcer of market rules, and to the public, in general, as
4 well as to the institution which we hope to foster, of a
5 fair and efficient market.

6 There are potentially contradictions or
7 difficulties that market monitors have to handle, potential
8 conflicts of interest, particularly in the acquisition of
9 information and the communication of information.

10 In order to do that, market monitors, like
11 doctors, like lawyers, like accountants, need to have
12 enshrined in their code of professional responsibility, some
13 independence for their ability to exercise their expertise
14 and to provide us with the value that their expertise gives
15 us.

16 So I think that we need to look for tariff
17 provisions, rules, and policies that give us a structure to
18 ensure that market monitors have the information necessary
19 to do their jobs, but, at the same time, the independence
20 necessary to do their jobs, and to also provide that market
21 monitors have the knowledge, the character, and the
22 integrity to do their jobs, and, finally, to look for a way
23 to maximize the benefit of the expertise that they develop,
24 so that it can redound to the benefit of the public. Thank
25 you.

1 CHAIRMAN KELLIHER: And Commissioner Moeller will
2 be joining us later today, and he'll have an opportunity to
3 make an opening statement when he arrives, and, our
4 colleague, Fred Butler, is here on the first panel, and we
5 have at least one other state colleague, Commissioner Dallas
6 Winslow from the State of Delaware, is here. If you could
7 stand for a moment? Where is he? There he is. Thank you,
8 sir.

9 Are there any other state colleagues here? Fred?
10 Judge Christie is here, okay, perfect. Laura Chappelle is
11 here, and Chairman Larson may be here later today, from the
12 Maryland Commission. Good, so we have a number of our
13 colleagues here. Thank you for joining us.

14 Why don't we start. Steve, do you have any
15 comments to make before we go?

16 (No response.)

17 CHAIRMAN KELLIHER: Panelists, you actually have
18 a relatively short period of time for your written
19 statements.

20 We usually are more relaxed towards our state
21 colleagues, but that is because we really want to have a
22 dialogue with you, rather than hear long prepared
23 statements, and any written statements you provided, are in
24 the record.

25 So, I will be the good cop; Steve will be the bad

1 cop and enforce the time limits. So, with that, why don't
2 we turn to our first panelist, and that is Robert Michaels,
3 Professor Economics, California State University. Thank
4 you.

5 MR. MICHAELS: Thank you, Chairman Kelliher, for
6 allowing me to be here. Electricity restructuring has been
7 a particularly problematic deregulation, for many reasons,
8 but I think that possibly the most important, is that we
9 brought new institutions with it that we really had no
10 understanding of when they came into being.

11 We took the industry's most important asset, put
12 them under the hands of nonprofit organizations; we took the
13 monitoring function, in a rather ad hoc way, and it somehow
14 became universal.

15 For those who do not recall, monitoring, as we
16 have been reminded, was not the outcome of a rulemaking.
17 Monitoring came about as a tactic in the California
18 restructuring when there were problems with the California
19 companies not being qualified for market-based rates.

20 Suddenly, we wound up with a situation where
21 there were approved monitors who were required for
22 everything, but nobody quite knew what "approved" meant. It
23 seemed that every size fit all.

24 You had some RTOs with employees, some were
25 appointed, and some with consultants, single, multiple.

1 As Chairman Kelliher said, we could not analogize
2 this to securities exchanges and we couldn't really say that
3 localization was going to be a good answer, either.

4 Answers about data familiarity, the counter is
5 politics. Questions that we know from my recent research
6 about the way the different RTOs have treated virtual
7 bidding and the fact that there were clearly political
8 elements --

9 What do we know? We know that, as the Chairman
10 said once, are these cops? Are these professors? We know,
11 legally, they're not cops, but they don't also seem to be
12 professors.

13 Have you ever seen a market monitoring
14 organization that had a minority report? If these are
15 markets which we understand very little about, in many cases
16 --

17 The arguments for decentralization, probably
18 aren't really there. The idea that this is a way of
19 spreading ideas or this is the way that the monitoring
20 organizations can learn from others, I simply haven't seen
21 that.

22 So, as a policy matter, I would ask you this:
23 Right now you have two-thirds of the nation under RTOs, you
24 have the remaining one-third under something or other.

25 You can't impose localization of monitoring on

1 the remaining one-third. What do we do?

2 The difficulty that we're facing, is that
3 competition, let's face it, has fallen on hard times. What
4 we need to have, is something more uniform, something that's
5 going to give us an idea of what really works and doesn't,
6 competitively, a single voice or something approximating
7 single standards.

8 It is time, in other words, for us to rethink
9 localized monitors completely, and establish a rulemaking at
10 the Commission.

11 CHAIRMAN KELLIHER: Thank you very much. I'd
12 like to now recognize the Honorable Fred Butler, Frederick
13 Butler, Commissioner of the New Jersey Board of Public
14 Utilities. And you are entrusted with, among other things,
15 protecting the rates of my parents, who live in northern New
16 Jersey.

17 (Laughter.)

18 COMMISSIONER BUTLER: Duly noted, Mr. Chairman.

19 (Laughter.)

20 COMMISSIONER BUTLER: Thank you. Before I begin,
21 I just want to say thank you to you for doing this, and that
22 New Jersey will be submitting written comments within the
23 time period stipulated. Thank you.

24 I'm going to be speaking from the New Jersey
25 perspective, but trying to be global in my treatment of RTOs

1 and market monitoring units, MMUs.

2 Almost forcibly, I will probably be referring to
3 the one I know the best. We see this as -- the market
4 monitoring function, as a fundamental practice to ensure
5 just and reasonable rates under the Federal Power Act, and
6 also providing a necessary element of confidence in the
7 markets, for energy consumers, market participants, and
8 regulators, alike.

9 In both traditional and restructured markets, the
10 role of the monitor is critical to ensuring that despite
11 structural conditions, the ultimate prices that clear the
12 markets, are, indeed, just and reasonable.

13 The market monitoring function should not only
14 serve as the Commission's eyes and ears in the field, but
15 also ensure the flow of free information to stakeholders, as
16 well as to the Commission.

17 With this in mind, I'd like to suggest a few
18 fundamental MMU characteristics and duties, which, if
19 accepted as valid, and if that list is anywhere near valid,
20 it should suggest to this Commission, the necessary
21 independent configuration that would optimize the
22 functioning of any MMU:

23 One, the scope of MMU monitoring and intervention
24 activities, must be broadly defined and independently
25 directed.

1 True market monitoring necessitates broad
2 latitude to evaluate market participant behavior, and to
3 impose Commission-approved mitigation when such behavior is
4 deemed anticompetitive.

5 The specific metrics employed, the conditions
6 requiring their application, and the specific mitigations,
7 should be independently determined by that MMU, subject to
8 Commission approval.

9 It is therefore essential that market
10 participants be required to submit all data that the MMU
11 deems necessary to the execution of its duties.

12 Point Two: The MMU monitoring activities must
13 also include the operations of the RTO itself. The MMU must
14 be entrusted with regular monitoring of all RTO activities,
15 including markets and transmission system design and
16 operations, and must be free to recommend design and/or rule
17 changes, directly to the Commission and without RTO
18 preapproval.

19 The same rules should apply also to analyses of
20 mergers and acquisitions among market participants. And
21 independent MMU can provide the Commission and other
22 stakeholders, whenever appropriate, with their partial
23 expert sources of information and suggest improvements to
24 the market design and operations.

25 Point Three: MMUs should also be responsible to

1 state regulatory commissions and their request for data and
2 expert analysis.

3 It's impossible for state commissions and staff
4 to have the expertise that a market monitor has, and they
5 should be informed of activities of the market monitor that
6 are of importance to them, such as referrals to the
7 Commission.

8 Establishing an effective MMU, is the second part
9 of my comments, and then I'll just close quickly with an
10 observation.

11 We believe that execution of the duties that I
12 listed, is only allowed when there's complete independence
13 of the market monitoring function.

14 Point One: The MMU must be guaranteed, through
15 Commission Orders and/or the RTO tariff, full independence
16 from all sources of inappropriate influence. Independence
17 must include daily monitoring and intervention activities,
18 the conduct of investigations, rendering of findings,
19 recommendation and other reporting activities, free from
20 influence and censorship by either the RTO or the market
21 participants.

22 The integrity of the MMUs' material and human
23 resource infrastructure -- Point Number Two -- must be
24 guaranteed to ensure reliable and independent execution of
25 responsibilities.

1 The MMU must have independent control over
2 development and expenditure of its budget, its data, its
3 databases, its personnel, and the retention of legal counsel
4 and consultant services, whenever necessary.

5 Point Three: The market monitor must be afford
6 substantial job security. The MMU must be subject to
7 removal, only for just cause, defined as failure to perform
8 tariff-specific duties.

9 Termination of the monitor must not be a
10 prerogative of the RTO, and market monitors should
11 ultimately be accountable to government regulators, whether
12 to this Commission, exclusively, or a joint FERC-state
13 utility commission body, which I would recommend
14 consideration of.

15 The externalization of market monitor functions
16 from the RTO, which I think you're going to hear more about
17 later today, has been suggested by some folks as a
18 sufficient solution for concerns over market monitoring unit
19 independence.

20 We do not agree. Such externalization of market
21 monitoring functions, per se, could actually facilitate
22 greater control over monitoring the activities by the RTO.

23 External MMUs are one step further removed from
24 the immediate access to data and system operations that they
25 need to perform their duties. In addition, the external MMU

1 design allows for the managerial prerogative of terminating
2 the market monitor through non-renewal of a consulting
3 contract by that RTO.

4 The implied threat of non-renewal provides a
5 significant and unjustified measure of control over the
6 market monitoring work product.

7 In sum and in conclusion, we view it that the
8 desired characteristics and duties of an ideal market
9 monitor, can only be undertaken by a truly independent
10 agency.

11 This agency must be governed separately from the
12 RTO, and perhaps, in fact, exist, as pointed out earlier by
13 you, Mr. Chairman, as direct employees of the federal
14 Commission, where oversight would be exercised by the entire
15 Commission or that joint federal board.

16 Doing such a configuration, we believe, would go
17 a long way towards inspiring the necessary degree of
18 confidence in markets. Thank you.

19 CHAIRMAN KELLIHER: Thank you very much, Fred.
20 I'd like to now recognize Benjamin Hobbs, a member of the
21 CAISO Market Surveillance Committee, and Professor of
22 Geography and Environmental Engineering, Johns Hopkins
23 University. Welcome.

24 MR. HOBBS: Thank you, Mr. Chairman. I'm going
25 to talk about what is a unique structure among U.S. RTOs,

1 which is the existence of a separate market surveillance
2 committee that's external to the RTO, which complements the
3 activities of the Department of Market Monitoring within the
4 California ISO.

5 I see a fundamental issue in the design of market
6 monitoring institutions as being the contradiction between
7 the need for independence, both real and as perceived by
8 stakeholders, and the need for an insider's close
9 familiarity with the day-to-day workings of the market.

10 A purely external monitor lacks day-to-day
11 interaction with operators, and may miss or react slowly to
12 behavior that an internal monitor could jump on.

13 I think we need -- well, the metaphors are boots
14 on the ground or an ear to the ground, the combination of
15 which is a rather peculiar mental image, I guess you would
16 agree.

17 (Laughter.)

18 MR. HOBBS: On the other hand, ISO management
19 might constrain in various ways, the independence of an
20 internal monitor. They're independent to tell FERC and the
21 market, three types of bad news that ISO management may not
22 care to hear:

23 That folks are behaving in a naughty way, market
24 participants; that ISO operator decisions are hurting
25 efficiency; or that market performance is poor.

1 My strong impression is that such constraints are
2 not a problem at the California ISO, in part, because of
3 excellent working relationships with management and the
4 Department of Market Monitoring, but that depends on the
5 personalities in the positions.

6 And so, personalities could change and the
7 pressures could change, and so, I think that, structurally,
8 we need something to ensure independence.

9 One approach is to have elements of both. The
10 California ISO system is a unique one. Actually, the only
11 other system like it in the world, was in the Netherlands,
12 consisting of a Department of Market Monitoring and a
13 complementary external advisory market surveillance
14 committee.

15 Our MSC consists of three independent outside
16 experts -- myself, Jim Bushnell, and the Chair, Frank
17 Wallach. We meet every other month, provide independent
18 advisory committees to FERC, ad hoc advice to the ISO, and a
19 forum for stakeholders to discuss market issues, including
20 the ISO's running of the market.

21 We complement the internal Department of Market
22 Monitoring, in two ways: Through our independence and our
23 expertise, which is informed by engineering and economic
24 theory, experience in other markets, as well as markets for
25 other commodities.

1 This independence and expertise is useful in
2 several ways: For example, meetings and forums where
3 stakeholders provide feedback on the ISO's operations in the
4 markets. We also provide other perspectives to the ISO, to
5 FERC, and market participants, on both important enforcement
6 issues, but, more importantly, long-term market design
7 issues.

8 And as an example of where we have, for example,
9 differed from the ISO, in April of 2002, the ISO Board of
10 Governors recommended a \$108 damage control cap on bids.

11 We disagreed, and in May, we recommended a \$250
12 cap as being more realistic and likely to result in better
13 market functioning, and FERC went along, or at least cited
14 our opinion as supporting their recommendation for \$250.

15 There was a lot of bluster and criticism in the
16 press of the political motives of FERC and other parties. I
17 felt what was really notable, though, is that none of this
18 was directed at the MSC or, in particular, at our Chairman,
19 Frank Wallach, and I think that's largely because Frank is
20 widely respected for his integrity and independence, and I
21 think that's very important.

22 To sum up, I think our existence can help balance
23 this tension between the need for independence and the need
24 to be inside and understanding what's going on day-to-day.

25 We can help, if, for example, sometime in the

1 future, there was implicit or other pressure on the
2 Department of Market Monitoring by ISO management, say, to
3 tone down conclusions. I'm certainly not saying that's
4 happening now.

5 I am saying, though, that the structure of the
6 system is such that there is that danger.

7 An obligation to report to us and FERC and our
8 ability to raise issues freely, I think, provides a check on
9 the ability of management to keep important issues from
10 being acknowledged and openly discussed.

11 Thank you.

12 CHAIRMAN KELLIHER: Great, thank you. I'd like
13 to now recognize the Honorable Bob Nordhaus, Robert
14 Nordhaus, a Member of Van Ness Feldman, former General
15 Counsel of FERC, former General Counsel of the Department of
16 Energy, and one of the original members of the Market
17 Surveillance Committee, I believe.

18 You have a unique perspective. You understand
19 the world we live in, and you understand the world that
20 we're examining today. Bob?

21 MR. NORDHAUS: Thank you, Mr. Chairman. This is
22 one of these peculiar missions, to give historical
23 perspective, but let me just start out by saying that the -
24 - I served as a member of the California ISO Market
25 Surveillance Committee during the first three years of the

1 operation of the ISO.

2 It was very much a shakedown period, and shook
3 down rather radically in 2000 and 2001. The independent
4 Market Surveillance Committee was set up, in large part
5 because of concerns with the stakeholder governing board of
6 the California ISO.

7 And in the early years, there were -- there was
8 quite a bit of difficulty in establishing the independence
9 of the Market Surveillance Committee.

10 There are instances where the ISO management had
11 bottled up reports and numerous instances when they
12 certainly didn't take our advice.

13 I think that one of the important developments
14 since then, is that the authority of both the internal and
15 external market monitoring units, has at least to gather
16 information and make reports and for the external monitors
17 to act independently, has been fairly well established.

18 And that portion of that aspect of market
19 monitoring, seems to be working considerably better than it
20 did in the early years.

21 I think the real questions that the Commission
22 faces today, are less what the market monitors do with
23 respect to monitoring, as such, than what is their role in
24 market intervention and enforcement?

25 And I would suggest there that at least as far as

1 market intervention -- and that is the ability to step in
2 and change -- to modify bids or to, in effect, modify a
3 market clearing price before transactions are executed -- is
4 very important.

5 It seems to me quite consistent with the
6 underlying theory of utility regulation, and that is, if
7 it's set out in the tariff, the utility has the obligation
8 to carry out the tariff, and that does not constitute a sub-
9 delegation that is impermissible under federal law.

10 With respect to enforcement, as such, that is,
11 levying sanctions after a violation has been discovered, I
12 think that raises some additional issues, but I think that
13 as you sort of look at the history of practice with respect
14 to FERC and FPC regulation, there's been a long history of
15 allowing regulated entities to impose sanctions in the form
16 of overrun penalties in the curtailment area; imbalance
17 penalties; scheduling penalties, so that I think the
18 practice and I think the theory of utility regulation, would
19 admit some limited authority certainly to enforce a tariff
20 and to impose these types of penalties that are specifically
21 set out in a tariff.

22 And, with that, I'll stop.

23 CHAIRMAN KELLIHER: Thank you. I'm going to
24 assume Commissioner Moeller is going to join us before this
25 panel breaks, and operating on that assumption, I think that

1 gives us 12 minutes each, and that's eating into the break a
2 little bit, and if Commissioner Moeller does not arrive,
3 we'll happily chop up his time and we can have a second
4 round of short questions.

5 So, why don't I start, and if there's a way to
6 set the clock at 12 minutes or someone wave me off when --
7 tell me when 12 minutes has expired. Steve, you're still
8 the bad cop with us, okay, not just the panelists, but with
9 us; otherwise, it's going to be a long day.

10 I'd like to follow up on what Bob said, and I
11 agree that a regulated entity can administer a tariff, and
12 the tariff can provide for penalties, especially when the
13 violations are objectively defined in the tariff.

14 I think it's much harder to have a tariff
15 provision that is completely subjective. It seems like
16 something like market manipulation is hard to define
17 objectively. It's something that we have defined, really,
18 to be something subjective. It's very much a fact-intensive
19 determination.

20 But I agree that a regulated entity can
21 administer a tariff and can collect penalties under that
22 tariff, and I think that's reflected in our Policy
23 Statement.

24 But part of the question is, well, what is the
25 market monitor? The regulated entity is not the market

1 monitor; it's the RTO.

2 The RTO is a public utility, so, to the extent
3 the market monitor is part of the RTO, they are part of a
4 public utility, and it seems they can help administer the
5 tariff.

6 But if the market monitor is external, what is
7 it? Is it -- it seems to be no more part of the public
8 utility than a law firm hired by the public utility would
9 be.

10 Do you think an external market monitor that
11 seems to have the same relationship with the utility as a
12 law firm would, can administer a tariff and collect
13 penalties?

14 MR. NORDHAUS: First of all, I'm not completely
15 familiar with the existing practice, but my understanding is
16 that it's fairly rare for an external -- it's certainly not
17 the case, as far as I know, with the Market Surveillance
18 Committee of the California ISO, but also the other external
19 monitors don't have the explicit enforcement authority that
20 the internal monitors may have.

21 But I think that even if they did purport to have
22 that authority, if they're acting as the agent of the
23 regulated public utility, as contractors can, that would
24 seem to me to be within the ambit of traditional utility
25 regulation, but if they are set up as independent entities

1 which impose penalties outside of the ambit of the
2 supervision of the regulated public utility, they're
3 independently enforcing the tariff, then I think that would
4 raise some questions.

5 But I'm not sure that, in the real world, that's
6 what any of the external monitors actually do. I'd be
7 interested in finding out.

8 CHAIRMAN KELLIHER: I think the MISO external
9 monitor, has some sort of role, but could a law firm collect
10 a penalty under a pipeline tariff, as an agent of the
11 pipeline?

12 MR. NORDHAUS: Our law firm would certainly
13 decline that.

14 (Laughter.)

15 MR. NORDHAUS: But you have, of course,
16 independent entities, decisional entities that are
17 recognized as having authority to make binding decisions, for
18 instance, arbitration panels.

19 It's a little more complicated, but I think that
20 you could perhaps devise a practice under which independent
21 entities are making the decision, which is then enforced by
22 the RTO.

23 I would think that you'd have to look carefully
24 at whether a fully-independent entity or individual could be
25 vested with the authority that it would otherwise be vested

1 with in a regulated public utility.

2 CHAIRMAN KELLIHER: I'd like to follow up with
3 Fred and Fred's description of, really, the independence of
4 a market monitor, and I believe, in you view, the necessary
5 independence.

6 If you look, it sounds like you're describing a
7 governmental function, a position where someone can only be
8 removed for cause, and, in effect, have a fixed term, and,
9 in effect, they serve the public interest or it seems that
10 their purpose is serving the public interest. That's your
11 charge, that's our charge here.

12 Someone who isn't otherwise accountable, perhaps
13 -- you seem to be describing a governmental function, when
14 you say "independent." We're independent within the
15 Department of Energy.

16 The operative words is more independent, rather
17 than within. I think that Bob would acknowledge that, that
18 FERC operates, really, largely independent of the Department
19 of Energy.

20 Do you think it should be a governmental role?
21 It seems to be a governmental role under your description.

22 COMMISSIONER BUTLER: First, Mr. Chairman, let me
23 recognize Chairman Larson, who is here.

24 CHAIRMAN KELLIHER: Mr. Chairman, thank you for
25 joining us.

1 COMMISSIONER BUTLER: I guess, by default, I am
2 describing a governmental agency. I am not sure that that
3 is the ideal place for it, but I see a tension here between
4 the necessary independence to perform the functions that the
5 market monitor needs to perform, and the need for
6 information and access, one of which is supplied by being in
7 the RTO, being there physically and operationally.

8 That's the information aspect of it, but the
9 other seems to be at odds with being inside the RTO.

10 Certainly, fiscally, they're beholden to the RTO.
11 It affects behavior. Almost by necessity, it would affect
12 behavior.

13 I've been at this eight years, and for a number
14 of those years, we've been out talking to new commissions
15 being established around the globe, about how to be
16 independent and do their jobs. A lot of what we're talking
17 about, are these kinds of things; being fiscally
18 independent; being managerially independent; performing your
19 job in an independent way, so that you make decisions that
20 may not be pleasant, may not be welcomed by all the
21 participants, but still having your job the next day.

22 That, I think, is the tension here, so perhaps we
23 are talking about a governmental type of agency, and, where
24 it's housed, to me, personally, again, now, this is just me,
25 one commissioner speaking here, is less important than that

1 independence and assuring that kind of access to
2 information.

3 If it can be done from within, okay; if it has to
4 be done somewhere else, perhaps here, then perhaps we should
5 look at that.

6 CHAIRMAN KELLIHER: Let me ask you, what is the
7 market monitoring role that demands the level of
8 independence, if you accept that the extent of the market
9 monitor being kind of an enforcement role, helping the RTO,
10 the regulated entity.

11 The market monitor is not the regulated entity;
12 the RTO is, and, to administer a tariff, do you accept that
13 they would actually work well together in that respect?

14 Is it identifying the need for rule changes? Is
15 it identifying problems in market operation, improvements in
16 market operation? Rule changes?

17 COMMISSIONER BUTLER: I think it's that, but I
18 also think it's interpreting the wording of that tariff. I
19 haven't read that tariff wording recently, but I've seen
20 more than one instance of disagreement over interpreting the
21 tariff language, as to whether there was, in fact,
22 manipulation, whether there was, in fact, some
23 anticompetitive behavior.

24 And I think the ability to say, no, this is our
25 independent observation and our independent conclusion, is

1 only allowed when you have a situation where there's fiscal,
2 managerial, and performance-based independence on the part
3 of the monitor.

4 CHAIRMAN KELLIHER: It seems that if you look at
5 the structure of market monitoring units, it seems there's
6 four options: One is purely internal, and that's the case
7 in PJM; another is that it's solely external -- MISO --
8 others where it's both internal and external; and a fourth
9 would be that it's a governmental function in some capacity.

10 The first three all exist to some extent. We
11 have three representatives from California. California has
12 both an inside and an outside function, and you seem to
13 suggest that you think that works reasonably well. Is that
14 the view of the Californians?

15 Bob, I don't know if you're actually from
16 California, but I'll put you in that category.

17 MR. NORDHAUS: Neither Ben nor I are physically
18 from California. I live in D.C. I'm from New Mexico, but I
19 think the arrangement in California, as it is presently --

20 CHAIRMAN KELLIHER: I'm sorry to interrupt, but,
21 Fred, your view is internal only, but independent.

22 COMMISSIONER BUTLER: I'm agnostic on whether
23 it's internal or external. I see problems with both and
24 advantages with both. I'm more focusing on making sure that
25 those functions can be done in an independent way and that

1 there's access to the information.

2 Let me just comment on something that I think Ben
3 said about personalities. You can set up a system that may
4 work well with the personalities involved today, but what
5 happens in two years or five years when the personalities
6 may change? I think that has to be considered.

7 CHAIRMAN KELLIHER: You're saying independence is
8 what's essential, and you're flexible on whether it's
9 internal, external, arguably both, or even governmental.
10 And the Californians believe that it can work with both
11 inside and outside?

12 MR. NORDHAUS: Could I just say that I think that
13 from the point of view of information-gathering and
14 reporting, both to the ISO Board and to FERC, it's very
15 helpful and perhaps essential, to have an external either
16 monitor or committee. I don't have any views on which is
17 better.

18 With respect to tariff administration and
19 potential levying of penalties, to the extent provided in
20 the tariff, it seems to me that that is really a role for
21 the regulated entity.

22 The reason I say that, is that it seems to me
23 that it is the regulated entity that is capable of being
24 supervised by FERC. The independent MSC, in our example, is
25 not. If we had tariff administration responsibilities and

1 strayed from the tariff, we're presumably not subject to
2 Commission regulation.

3 CHAIRMAN KELLIHER: I agree entirely.

4 MR. NORDHAUS: We're just some private citizens
5 who happen to get dragged into this. That, to my mind, is
6 maybe an appropriate division of labor.

7 CHAIRMAN KELLIHER: Thank you very much.

8 MR. HARVEY: Mr. Chairman, your time is almost
9 up.

10 CHAIRMAN KELLIHER: Let me make a statement in
11 the guise of a question for Mr. Michaels. You used my
12 analogy of cops. You didn't say cops and robbers, you said
13 cops and professors.

14 (Laughter.)

15 CHAIRMAN KELLIHER: It's useful, for me at least,
16 to look at it that way, but that doesn't mean market
17 monitors can't have some role. To me, they can't carry a
18 gun, they can't carry a billy club, but they can be in the
19 neighborhood watch; they can have a whistle; they can and
20 should make referrals to the Commission.

21 That is a role in enforcement, and if they see
22 wrongdoing, they can conduct some kind of investigation to
23 determine whether or not, actually, they think there is
24 wrongdoing, but they can make a finding that there's
25 wrongdoing and they can relay their suspicions to us.

1 That is some role and that is an important role,
2 but I ultimately think the law doesn't allow us to let them
3 carry a gun or a billy club or a badge. We can't really
4 deputize them.

5 MR. MICHAELS: If I could respond to that,
6 there's been one topic that simply has not been discussed
7 here, namely, who is likely to make the most accurate
8 decisions?

9 There seems to be a presumption here that all you
10 ned to do is give somebody a certain piece of information
11 and the right decision is going to be made and policy will
12 ensue.

13 I would start asking the question a different
14 way. The usual principle says to put the decision where the
15 information is, put the decision where there are persons who
16 can acquire the information that matters, who have a
17 motivation to utilize it efficiently.

18 That's really the question of, is that to be
19 localized or is it, in fact, better to be federalizing it?

20 That's really a question, because, if you assume
21 that the monitors can always operate almost flawlessly, the
22 real locus of where they are, matters a whole lot less.

23 CHAIRMAN KELLIHER: Thank you. Just one last
24 short comment, and that is -- and I asked you to be ruthless
25 and I hope you're not being soft on me, but I just want to

1 be clear that I don't think it's fair to lay the blame for
2 the California crisis, on the authority or lack of authority
3 of market monitors in California.

4 I think it also had to do with glaring weaknesses
5 in federal electricity law, that market manipulation wasn't
6 outlawed under federal electricity law. FERC really had no
7 enforcement authority.

8 I think we're ultimately accountable for
9 enforcement. Now we have the tools we need, but I don't
10 think those tools existed in 2000, so I think it was a
11 failure of law.

12 I don't want to blame Congress in 1935. They
13 didn't anticipate how electricity markets would evolve over
14 the following 70 years, and it's a little bit unfair to hold
15 them accountable.

16 Why don't I recognize Commissioner Moeller, if
17 you want to make an opening statement.

18 COMMISSIONER MOELLER: Thank you, Mr. Chairman.
19 I'll wait till all the questions have been asked.

20 CHAIRMAN KELLIHER: Colleagues, questions,
21 anyone? Commissioner Spitzer?

22 COMMISSIONER SPITZER: I just wanted to refine
23 some of the questions posed by the Chairman. Fred, I know
24 we're wrestling with this dilemma of independence versus
25 access to information.

1 How do you feel about the type of model in
2 California, where you have both, bearing in mind that how
3 the authority is delineated in California between the
4 external, which has, apparently -- what is it, monthly?

5 MR. HOBBS: Bimonthly, plus ad hoc forums.

6 COMMISSIONER SPITZER: PJM may require more
7 frequent meetings on external, but does that resolve the
8 dilemma of access to information versus independence?

9 COMMISSIONER BUTLER: I think that goes to my
10 concern about placing a check and balance on any undue
11 influence from participants in the market, if there is this
12 outside committee.

13 I guess there are different configurations you
14 could have -- representatives of FERC and the states on an
15 outside committee like that. It wouldn't necessarily have
16 to be public, just citizens or expert citizens, but that
17 would provide a check and balance on anything.

18 There would be an appeal process for anything
19 that might happen that would look like undue influence and
20 compromising of independence.

21 COMMISSIONER SPITZER: So then the external
22 function could provide some cover for a circumstance in
23 which the internal monitoring function, which has the access
24 to information, may feel reticent. Who wants to blow the
25 whistle on the boss?

1 COMMISSIONER BUTLER: Exactly.

2 COMMISSIONER SPITZER: That gives them some
3 protection, and you've got the outside folks; you've got --
4 there is no reason why it couldn't be a combination of both.

5 COMMISSIONER BUTLER: Not being that familiar
6 with the California process, at first blush, it looks like
7 something that might be of interest and might work.

8 I don't think you can equate independence with
9 externalizing. I think that's a mistake, for the reasons
10 that I've cited, so, perhaps if it stays within, you have
11 this sort of check-and-balance of the committee, the appeal
12 committee, the Market Surveillance Committee, that could
13 suffice.

14 COMMISSIONER SPITZER: Mr. Nordhaus, you
15 described the bifurcation between a mechanical application
16 of a tariff, which plainly would not involve a U.S. Telecom,
17 and then an independent sanction that might, that would
18 presumably be more severe than a simple tariff
19 administration and might involve independent findings of
20 fact and conclusions of law.

21 I can come up with some hypotheticals that are
22 gray areas. How would you analyze, maybe in a more refined
23 manner, the distinction between those two scenarios?

24 MR. NORDHAUS: I think where I come out, it's
25 pretty clear to me that the regulated entity not only has

1 the authority, but also the duty to carry out the tariff,
2 and if the tariff provides for sanctions for violating
3 provisions of the tariff, that those sanctions can be
4 administered by the regulated entity.

5 FERC, of course, has to determine that the tariff
6 is both just and reasonable. The question would be, in my
7 mind -- and I'm not quite sure what the answer is -- could
8 you give the RTO, the same breadth of authority to penalize
9 violations of the tariff or penalize market manipulation
10 that, for instance, a self-regulatory organization such as
11 NASD or the ERO, might have, where there's a specific
12 Congressional authorization to set up a self-regulatory
13 organization?

14 I'm not sure I know what the answer is. I think
15 that it's possible that you could, by tariff provisions,
16 give the regulated entity, that is, the RTO, some
17 significant discretion with respect to imposing sanctions on
18 market manipulation, if the level of the sanctions was
19 spelled out and there were general sanctions for what
20 constituted market manipulation.

21 I don't know what the answer to that is. I think
22 that the Commission, as a matter of policy, might well
23 decide, where we're talking about offenses against the
24 public interest, as opposed to failure to carry out specific
25 provisions of the tariff, as a matter of policy, we'd want

1 to reserve that for the Commission.

2 COMMISSIONER SPITZER: Do you think a market
3 manipulation sanction could be imposed by a market monitor,
4 that would not run afoul of the sub-delegation concept?

5 MR. NORDHAUS: It would depend. I don't think a
6 market manipulation -- the question as to whether a market
7 manipulation rule such as the one promulgated by the
8 Commission in response to the new rulemaking under the
9 Energy Policy Act, anything that broad and with as little
10 specific content, could be administered by a non-federal
11 entity.

12 COMMISSIONER SPITZER: It seems to me that a
13 clever lawyer could turn the entire violation into a
14 manipulation case, and that you would have a reductio ad
15 absurdum.

16 MR. NORDHAUS: Tariff violation can be a market
17 manipulation case, but if it's pursued as a tariff
18 violation, it seems to me that it's something that the
19 regulated entity can enforce.

20 The question is, could you build into a tariff,
21 sort of a general anti-market manipulation provision,
22 similar to what the Commission promulgated by rule last
23 year?

24 I'm not sure whether anything that general, could
25 pass muster as an enforceable tariff provision. I'm not

1 sure I have an answer to that.

2 COMMISSIONER SPITZER: Is there anything unique
3 to the process, that would cause you to be on one side of
4 the line or the other of the adjudicative process?

5 MR. NORDHAUS: With respect to what?

6 COMMISSIONER SPITZER: The determination of a
7 violation, as opposed to the imposition of the sanctions?

8 MR. NORDHAUS: The predicate of all of this, is
9 that any enforcement by an RTO, of a tariff provision, is
10 subject to supervision by FERC, so that if the adjudicatory
11 process that an RTO went through in order to determine
12 whether a violation of the tariff occurred, was flawed or
13 erroneous, there would be, by complaint or other mechanism,
14 an appeal to FERC and de novo examination, or, potentially,
15 de novo examination by the Commission of the RTO decision.

16 It seems to me that anything you do that's in the
17 context of tariff administration, is ultimately subject to
18 your review. I think the question is, when you get to a
19 fully independent entity that's not part of the regulated
20 public utility, is their decision in administration of the
21 public utility's tariff, something that is permissible?

22 Maybe, if there were adequate FERC supervision of
23 the result, but to me, it's fairly clear that if there's a
24 specific tariff provision, that there is authority for the
25 RTO, through its internal market monitoring unit, or through

1 its Board of Governors, to enforce the tariff, subject to
2 supervision by the Commission.

3 COMMISSIONER SPITZER: What you describe as the
4 de novo review by the aggrieved party, is a distinction from
5 the U.S. Telecom case, where, as I recall, determinations of
6 the state commissions with regard to whole sale pricing,
7 were final.

8 MR. NORDHAUS: They were not effectively subject
9 to review.

10 COMMISSIONER SPITZER: So that's a distinction
11 that could.

12 MR. NORDHAUS: As I mentioned earlier, I think
13 the longstanding practice, going back to the FPC days, in
14 the curtailment era, has been that the regulated entity can
15 impose penalties for its customer's violation of the tariff.

16 There has never been much question about that.
17 The entity required to pay the penalty, always has access to
18 FERC to contest it, but I think that that's part -- always
19 been part of federal energy regulation.

20 COMMISSIONER SPITZER: Thank you.

21 CHAIRMAN KELLIHER: Colleagues? Jon?

22 COMMISSIONER WELLNGHOFF: Thank you, Joe. I'd
23 like to follow up a little bit on that, Mr. Nordhaus, with
24 respect to your discussion with Commissioner Spitzer.

25 It seems to me that FERC's primary role in

1 protecting the public from market manipulation, in having a
2 market monitor, one thing we want a market monitor to be
3 able to do, is stop that manipulation, if they see it
4 occurring.

5 But that doesn't necessarily mean that, in
6 stopping it, they have to assess a penalty at that time.

7 When a cop writes a traffic ticket, you know,
8 they're not assessing a penalty, but they're probably
9 stopping you from speeding. When you drive away, you're
10 probably not going to drive away beyond the speed limit.

11 Can you see an analogy with respect to market
12 monitors, on how they can function to stop something
13 observed, but then the penalty function of that
14 determination, I agree with you that if it's clearly within
15 the tariff and it's spelled out in an unambiguous way in the
16 tariff, I think the regulated entity could, in fact, impose
17 that penalty.

18 But, to the extent it's more or less defined as a
19 manipulation, we may not be able to define that. It's going
20 to have to come to us for some determination as to what the
21 ultimate penalty is.

22 But it seems to me that the real key for the
23 market monitors, is to stop the manipulation. Then we can
24 worry about the penalty later, to impose on somebody who, in
25 fact, was found, under due process, to have manipulated the

1 market.

2 MR. NORDHAUS: A couple of things: One is that
3 one of the issues that certainly came up in the early days
4 of the California ISO, and, I think, for other RTOs and ISOs
5 also, was the problem that the tariffs were fairly rigid.

6 And in order that much of what could be
7 characterized as market manipulation, was simply market
8 participants taking advantage of loopholes or defects,
9 loopholes in the tariff or defects in market design, which,
10 at the time, at any rate, it was thought, had to be
11 corrected by changing the tariff.

12 The process of changing the tariff turned out to
13 be incredibly cumbersome. Usually, it would take about a
14 year, so that by the time you got things fixed, market
15 participants had figured out a whole series of other ways to
16 game the market.

17 So, I think that part of the answer to that is,
18 if it requires a tariff change, there ought to be a
19 mechanism for making a prompt change, which has happened in
20 a number of cases over the years, and if it's something that
21 can be dealt with within the ambit of the existing tariff,
22 then it should be.

23 I think the experience over the years has been
24 that if the market monitor or the RTO can intervene in the
25 market before transactions are executed, it greatly

1 simplifies the whole problem, because you don't have to
2 untangle transactions that have already been executed.

3 So, I think, from a policy point of view, it's
4 very important to have the ability to intervene as promptly
5 as possible. The question is, of course, whether the tariff
6 gives the RTO or the market monitoring unit, adequate
7 authority to do so.

8 I think you could deal with that, if you chose
9 to, through making it clear that there is some form of
10 emergency intervention authority.

11 The Commission, as matter of policy, may decide,
12 no, that's our job, not the market monitor's or the RTO's.

13 COMMISSIONER WELLNGHOFF: Thank you, Mr.
14 Nordhaus. Professor Hobbs, if I could explore with you a
15 little bit more, the role of the Market Surveillance
16 Committee and another aspect of market monitoring that I'm
17 interested in, and that is not so much the enforcement of
18 the market manipulation issues, but more looking at
19 betterment of the markets and how to make the markets work
20 better.

21 How does the Market Surveillance Committee work
22 in that regard? Let me focus you on one area that I am very
23 interested in, and that is better integrating of demand
24 response into the market. Does the Market Surveillance
25 Committee have a role there? Has it played a role in the

1 past, and do you see how -- is it functioning well there?

2 MR. HOBBS: Thank you for the question. Yes,
3 indeed, in fact, I think that's the most important role.

4 When I first joined, there was discussion of
5 maybe some quasi-judicial type role for the Committee and so
6 forth, and enforcement, and it turns out that, actually,
7 under MRTU, which, once upon a time, was called MDO2-2007,
8 there have been many, many important issues, and, among
9 them, demand response that requires both hard thinking about
10 the right way to do it, from the theoretical point of view,
11 and also requires a thorough airing among stakeholders.

12 So we've contributed to both by providing formal
13 opinions and informal advice on how certain things should be
14 done, whether incorporating demand response or virtual
15 bidding, or giving congestion revenue rights to merchant
16 transmission.

17 The million and one details that go into the MRTU
18 filing, also in regular meetings and in ad hoc separate
19 forums that have been organized and we've chaired, have
20 given stakeholders an opportunity to discuss these issues
21 and figure out what the most important things are to discuss
22 and figure out.

23 I think this has helped the ISO in its thinking
24 and helped the stakeholders come, sometimes, to a consensus
25 -- sometimes not, but at least to a clarification of the

1 issues.

2 In summary, market design has been actually our
3 most important role, I think.

4 COMMISSIONER WELLNGHOFF: In that role, how do
5 you interface with FERC?

6 MR. HOBBS: We have a formal role, which is to
7 write opinions, purely advisory, that get submitted to FERC.
8 These opinion drafts are posted and there is opportunity for
9 public comment, and usually, prior to writing one of these
10 opinions, we discuss the issues in one or more of our
11 meetings, to give a chance for stakeholders, such as Jeff
12 Nelson, from Southern California Edison -- I just highlight
13 him, because he's one of our most faithful attendees, and we
14 can always count on him having an interesting opinion.

15 I think this is useful. This is different than,
16 for instance, than my experience in participating in PJM-
17 type meetings, to have an independent entity holding these,
18 perhaps gives an opportunity to air opinions or have the
19 kind of discussion you might not otherwise have.

20 Then the opinion gets filed, so there's the
21 formal opinion process. There's also informal advice. We
22 interact with stakeholders, we interact as individuals, with
23 the staff of the ISO.

24 Then, finally, sometimes, as individuals, we act
25 as chairs of meetings. Last month, for example, I chaired a

1 meeting on capacity markets, where we talked about
2 alternative designs.

3 So, there are a variety of ways -- some formal,
4 some informal ways of us providing advice or facilitating
5 the process of thinking about good market design questions.

6 COMMISSIONER WELLNGHOFF: Thank you.

7 Commissioner Butler, Fred, I appreciate very much your
8 comments, especially your listing out the characteristics
9 you believe of a well-functioning market monitoring unit.

10 I was very interested in your second
11 characteristics, that the activities of the market
12 monitoring unit must also monitor the activities of the RTO.
13 I think that is maybe one area where we may be somewhat
14 deficient in some of the current structures we have.

15 In that regard, and, somewhat similar to my
16 question to Dr. Hobbs, would you then see that entity
17 monitoring activities which would include the proposed
18 tariffs, rules and conditions of service that the RTO will
19 be formulating with respect to such things as integrating
20 demand response into those markets? Would that be one thing
21 that the market monitor would be doing in looking at the RTO
22 activity in your vision of an ideal market monitoring unit?

23 COMMISSIONER BUTLER: Let me answer your
24 question, Commissioner Wellinghoff, and go back to the
25 discussion you were having with Mr. Nordhaus. I think they

1 are related, actually.

2 COMMISSIONER WELLNGHOFF: Certainly.

3 COMMISSIONER BUTLER: I do think that the market
4 monitor has responsibility, even a duty to look at the way
5 the rules are working.

6 Mr. Nordhaus suggested, you know, that
7 participants who may want to act contrary the way the rules
8 are set up, are always thinking of new ways to get around
9 the rules.

10 That means the rules need to constantly be
11 evaluated as to how they need to be strengthened, et cetera.

12 Certainly, demand response, in any pronouncement
13 that, say, the RTO makes about, well, we want to add demand
14 response as a component, I believe it's the responsibility
15 of the monitor to say, well, all right, how would this work,
16 even within the market?

17 If the rules are set up in a way that don't seem
18 to be idea or optimal, then I think the monitor would be
19 involved in making some comments on that.

20 I want to go back to the discussion that ensured
21 earlier, and talk about what I think we're not covering
22 here. That's the deterrence aspect of the market monitor's
23 role, and go back to your reference to the policeman who can
24 write the ticket, because they see a violation occurring.

25 If the person incurring the violation, knows that

1 that ticket can be quashed, if that ticket's not going to go
2 anywhere, if nothing's going to happen, that something's
3 going to be stopped somewhere along in the process, then the
4 ticket means nothing.

5 In the converse, if they know that the rules are
6 going to be enforced and that there will be penalties
7 invoked, if something is not followed, you know, you're more
8 likely to drive more carefully in the jurisdiction where you
9 know you're going to get a ticket and it's going to mean
10 something, like you're going to pay a heftier fine than,
11 perhaps, in another jurisdiction.

12 That's not you and I, of course, but that, in
13 essence, is what I'm saying; that there's a deterrence
14 component to what the market monitor does. If the market
15 monitor is truly independent and truly can call what they
16 see, and it gets enforced, then I think that it improves the
17 overall performance of the market.

18 COMMISSIONER WELLNGHOFF: Thank you, Commissioner
19 Butler. How am I don't time-wise, Steve?

20 MR. HARVEY: About a half a minute.

21 COMMISSIONER WELLNGHOFF: Professor Michaels, in
22 half a minute, could you comment on your principle that you
23 usually put the decision where the information is? That's
24 what you said.

25 From that, you seem to propose a dichotomy

1 between localization and federalization. Wouldn't it be
2 possible to have the market monitor be part of the federal
3 structure, but still have that local information?

4 MR. MICHAELS: Probably what I said about putting
5 the decision where the information is, is an incomplete
6 statement.

7 The other aspect of effective decisionmaking is,
8 give the decisions to the persons who are best at processing
9 it in order to achieve -- most likely to achieve a correct
10 outcome.

11 That's where you point might well come in, that,
12 in fact, if we have this mix of local and federal, we know
13 what kind of information should be collected, and we now
14 have the possibility of people who are able to synthesize
15 information from a number of sources and put it into a
16 better decision.

17 In that sense, I think you do have a point there,
18 and it is important that we think about the ability to
19 process the information.

20 COMMISSIONER WELLNGHOFF: Thank you, Professor
21 Michaels. Thank you, Mr. Chairman.

22 CHAIRMAN KELLIHER: Commissioner Kelly?

23 COMMISSIONER KELLY: Thanks. First, I wanted to
24 pick up on the internal/external concept. I think we may be
25 missing a nuance here, but I'd like your input.

1 It seems to me that when we talk about internal
2 and external, really, California's situation is different
3 from internal and external. Let me be a little clearer:

4 PJM has their entire market monitoring function,
5 all of those tasks associated with it, between employees.
6 MISO has a situation where all of the tasks associated with
7 its market monitoring function, are with a contracted
8 employee.

9 I tend to think of it as an employee by contract,
10 rather than grow up the expertise inhouse. The expertise
11 exists with a consulting firm and is contracted.

12 Then we have a third kind of situation,
13 exemplified here by California, where the part of the market
14 monitoring bundle of objectives and tasks, is internal.

15 Or, maybe I'm wrong; maybe they're all internal
16 with an employee, but California's External Market
17 Surveillance Committee, does something over and above or in
18 addition to what the internal one does? Certainly you don't
19 do what the internal one does, do you?

20 MR. HOBBS: We're definitely not talking to the
21 operators every day. We're focusing more on longer-terms
22 things. We do get involved in potential enforcement actions
23 in terms of reviewing things in confidential meetings, but
24 this is definitely not a day-to-day activity.

25 COMMISSIONER KELLY: Reviewing decisions or

1 recommendations that the internal market monitor makes?

2 MR. HOBBS: Right, or investigations that are in
3 process, in terms of trying to understand, for example, what
4 might be going on, so we may participate in those sorts of
5 discussions, but, yes, our role really is quite distinct and
6 quite complementary.

7 It's more of a long-term role. Sometimes it's
8 reactive in terms of a market design issues that comes to
9 us. Sometimes it's proactive, that we just think that
10 something is important that needs to be raised.

11 COMMISSIONER KELLY: For the day-to-day market
12 monitoring activities, does it matter whether that's
13 conducted by an employee or a contracted employee; do you
14 think? Should it make a difference with any legal issues?

15 MR. HOBBS: I'm not qualified to answer that, as
16 an engineer.

17 (Laughter.)

18 COMMISSIONER KELLY: Bob?

19 MR. NORDHAUS: I think that the distinction
20 between an employee and an independent contractor, is
21 subject to the supervision and control of the RTO.

22 It's not an important one. Either are,
23 essentially, in the same category.

24 The question, I think, that's been raised, is, if
25 you try to vest important tariff administration or sanction

1 authority, in an entity that was not subject to the control
2 of the regulated entity, either an individual who was hired,
3 not subject to the control of the RTO, or a committee that
4 was not subject to the control of the RTO, beyond being
5 appointed and reappointed and paid from time to time, I
6 think it would raise questions as to whether it was the
7 regulated entity subject to the ultimate control and
8 supervision of the Commission, or some other entity that
9 was not, which was making these decisions.

10 I think, to my mind, that's the real question.
11 Is there somebody administering the tariff, who you could
12 hold accountable for compliance with the tariff?

13 COMMISSIONER KELLY: So then, it seems to me,
14 that where we should be focusing on, is not whether this
15 entity works for the RTO, by contract, or is a direct
16 employee, but, rather, what obligation do we put on the RTO
17 in the tariff, in that it's their choice whether to carry
18 out that obligation by an inside employee or a contracted-
19 for employee.

20 Maybe they wouldn't even have an opinion, but the
21 focus should be on the tariff and what obligation is placed
22 on the RTO.

23 MR. NORDHAUS: I think that's correct.
24 Ultimately, you have to rely on the RTO to carry out the
25 tariff, and the issue that would come up, is, if you have

1 some entity that's not subject to supervision and control,
2 either by the RTO or by you, because they are not a public
3 utility, does that satisfy the requirements of the Federal
4 Power Act?

5 COMMISSIONER KELLY: Then I see that Fred would
6 like to say something. It may be that, as a matter of
7 policy, and, therefore, in the tariff, FERC might decide
8 that an employee somehow has an advantage over a contracted-
9 for employee, or vice versa.

10 COMMISSIONER BUTLER: In my comments, I think I
11 addressed the fact that I think an employee inside the RTO,
12 has better access to information, just because of where they
13 are situated in the day-to-day context.

14 I think there's another question that was not
15 posed in that las interchange, and that is, what happens
16 when there's a disagreement over whether the tariff
17 provisions are being properly applied, or there's a judgment
18 call?

19 I'm saying there's a violation and I almost want
20 to ask if I'm allowed -- for the California experts, whether
21 there are instances where there were differences of opinion,
22 and did they ever come to the Market Surveillance Committee
23 and say, we think there was, and we were told, no, there
24 wasn't?

25 Did you ever adjudicate anything along those

1 lines? I would feel more optimistic that that would solve
2 some of the independence problems of an internal monitor
3 situated inside.

4 COMMISSIONER KELLY: Actually, the question you
5 asked, applies equally to an entity that's contracted for.

6 COMMISSIONER BUTLER: Absolutely, I agree with
7 you absolutely, Commissioner. It really doesn't matter.

8 You can fire a consultant, just the same way you
9 can fire or make life difficult for a consultant, just the
10 same way you can make life difficult for an employee.

11 COMMISSIONER KELLY: I would be happy to cede my
12 time to Dr. Hobbs and Mr. Nordhaus to answer that question.
13 It's very valuable.

14 MR. HOBBS: If I'm not telling tales out of
15 school, there's never been a circumstance where I've seen
16 the Department of Market Monitoring making a recommendation
17 about an enforcement action that they referred to FERC and
18 management, saying no.

19 I've never seen that. I doesn't mean that it
20 hasn't happened. I've never been asked to try to facilitate
21 an agreement or anything like that.

22 It usually involves, a bit earlier, trying to
23 figure out what's going on and what might be appropriate.
24 I've never been in a situation where management is on one
25 side arguing one thing, and the market monitor is on the

1 other.

2 Certainly, I've seen many circumstances where,
3 with the ISO, there are disagreements about how a particular
4 market design issue should be resolved, however, over the
5 long run, we should deal with certain circumstances and
6 would play a facilitating role, throwing in our own ideas on
7 that.

8 Hopefully, I think our engagement, generally, has
9 been constructive in that regard.

10 COMMISSIONER BUTLER: Quick followup question:
11 Does the market monitoring office know that if they had a
12 question, if there was a disagreement, that they could, in
13 fact, come to you?

14 MR. HOBBS: I think so, but perhaps that question
15 could be put to Keith Casey in the next session.

16 COMMISSIONER KELLY: I'll do that. I think that
17 part of our task is to focus on what jobs you think this
18 market monitoring operation, however it's parsed out or
19 however it's implemented, should do.

20 What I'd like to see, is if there is consensus
21 that any -- that the following are jobs of the market
22 monitoring operation. I've counted five that have been
23 raised:

24 One, monitor the markets; two, mitigate prices in
25 accordance with specified tariff provisions; three, possibly

1 impose penalties; four, recommend actions and changes to
2 existing market rules; and, five, recommend, evaluate the
3 market impacts of proposed RTO initiatives.

4 I'd like your opinions on whether you think those
5 are functions that a market monitoring operation should
6 pursue or not, or are there ones we should add to that?

7 MR. HOBBS: Let me just add one. Though there
8 are a lot of rules, operators still have an awful lot of
9 discretion, so, a sixth one would be monitoring the effect
10 of operating decisions, all of which may fall within the
11 rules, but because of the exercise of discretion, which
12 could definitely affect market efficiency and outcomes --

13 COMMISSIONER KELLY: Say that again. Monitoring
14 the effect of?

15 MR. HOBBS: Operator discretion. I hope that's
16 not a pejorative term. There is a lot of discretion within
17 the rules.

18 COMMISSIONER KELLY: As there would have to be.
19 It's a pretty complex operation.

20 MR. HOBBS: Systematically, decisions can be
21 made, which can help or hurt efficiency, that really aren't
22 covered under the rules.

23 COMMISSIONER KELLY: Okay. Bob?

24 MR. NORDHAUS: Go ahead, Ben.

25 MR. HOBBS: I was thinking of a seventh. To

1 facilitate stakeholder discussion of issues, provide an
2 independent forum for such discussions.

3 COMMISSIONER KELLY: Thanks.

4 MR. NORDHAUS: As I think about market
5 monitoring, it seems to me that there is a sort of larger
6 issues here, which I'm not sure the RTO, the individual RTO
7 market monitors are the right people to do, that is, looking
8 at the overall performance of a market, not just whether,
9 you know, your price spikes are a reflection of competitive
10 forces or market manipulation, but looking at the overall
11 performance and comparing it to the performance of other RTO
12 markets and doing essentially a benchmarking exercise.

13 It seems to me that you have great variations in
14 the efficiency and cost-effectiveness of our various RTOs
15 and ISOs.

16 Part of the job of inculcating best practices
17 throughout the industry, is doing some benchmarking,
18 figuring out who's running an efficient market; who's got
19 the lowest administrative cost; and why it is that some
20 markets are working better than others, so that you can get
21 best practices adopted throughout the portion of the
22 electric power industry that has organized markets.

23 That may be more of a job for FERC than for the
24 individual RTOs, but I think it's an important job that has
25 to be done, as I think we don't really have a good sense --

1 as far as I know, we don't have a good sense as to -- we
2 have some sense as to who's doing better, who's running the
3 most cost-effective operations.

4 We don't know why, we don't quite know how to
5 improve the ISOs and RTOs that have high-cost operations
6 and, perhaps, ineffective markets, as compared to those who
7 are working very efficiently.

8 MR. HARVEY: Commissioner Kelly, that's about
9 your time.

10 COMMISSIONER KELLY: Thank you all very much.

11 CHAIRMAN KELLIHER: Commissioner Moeller?

12 COMMISSIONER MOELLER: Thank you, Mr. Chairman.
13 First, I want to thank the panelists, whether they came from
14 far or near, for the effort today, and Staff for putting
15 together a great set of panels to discuss this issue.

16 One of my priorities is the functionality of
17 these markets, improving that, and, obviously, the market
18 monitors play a key role in that.

19 I'm hoping that by the end of the day, that at
20 least I'll learn more about the roles that the market
21 monitors think they should play, what roles the RTOs and
22 ISOs think they should play, and, obviously, the states,
23 what role they should play.

24 Obviously, our expectations, and, obviously, the
25 consumer benefits of having a market monitor, I'm also

1 interested in hearing about market monitors that reconcile
2 conflicting duties and how difficult or easy that task has
3 been.

4 I hope the panelists, at least the panelists that
5 come after this one, can give us a little guidance or their
6 perspective on our 2005 policy guidance on market monitors,
7 whether it's too specific, not specific enough, throughout,
8 a little bit different perspective.

9 Should we have a market monitor for the non-RTO
10 markets? Again, I appreciate everyone's efforts, and I will
11 assure the first panel, especially my friend, Mr. Nordhaus,
12 that I'll go back with the archive of your remarks that I
13 missed. Thanks for being here.

14 CHAIRMAN KELLIHER: Any questions?

15 (No response.)

16 CHAIRMAN KELLIHER: I think that means we're
17 ending on time. I just want to commend the Staff.

18 This really was a very good briefing book. I'm
19 sure we could sell this information for a large amount of
20 money.

21 (Laughter.)

22 CHAIRMAN KELLIHER: But, it's a truly exceptional
23 summary of the history of market monitoring and the
24 Commission's policies. I just want to commend the Staff. I
25 think we're all very well prepared.

1 MS. COURT: A lot of people worked hard.

2 CHAIRMAN KELLIHER: I want to thank the panelist.
3 It was very good testimony, and you've given us a lot to
4 think about.

5 With that, we're going to take a short break and
6 resume at 11:00.

7 (Recess.)

8 CHAIRMAN KELLIHER: I'd like to call up the
9 second panel, please. Thank you.

10 I'd like to thank the second panel for helping us
11 today. This panel is composed of market monitors in the
12 various organized markets.

13 Are you all internal? Some of you are external.
14 I see Mr. Patton, so I know that some of you are external,
15 so you have both internal and external market monitors here.

16 And as with the first panel, I'll be the good cop
17 and I will introduce you, and Steve Harvey will be the bad
18 cop and he will enforce the time periods.

19 Let me start with the first panelist, and that's
20 Keith Casey, Director of Market Monitoring with the
21 California ISO. Thank you.

22 MR. CASEY: Thank you, Chairman Kelliher and
23 fellow Commissioners. It's a pleasure to be here. I see my
24 clock is ticking, so I'll get right to it.

25 In terms of the questions you posed to this

1 panel, with regard to the first one, what are the functions
2 of the market monitoring unit, I would say that with regard
3 to the California market monitoring unit, which I will refer
4 to as DMM, as we're known, the Department of Market
5 Monitoring, our functions are largely consistent with those
6 outlined in the Commission's Policy Statement on Market
7 Monitoring Units.

8 We strived to quickly identify ineffective,
9 problematic market rules and tariff provisions, and provide
10 recommendations to fix them.

11 We identify potential anticompetitive behavior by
12 market participants, and review and report on the
13 performance of wholesale markets.

14 Of course, we routinely interact with the Office
15 of Enforcement on various market issues. I would like
16 to point out that these functions not only benefit the
17 Commission and its Staff, but they also provide important
18 benefits to our Governing Board and ISO management as they
19 struggle with various issues relating to markets, as well as
20 our ISO internal departments, our Operations Group and
21 Market and Product Development Group, and state regulators,
22 as well as market participants and other stakeholders.

23 With regard to how these functions could be
24 changed or improved, I think they are largely right for our
25 group. They've improved significantly since we underwent

1 realignment in June of 2005, which included, among other
2 things, a change in the reporting structure, where I now
3 report directly to the CEO.

4 I think that a lot of those changes had the
5 effect of making us a more autonomous and independent group,
6 with greater discretion in terms of how we devoted our
7 limited resources.

8 One function that I think could be further
9 refined, concerns our administration of rather routine
10 compliance-type rules in the ISO tariff, and I'd like to
11 come back to those.

12 But some of those, I don't think -- there are so
13 routine, I don't think they necessarily are a best use of
14 our monitoring groups, and could be taken care of by other
15 business units at the ISO.

16 And then the last point, and just in terms of
17 function, I think that one monitoring function that
18 Commissioner Moeller touched on, is one about non-ISO RTOs;
19 do we need a monitor there? I think that with respect to
20 the Western Regional market, I think that is an area that
21 needs to be looked at.

22 With regard to your last question, what changes,
23 if any, to the current structure of MMUs, would better
24 assist the Commission in its oversight activities, I do
25 think we currently are very well situated to assist you.

1 I recognize that our staff, the Department of
2 Market Monitoring staff, are employees of the ISO, but I
3 think the independent role that we provide in monitoring, is
4 well understood and respected within the ISO management.

5 It starts with the CEO and the officers, and I
6 think our role is really viewed as somewhat akin to an
7 internal audit function, and there's a lot of deference
8 given to what we do.

9 And, as you heard from the previous panel, the
10 independent role of monitoring in California, is bolstered
11 by our Market Surveillance Committee, and I'd be glad to
12 elaborate on that.

13 That said, I do think there are some
14 vulnerabilities to the independence of our monitoring role,
15 and I would be happy to, through the course of the
16 discussion, to elaborate on some areas where I think our
17 role and our independence could be improved.

18 I see I have exceeded my three minutes, so I will
19 stop there and look forward to the discussion.

20 CHAIRMAN KELLIHER: Thank you very much, Mr.
21 Casey. I'd like to now recognize Joseph Bowring, Market
22 Monitor for the PJM Interconnection. Welcome.

23 MR. BOWRING: Thank you. I appreciate the
24 opportunity to participate in today's technical conference.
25 PJM market monitoring performs a number of functions in

1 assisting the Commission, and, as said already in the panel
2 before, identifies market participants who may be violating
3 the PJM tariff or FERC rules; provides support to PJM in
4 administering the tariff; and provides analysis of market
5 performance and issues.

6 The MMU, in addition to monitoring the markets,
7 also has the responsibility to monitor the RTO itself, and
8 as we understand, the RTO itself can have very significant
9 impacts on the market.

10 The MMU also regularly communicates, both
11 formally and informally with market participants from all
12 market sectors, from generators to load, to state
13 regulators.

14 Market participants rely upon the Market
15 Monitoring Unit for objective analysis of markets.

16 That analysis helps provide confidence to all
17 market participants that competitive markets are working,
18 and that issues will be identified when they arise.

19 The role of monitors has been clearly defined by
20 the Commission, in the Policy Statement and elsewhere.

21 Enforcement authority lies with the Commission,
22 as does the authority to require changes in participant
23 behavior. I don't have a gun; I have a whistle. I'm a
24 professor with a whistle.

25 The role of market monitors is advisory and

1 informational.

2 Representatives of the PJM Market Monitoring Unit
3 meet regularly with FERC Staff from the Office of
4 Enforcement and other parts of the Commission. I believe
5 that in terms of potential improvements, it would be
6 beneficial for the Market Monitoring Units to also meet
7 regularly with senior Staff from the Office of Enforcement
8 and other interested Commission Staff, to provide status
9 reports on monitoring activities, market issues, pending
10 issues, and also to get feedback from the OE about the
11 interests of the Commission and how the MMU could be of
12 additional assistance.

13 While relatively informal contacts are critical,
14 I believe that more structured interactions could also be
15 helpful to the Commission.

16 In addition, I believe it would be beneficial if
17 the MMU provided more structured reports or presentations on
18 a regular basis to Staff, based on Staff and Commission
19 interests and requirements.

20 I believe it would also be beneficial to initiate
21 and sustain an ongoing discussion among all monitors and
22 Commission Staff about theoretical and practical approaches
23 to the definition of mitigation of market power.

24 Systematic discussion and review of approaches
25 and results, can contribute to continued improvements in

1 monitoring mitigation practices.

2 In order to effectively assist the Commission,
3 the Market Monitoring Unit needs resources. We need staff
4 resources, IT resources, hardware, data, and so forth.

5 In order to effectively assist the Commission,
6 the MMU also needs independence. You all talked about
7 independence a little bit on the prior panel. I have a
8 slightly different take on it, having lived through some
9 issues at PJM.

10 I would define independence as independence from
11 market participants and independence from the RTO.

12 It's clear that market participants have varied
13 financial interests, so that the MMU must be independent
14 from market participants.

15 It's equally clear that the MMU must be
16 independent from PJM, from the RTO. While PJM is, itself,
17 independent from market participants, PJM, as an
18 organization, has specific interests, which may differ at
19 times from the MMU objective of providing objective,
20 critical evaluations of markets, of market participants, and
21 of PJM itself.

22 While PJM has a variety of objectives, an MMU
23 really only has one objective: To assist the Commission in
24 enhancing the competitiveness of markets. Ultimately, only
25 the Commission can define the level of independence that it

1 believes necessary for market monitors to reform the
2 functions defined by the Commission and assist in enhancing
3 the competitiveness of RTO markets.

4 Only the Commission can assure that the desired
5 level of independence is achieved.

6 MR. HARVEY: Dr. Bowring, your time is up.

7 MR. BOWRING: Okay. Can I just make two points
8 that I wanted to get to?

9 MR. HARVEY: Very quickly.

10 CHAIRMAN KELLIHER: Very quickly.

11 MR. BOWRING: The first is that my experience --
12 and it's in my written document, as well -- my experience
13 at PJM is that we have not been permitted to be independent
14 and there have been -- we've seen significant issues with
15 conflicts with PJM, and where there were conflicts, our
16 independence has at times -- not all the time, obviously --
17 but has, at times, been compromised.

18 PJM views us primarily as employees, as employees
19 who are responsible to management, rather than being
20 responsible to provide our independent views.

21 And just again, so you are aware, I believe the
22 independence, in fact, the very viability of the PJM Market
23 Monitoring Unit, has reached significant proportions at PJM.
24 We were informed last week by PJM management, that in order
25 to assure independence, the market monitoring function would

1 best be provided by an external consultant, rather than the
2 current Market Monitoring Unit.

3 At the meeting, my employees were told that there
4 were other jobs in the organization for which they were
5 qualified and could apply for. I was also told that our
6 database, which is central to meeting our tariff
7 obligations, would be removed from the Market Monitoring
8 Unit's control.

9 This has had, to say the least, a negative impact
10 on morale at the Market Monitoring Unit, although we're
11 continue, I and my staff are continuing to do our work.

12 I'll stop there, and I appreciate the extra few
13 minutes, and I'm open to questions when it's that time.
14 Thank you.

15 CHAIRMAN KELLIHER: Thank you, Mr. Bowring. I'd
16 like to now recognize Mr. Hung-Po Chao, the Market Monitor
17 for ISO New England.

18 MR. CHAO: Thank you for this opportunity to
19 appear before the Commission. As the role of the Market
20 Monitoring Unit's role is reevaluated, I believe that a
21 guiding principle is that a Market Monitoring Unit must be
22 independent, but not isolated.

23 And I have heard during this morning's
24 discussion, three kinds or three types of independence:
25 Jurisdictional independence, managerial independence, and

1 professional independence.

2 I believe that a market monitor must have strong
3 support in four areas to accomplish these objectives:

4 Number one, its structure. To foster independence without
5 isolation, considerable structural advantages result from
6 having both internal and external market monitors at an ISO
7 and RTO.

8 Both market monitors can report, functionally, to
9 the Board of Directors. As a profession, this is analogous
10 to the oversight structure of internal and external auditors
11 in corporate finance.

12 At the ISO New England, the two monitors work
13 independently, but can collaborate closely to address
14 specific issues, as needed. The result is a balanced and
15 objective analysis of issues.

16 Second, access: Independence requires that a
17 Market Monitoring Unit have access to both FERC and the
18 ISO's or RTO's board of directors. This arrangement enables
19 the Market Monitoring Unit to work within the ISO/RTO
20 organization, while fulfilling its obligation to inform
21 regulators and the independent board of any problems that
22 require attention.

23 Three, interaction: To avoid isolation, the
24 Market Monitoring Unit needs to be able interact closely
25 with the ISO and RTO operations team and maintain sufficient

1 contact with the market participants to ensure that their
2 concerns are addressed.

3 And an especially important consideration is a
4 physical proximity, so that the Market Monitoring Unit can
5 observe market operations firsthand, to form independent
6 judgment, based on the best available knowledge and
7 information and data.

8 Four, resources: Market monitors need access to
9 state-of-the-art analytical tools and the related resources,
10 including, particularly, market simulation capability.
11 These resources are especially needed to monitor compliance
12 of participants across multiple markets; assess performance
13 of multiple markets that interact; and determine the impact
14 of emerging markets on the mitigation rules.

15 One indication of the importance of this issue
16 for the Market Monitoring Units, is that the review of
17 market simulation models for market monitoring, will be one
18 of the topics to be discussed at the Economic Infrastructure
19 Surveillance Group, the EISG Conference later this month in
20 Little Rock.

21 Finally, I would like to comment that the current
22 interaction between the Market Monitoring Unit and FERC, is
23 largely one way. I believe that a more comprehensive and
24 bidirectional communication between the Market Monitoring
25 Unit and FERC, would be very helpful as wholesale markets

1 make progress and mature, including the emphasis on
2 cooperating on demand response.

3 A first step towards facilitating better
4 information-sharing, would be to define clear objectives and
5 goals for such two-way communications, while we recognize
6 the legal limitations.

7 Ultimately, a more collaborative relationship may
8 be able to evolve, resembling the one that internal and
9 external market monitors have at individual ISOs and RTOs.
10 Thank you.

11 CHAIRMAN KELLIHER: Thank you very much. I would
12 like to now recognize Nicole Bouchez, the Manager and Market
13 Monitor of the New York ISO. Welcome.

14 MS. BOUCHEZ: Thank you. I would like to thank
15 the Commission for the opportunity to be here to address
16 what the NYISO Market Monitoring Performance Market, which I
17 will refer to as MMP, does, as well as providing some
18 recommendations to the Commission.

19 My recommendations are not going to be on what to
20 change, but actually on what should be retained.

21 I see the role of MMP as threefold: First and
22 foremost, MMP's role to administer the NYISO's Commission-
23 accepted market monitoring plan and market power mitigation
24 measures.

25 The NYISO market's services tariff contains

1 specific market power mitigation measures that provide the
2 means for the NYISO to mitigate the market effects of
3 conduct that would substantially distort competitive
4 outcomes in our markets, while minimizing the interference
5 with open and competitive markets.

6 If the MMP determines that there may be an abuse
7 of market power that does not trigger the specific
8 thresholds for mitigation, the NYISO will notify the
9 Commission in accordance with the Commission's Policy
10 Statement and our own market mitigation measures.

11 This role dovetails very well with our other two
12 roles: To provide a competitive market and to provide
13 information about NYISO-administered markets, to the NYISO,
14 stakeholders, state regulators, and the Commission,
15 primarily through the Division of Energy Market Oversight.

16 MMP also provides information to regulators
17 through regularly-scheduled teleconferences with both
18 Commission Staff and the New York Public Service Commission
19 staff.

20 We also are in near daily communication with
21 Commission Staff to provide information on market outcomes
22 and to respond to Staff questions.

23 In order to do this, we work closely with the
24 NYISO's independent market advisor in the administration of
25 our functions and roles.

1 MMP appreciates the independent voice and checks
2 and balances as overlapping and complementary responsibility
3 that are provided by having an independent market advisor,
4 as well as an internal MMP.

5 Both the MMP and the independent market advisor,
6 review market outcomes and participant behavior, to provide
7 better oversight than either could independently.

8 My written remarks contain more detail on how we
9 provide for a competitive market and administer our
10 Commission-approved market monitoring plan and market
11 mitigation measures, as well as details of our department
12 organization and more about how we provide information about
13 NYISO-administered markets.

14 Before I conclude, though, I would like to
15 identify two aspects of the existing regulatory structure
16 that I believe work very well, and which we recommend that
17 the Commission should not change.

18 The first is that flexibility in the structural
19 aspects of market monitoring groups, is important. As I am
20 sure you will be hearing today, there are many variations on
21 how to effectively monitor markets.

22 In New York, our combination of a Market
23 Monitoring and Performance Department, with an independent
24 market advisor, is one of overlapping and complementary
25 responsibilities and provides checks and balances that we

1 believe have worked very well, and which I believe our
2 market is very comfortable with.

3 Other regions may have different needs, and we
4 see no reason for strict standardization of market
5 monitoring structural arrangements beyond guidelines that
6 have already been issued by the Commission via its Policy
7 Statement on Market Monitoring.

8 In addition, the difference in focus between
9 monitoring done by the Staff of the Commission, which is at
10 a higher-level, national focus, and the role of MMUs and
11 IMMs, which is focused on the detail in their regional
12 markets, fosters a complementary relationship, which I
13 believe is also working very well.

14 This concludes my remarks, and I will be happy to
15 answer any questions that you may have.

16 CHAIRMAN KELLIHER: Thank you very much. I'd
17 like to now recognize David Patton, who is here today as the
18 Market Monitor of the Midwest ISO, and President of Potomac
19 Economics.

20 MR. PATTON: Good morning. I appreciate the
21 opportunity to address the Commission on market monitoring
22 issues.

23 I want to start by clarifying some questions that
24 have been raised regarding what market monitors do. For my
25 part, I want to stress that I have no enforcement authority

1 to impose sanctions or penalties or to engage in any other
2 enforcement.

3 In fact, the development of the law and
4 Commission resources in the enforcement area, have been
5 enormously helpful, for a number of reasons, not the least
6 of which is the fact that it is difficult to afford the due
7 process that, as a market monitor, that the FERC enforcement
8 process provides.

9 We have developed a very productive relationship
10 with the Office of Enforcement and are in contact with them
11 multiple times a week. This is in addition to making formal
12 referrals to the Commission.

13 In these informal contacts, we discuss market
14 outcomes and also potential changes in the market rules. In
15 the context of this discussion, I believe it's very useful
16 to separate the role of the market monitor and the
17 enforcement process, from all the other functions that the
18 market monitor performs.

19 Equally important to the support that we provide
20 to the Commission, are the services that the IMM provides to
21 the RTO Board of Directors, the RTO management, the states,
22 and the market participants.

23 In all of these roles, maintaining independence
24 from the market participants and the RTO itself, is
25 critical.

1 In the Midwest, independence was among the
2 highest priorities of both the states and the market
3 participants, and was achieved by having the market
4 monitoring function be performed by an independent entity,
5 the independent market monitor, rather than by employees of
6 the RTO.

7 Independence of the market monitor from the RTO,
8 is critical, due to the role in monitoring the RTO's rules,
9 procedures, and the operations of the RTO.

10 The actions of the RTO have larger effects, in
11 practice, on the market outcomes, than the actions of any
12 individual market participant.

13 Beyond establishing the IMM, the independence of
14 the market monitoring function, was further protected by
15 filing the contract renewal and termination provisions as
16 part of the Midwest ISO tariff.

17 FERC's oversight of this process, prevents the
18 Midwest ISO from using this process to compromise the
19 independence or otherwise influence the IMM. This structure
20 provides more institutional protection than can be afforded
21 to a purely internal market monitor.

22 There has also been a question about whether an
23 external market monitor can have the same access to data,
24 and the Staff -- and I want to assure you that the answer to
25 that is yes.

1 We have full access to both Midwest ISO staff and
2 Midwest ISO data. We have staff that are located in the
3 Midwest ISO offices, and have a continual stream of data
4 from both market data and operations data that we use to
5 monitor the market.

6 In addition, we have offline versions of the
7 Midwest ISO's actual market software that we use in an
8 automated fashion, to evaluate and screen the market
9 results, but we also use it to investigate the effect of the
10 conduct of market participants is having on the market, as
11 well as the actions that the RTO market operators have on
12 the market outcomes.

13 In summary, effective market monitoring would not
14 be possible without this extensive monitoring software and
15 infrastructure that's been developed over the past four
16 years with the support and assistance of the Midwest ISO
17 staff.

18 However, independence from the Midwest ISO is
19 important, and the institutional structure and safeguards
20 that were implemented by the Commission in the Midwest ISO
21 region, have been effective in protecting our independence.

22 CHAIRMAN KELLIHER: Thank you, Mr. Patton. I
23 would like to now recognize Richard Dillon, the Director of
24 Market Development and Analysis with the Southwest Power
25 Pool. Welcome.

1 MR. DILLON: Good morning, and thank you,
2 Chairman Kelliher and Commissioners. I am here this morning
3 to talk about the market monitoring function at the
4 Southwest Power Pool.

5 The market monitoring function at the Southwest
6 Power Pool reports to the Board. It is holistically handled
7 that way.

8 It also performs market monitoring, not only of
9 the energy market, but the transmission market, and has been
10 performing the market monitoring of the transmission market
11 for several years.

12 The function includes both the monitoring of
13 participants and the RTO, especially with sensitivity
14 towards the RTO's ability to make a market through their
15 actions that may not have been justified, either through
16 tariff or reliability reasons.

17 The market monitor activity also goes through and
18 reviews the market operations for improvements in the market
19 itself, in making sure that the design is there to
20 facilitate the markets and also to eliminate the potential
21 for abuse, not just occurrences of abuse.

22 And the market monitor is also available -- and
23 this is something that we have maintained for educational
24 and also discussion, both by participants and by FERC staff.

25 The market monitor at the Southwest Power Pool

1 has ongoing, basically weekly dialogues with FERC Staff.
2 Most of them happen to be educational, because one of the
3 concerns that David addressed, is that there are times that
4 you have to be on the site to understand what is going on.

5 And David has structured his organization such
6 that he is able to get that onsite information.

7 As the market monitor, we provide the educational
8 and also the review of operational results. Something else
9 that has not generally been mentioned that market monitoring
10 has resulted in, through most of the organizations, is that
11 it has become a central source of information, as opposed to
12 data.

13 Data is numbers; information is something that
14 you can make decisions on. Because of the span of knowledge
15 in the market monitoring organizations, they are able to
16 pull together what the data represents as far as what is
17 going on, and use that in educating, internal, external, and
18 FERC personnel. Thank you very much.

19 CHAIRMAN KELLIHER: Thank you very much, Mr.
20 Dillon. Now, it looks like we have 33 minutes or so, so why
21 don't we go with six minutes each, and that's assuming we'll
22 bleed over a little bit, at least into the extra three
23 minutes.

24 Why don't I start with a few questions? First of
25 all, I want to thank the panelists for their testimony. And

1 I do agree with a number of you who remarked that the
2 Commission and market monitors have developed a good working
3 relationship over the years; I agree with that and I think
4 that's important.

5 But to respond to Mr. Chao, there is a -- we
6 can't have completely free, two-way bilateral communication.
7 We know from the Electric Power Supply Association decision,
8 that there are limits on what we can say to you.

9 I don't think there are limits on what you can
10 say to us, but there's limits on what we can say to you.

11 But let me address something about
12 accountability. We have been using the "independence" word
13 a great deal, and I don't know that we've talked very much
14 about accountability.

15 I just want to ask a general question: If market
16 monitoring is done badly in a certain RTO, who is
17 accountable? Who is responsible for that?

18 From my point of view, I think it's the RTO
19 itself, because market monitoring is a responsibility of the
20 RTO, and we've been deferential on how they go about
21 exercising that responsibility. They can have an internal,
22 an external market monitor, both, but if market monitoring
23 were done badly in a certain RTO, I think it's the RTO that
24 we would hold accountable and responsible, and I think
25 that's important to lay out.

1 Now, with respect to independence, I agree that
2 there will be prospects, if you assume there's an internal
3 market monitor -- I want to address some of Mr. Bowring's
4 concerns -- if there is an internal market monitor and
5 there's disagreement between -- and the internal market
6 monitor reports to management and there are disagreements,
7 what should happen?

8 I think that's a legitimate question; what should
9 happen? Should there be some -- I don't think that
10 necessarily leads to the notion that the internal market
11 monitor is independent, with some kind of fixed job
12 security, somehow removal only for cause. I don't think
13 that concern necessarily leads to that end result.

14 But it could lead to something more normal, which
15 would be some appeal right. If there's a disagreement
16 between the internal market monitor and management, should
17 there be some ability to appeal to the Board?

18 As another, should the internal market monitor
19 report to the Board, rather than management? I think that
20 in ISO New England, the internal market monitor reports to
21 the Board -- or to management?

22 MR. CHAO: The internal reports to the Board.

23 CHAIRMAN KELLIHER: Okay. So I think there are
24 other solutions to that generic problem, which wouldn't
25 exist only in PJM, and I think we should look at more than

1 one solution, perhaps, to that problem.

2 Mr. Patton, David referred to due process and the
3 cost of due process, and it is costly and it actually is
4 time-consuming. But in the earlier panel, the concern was
5 raise -- some of my colleagues raised it.

6 Let's say we see some problem that exists in an
7 RTO market, but let's assume that that problem is not at all
8 inconsistent with the tariff. It's a problem in the tariff,
9 it's a loophole, I think one of the first panelists said.
10 It's a flaw in the tariff that's resulting in a bad outcome.

11 Some concern has been -- well, someone should be
12 able to act very quickly to address that flaw in the tariff.
13 I think, generally, that that someone should probably be us,
14 rather than the market monitor, because, again, RTOs are not
15 self-regulating organizations; they cannot set rules and
16 enforce rules unilaterally; they can only -- I mean, we set
17 and enforce the rules, so we're ultimately responsible.

18 But it does raise a legitimate question,
19 something that we talked about internally a bit, of should
20 the Commission have some authority to, on an interim basis,
21 on an emergency basis, make a change to an RTO tariff to
22 prevent that ongoing harm, if you will, that's produced by a
23 flaw in the tariff, that's not produced by manipulation, per
24 se; it's not produced by tariff violations, but it's an
25 outcome of a rule flaw?

1 I think we might need consider, should we seek
2 that authority from Congress, to make a rule change quickly,
3 on an interim basis, to prevent that ongoing harm? How am I
4 doing on time?

5 MR. HARVEY: A little over two minutes.

6 CHAIRMAN KELLIHER: Two minutes left?

7 MR. HARVEY: Two minutes left.

8 CHAIRMAN KELLIHER: Two minutes left, okay,
9 that's good.

10 Structure, we talked -- I mean, the first panel -
11 - there really seems to be four -- we can look at the role -
12 - we can look at market monitors in a number of ways:

13 We can look at structure, we can look at role,
14 and there is a relationship between the two, I think. I
15 think there's four -- as I said earlier, there's four
16 conceivable structures, there's internal only, external
17 only, there's internal and external, and there's
18 governmental.

19 Now, Joe, is it your suggestion that you think it
20 either should be internal only or both internal and
21 external? When you say "onsite," that, to me, suggests
22 there needs to be some internal market monitor, or do you
23 think that's the best arrangement? But are you saying that
24 it has to be internal only, or internal plus external?

25 MR. BOWRING: I think, actually, what makes

1 sense, is that MMU staff be onsite, with access to
2 personnel, for all the reasons that you've heard.

3 But when we think about external/internal, it's
4 not really where you're located; it's to whom you are, as
5 you said, accountable or responsible. I think it's
6 critical, based on my own experience over the last couple of
7 years, and, particularly, more recently, that the market
8 monitoring units be accountable and responsible to some
9 entity other than the RTO.

10 I mean, ultimately, we obviously are responsible
11 to our market participants, as well as the RTO, but --

12 CHAIRMAN KELLIHER: But you're saying you're
13 accountable to us, because we don't hire you or license you?

14 MR. BOWRING: I understand, and, I mean, there
15 are a number of possible relationships: One is to be an
16 employee, and, as you can tell from what I said -- and I'll
17 amplify it, if you want.

18 CHAIRMAN KELLIHER: An employee of the
19 Commission?

20 MR. BOWRING: No, no, I'm sorry; being an
21 employee of the RTO. Being an employee of the RTO has what
22 I think -- or creates what I think are impossible ongoing
23 differences, because, for whatever reason, for better or
24 worse, it's not an indictment of either market monitoring or
25 the RTO management.

1 There are differences of opinion and there will
2 continuously be differences. As David and others have
3 pointed out, I think it's important that we be monitoring
4 the RTO, that we be critical of the RTO, if it's necessary,
5 and it's very difficult to do that, if you're an employee,
6 if you're criticizing the person that fills out your
7 performance review.

8 I mean, that sort of puts it in a nutshell. If
9 you are reporting on the people who have the ability to
10 control your resources, your HR resources, all the basic,
11 nitty-gritty decisions that we live with every day and that
12 affect the kind of work we do, are under the control --

13 CHAIRMAN KELLIHER: Until and unless we are
14 hiring market monitors, aren't market monitors necessarily
15 accountable to RTO management or the RTO Board?

16 MR. BOWRING: I think that is one level of
17 accountability, but I think an interesting difference, is
18 the difference between David's contract and our relationship
19 with PJM management.

20 It's very, very different, and I don't think
21 there's any question that MISO management could affect
22 David's HR decisions or his budget decisions, or, in fact,
23 cause him to change the outcome of a report, whereas that
24 can happen in PJM, with the current structure.

25 So I'm not telling you that I have the perfect

1 answer, but I am telling you -- I wish I did -- but I am
2 telling you that there is a very big difference between
3 those reporting relationship, and I think, in my view --
4 it's your decision, of course, but, in my view, the market
5 monitors need to be independent, in order to serve your
6 needs, in order for you to be confident that you're getting
7 unvarnished opinions.

8 And we might not always be right, and, obviously,
9 market monitors are no more perfect than anybody else, as
10 much as we sometimes like to think we are.

11 But we have to be accountable, and, ultimately,
12 we're accountable to markets. Our work is reviewed by
13 thousands of people, as it should be, and if we do a bad
14 job, then we should no longer be the monitors.

15 CHAIRMAN KELLIHER: My time is up?

16 MR. HARVEY: Yes.

17 CHAIRMAN KELLIHER: I apologize.

18 MR. BOWRING: I'm sorry.

19 CHAIRMAN KELLIHER: That was a good two minutes,
20 though, I have to say.

21 (Laughter.)

22 CHAIRMAN KELLIHER: Commissioner Wellinghoff.

23 COMMISSIONER WELLNGHOFF: Thank you, Joe.

24 Hopefully, Joe, if we can, if we have to push into lunch,
25 I'll take my six minutes now, but this is an extremely

1 interesting dialogue we're having here, and I think
2 everything that's been said here, has been very useful, and
3 I know that there's probably a lot of questions.

4 And to follow up on your discussion with Mr.
5 Bowring, Joe, but going over to David, Joe indicated that
6 it's his belief that the MISO could not in any way influence
7 your HR, your budget, or the outcome of a report, but who
8 holds your contract?

9 MR. PATTON: They do, but they can't make any
10 substantive decisions regarding my contract, without your
11 approval.

12 COMMISSIONER WELLNGHOFF: Okay, so, what's the
13 term of that contract for?

14 MR. PATTON: It's renewable every two years.

15 COMMISSIONER WELLNGHOFF: Okay, so at the end of
16 two years, though, they could terminate the contract?

17 MR. PATTON: Not without your approval. It's in
18 the tariff. This was the subject of quite a bit of debate
19 and filings by the states in the Midwest that wanted
20 additional assurance that there would be independence, and
21 the Commission ordered that the contract provisions be in
22 the tariff, and that MISO not have the authority to
23 terminate or fail to renew us, without filing with the
24 Commission and getting approval.

25 COMMISSIONER WELLNGHOFF: Okay, so that then

1 gives you that level of independence with approval authority
2 on the contract.

3 MR. PATTON: Yes.

4 COMMISSIONER WELLNGHOFF: And, Joe, you indicated
5 in your statement that there seems to be some indication by
6 your management, that there's going to be a change in the
7 structure of the MMU.

8 With respect to that, let's assume that there is
9 going to be such a change. Could you tell me what you
10 believe would be the best way to do the transition? In
11 other words, I recognize that if you've got internal
12 employees that were doing a job and, at some point in time,
13 they think they're not going to be doing that job, there is
14 some internal morale issues and others.

15 What would be the most effective way to ensure
16 that we can continue to have good market monitoring in the
17 face of a transition, if there's one at PJM, or, more
18 generically, if this Commission's rulemaking were to decide
19 that there should be a transition throughout the RTOs with
20 respect to the structure of an MMU? What would be the best
21 and most effective way to do that transition?

22 MR. BOWRING: The first thing is to ensure the
23 maintaining of the current structure during the discussion
24 period. And the problem is that, based on PJM's strategic
25 report, there's going to be a discussion period, although

1 we've been told that management has a particular view about
2 that.

3 But during the discussion period, it's critical
4 that the resources be maintained for the market monitoring
5 unit; that employees not be recruited away; and that we
6 continue to be able to maintain our effectiveness.

7 In addition, unless there is a reason not to, I
8 would think that the same staff be given the opportunity to
9 be in whatever the new structure of the market monitoring
10 unit turned out to be.

11 I mean, I think that the staff of the market
12 monitoring unit in PJM has been doing excellent work for a
13 number of years, but what makes sense, is to have a stable
14 transition that everyone understands, rather than a process
15 where the market monitoring unit and their staff feel that
16 they're being attacked and subject to, really, an
17 unacceptable degree of uncertainty.

18 So, ideally, the process of decisionmaking would
19 be quick, and then the ability to have a stable transition
20 would make sense.

21 And I would agree with your question before,
22 which is clearly that a short-term contract, provides even
23 less independence than being an employee, but having --
24 again, I'm not sure that David knows the details, but having
25 a contract which is subject to the Commission's authority to

1 renew or not, I would think is a substantially different
2 matter.

3 COMMISSIONER WELLNGHOFF: Well, let me go back to
4 David on that particular question. David, would you view
5 your role or your function, your activities, any differently
6 and would you see any advantages to FERC holding that
7 contract, instead of MISO?

8 MR. PATTON: Well, I worked for the Government
9 and have done some contracting. I think it would be far
10 more complex.

11 COMMISSIONER WELLNGHOFF: Okay, so let's set
12 those complexities aside.

13 (Laughter.)

14 COMMISSIONER WELLNGHOFF: Let's talk about they
15 day-to-day operation. I mean, certainly there's getting the
16 contract in place and those complexities. That's a separate
17 issue, as I see it.

18 But as to the issue of doing your job, how would
19 it differ, if at all, in your view, and would there be any
20 advantages or disadvantages, again, other than this
21 complexity of contracting with the Government, to having it
22 structured that way?

23

24

25

1 MR. PATTON: I don't see it as being
2 significantly different. Ultimately FERC is the decision
3 maker on my contract, the way it's been structured, under
4 the RTO tariff. I'm not sure in reality it would change
5 very much.

6 COMMISSIONER WELLINGHOFF: You have actual
7 employees onsite that are there every there.

8 MR. PATTON: Yes. And our access to data really
9 is extraordinary. The market runs every five minute period
10 and with 30 seconds we have all the information on all the
11 inputs and outputs of each five minute period, and an
12 automated software that processes and screens the data for
13 anyone who is not located in offices, we're virtually there
14 through out directing officials with all the MISO data
15 systems.

16 CHAIRMAN KELLIHER: If you could comment on some
17 of the discussion with had with Mr. Nordhaus about one of
18 the potential roles of the Market Monitors and that's
19 looking at the best practices and how they can do some
20 benchmarking. Is that some function you perform with MISO?

21 MR. PATTON: As part of the state of the market
22 report, we all report on and evaluate the performance of the
23 market and we've engaged in a process with FERC to
24 standardize the metric that can be used for that sort of
25 benchmarking.

1 That work I would say is fairly preliminary and
2 you know, more work could be done in that area to get
3 comparable benchmarks across the markets.

4 It's a hard job to do though because the
5 performance is so linked to the market rules that you're
6 examining, but I think that probably there are ways to
7 develop standard matrix that can be used to do comparative
8 evaluations of the markets.

9 MR. HARVEY: Commissioner Wellinghoff your six
10 minutes is up.

11 COMMISSIONER WELLINGHOFF: Amazing how fast it
12 goes.

13 CHAIRMAN KELLIHER: I'm willing to eat into lunch
14 time at the end and why don't we go through, colleagues?
15 Commissioner Kelly.

16 COMMISSIONER KELLY: FERC has a number of ways to
17 implement regulations of RTOs. One of them is, as David has
18 suggested, by approving contracts. It sounds like their
19 contract has a lot of protections in it that protects the
20 Independence of the Market Monitor.

21 It seems to me that the same protections could be
22 achieved by having those protections in a tariff. In fact,
23 you said that your contract is part of the tariff. It seems
24 to me there could be tariff provisions that impose the same
25 obligations on the RTO as your contract does and impose the

1 same obligations on an entity called the Market Monitor,
2 whether that Market Monitor is employed by contract or
3 employed directly through payroll deductions by the ISO or
4 the RTO. Would you agree Joe?

5 MR. BOWRING: Yes I would. I'm assuming as long
6 as that tariff is enforceable by the Commission, I think
7 absolutely.

8 COMMISSIONER KELLY: It sounds to me, again that
9 this is the way we should be thinking about it, is looking
10 at the tariff provisions and trying to include in our
11 policies, our rules, our regulations, which go into the
12 tariff.

13 To be more specific about the functions that we
14 expect the Market Monitor's job to entail, that is the RTO's
15 job, at least at this point, unless Congress gives us a lot
16 of authority and a lot of budget, and a lot of resources and
17 two specifies to the degree of specificity that's deemed
18 necessary how those functions are to be carried out.

19 In other words, to assure the appropriate level
20 of independence. One thing that Dr. Hobbs mentioned in his
21 testimony, that I thought was interesting, is he said,
22 whether you're internal or you're external, whether you're a
23 contractor employee or a regular employee, RTOs there is
24 sometimes bad advice that Market Monitors have to give RTOs.
25 RTOs will not be predisposed to want to hear (1) misbehavior

1 of market practice (2) RTO initiatives that might be hurting
2 the market and (3) pure market performance of the RTO's
3 established market.

4 I thought that was insightful and probably
5 truthful. I want to ask him, what would the Commission do
6 to ensure that the Market Monitor would be able to deliver
7 that information without any fear of delivering and
8 certainly without any retribution?

9 Do we impose an obligation on the RTO to ask you
10 for this info? Do we impose an obligation on the Market
11 Monitor to give the info? Isn't there some other way to
12 achieve it? Do we have an internal and an external?

13 MR. BOWRING: In think in order to get to the
14 right answer, if you assure independence via tariff or a
15 contract, you will get the rights answers and the Market
16 Monitor will be independent, feel independent, and can give
17 you all the advice that the Market Monitor thinks is
18 appropriate about the markets.

19 If it's bad news, everyone needs to hear the bad
20 news about the markets. If it's good news, people need to
21 hear the good news about the market. Usually it's somewhere
22 in between.

23 So I believe that the assurance of independence
24 catches it rather than having more specific rules to say you
25 must tell us bad news. You provide the independence of the

1 Market Monitor and you will get all the news about the
2 markets.

3 COMMISSIONER KELLY: Thank you. Keith.

4 MR. CASEY: Commissioner Kelly. This is you
5 independence and the ability to provide bad news, you have
6 to attack it from a lot of different angles and I think
7 you're absolutely right.

8 There is more that could be done to the tariff
9 provisions to further clarify and reinforce our independent
10 role, monitoring, and that would certainly help in our
11 ability to convey that information.

12 I also think, as you heard from the prior panel,
13 that having an external independent committee or advisor is
14 another vehicle for getting that information out. I don't
15 think there is one solution to this. I think you have to
16 look at a collection of things. That facilitate the role of
17 monitoring and providing that information.

18 COMMISSIONER KELLY: Thank you. Hung-Po.

19 MR. CHAO: Thank you. I can speak just from the
20 ISO Mew England experience. With regard to your question
21 about bringing bad news to management and how that is
22 working.

23 I personally feel that it works well in New
24 England with our current structure with the independent and
25 external and internal independent market monitors. When the

1 issue here can be looked at from three perspectives. One is
2 that it's a jurisdictional obligation we all feel.

3 Along with the RTO we have the obligation to
4 ensure the market performs long term. The question is only
5 how to do that. So I will speak from two other
6 perspectives. The managerial and the professional
7 viewpoints.

8 From a managerial standpoint and when we have
9 both internal and external market monitors or either one of
10 us has identified areas that warrant management attention,
11 usually we consult with each other.

12 When we have a consensus on this view, then the
13 management usually can not ignore that. So management is
14 responsible for resource allocation, making decisions and
15 the overall organization efficiency, so we respect that.

16 Then from a professional standpoint of view, no
17 matter how rigorous one individual can be, always in the
18 profession, we always would like to have a peer review.

19 So in the case of internal mitigation, we always
20 would like to go out and before we go out to get a referral
21 to take action to get the internal market monitor's
22 confirmation on that, then we can adjust our opinion
23 objectively based on facts.

24 In the same way when the external market monitor
25 has undertaken an assessment, we always can serve as a peer

1 review to check the facts and to give us our comments. So I
2 think this whole process benefits from that.

3 When the views here are going through this
4 professional process and also respecting management
5 priorities, so far, as far as I can tell in ISO New England,
6 this process works well in the balance.

7 COMMISSIONER KELLY: As a follow-up, you
8 mentioned in your testimony that having a more interactive
9 relationship would be helpful. Are you thinking that from
10 the perspective of peer review?

11 MR. CHAO: Thank you for that question. I'm
12 thinking about this restructuring as a process, as an
13 evolutionary process. As Commissioner Kelliher mentioned
14 about seven years ago, the significance of market
15 manipulation was underestimated, the scope and severity.

16 We all learned from that. We're still on a very
17 steep learning curve. Overall, ultimately what we see this
18 market is moving towards as it matures, is to embrace demand
19 response and I could, in 2000, at the National Academy, I
20 put together a list of engineering accomplishments of the
21 20th Century. At the top of the list is electrification.

22 So far, what electrification has accomplished is
23 a very efficient supply system. As I came to the ISO I
24 fully respect that as I saw how things were working. The
25 house side is as simple as a clock, but until you open it up

1 and you can see how the various parts are working together
2 as we move forward.

3 Some other colleague used another metaphor,
4 saying that this is like a bee hive. There is an order in
5 there. It produces honey, however, as we move forward. To
6 bring the demand side into this market, I see that a lot
7 more communication will be helpful.

8 As you said, this is a profession. I fully agree
9 and as Commissioner Kelliher mentioned whether this job is
10 professor or cop, probably I'm leading towards the
11 professor, but I think this professor needs to be able to
12 cover four areas: engineering, to understand Kirchoff's
13 laws; economics, to understand the laws of supply and
14 demand, business and also the law.

15 If we can find that ideal candidate that embodies
16 all this different expertise, I think that I would call a
17 market monitor.

18 MR. HARVEY: Speaking of the clock.

19 (Laughter.)

20 COMMISSIONER KELLY: I think we have six right
21 here.

22 CHAIRMAN KELLIHER: Commissioner Spitzer.

23 COMMISSIONER SPITZER: Thank you Mr. Chairman.
24 First an observation, then some questions. On the question
25 of independence, I'm inclined to agree with Commissioner

1 Kelly that the distinction between independent contractor
2 and employee, while very important for federal tax purposes,
3 is not particularly important for independence.

4 I can certainly construct hypotheticals where an
5 employee would have unfettered independence and a contract,
6 no matter how well written, could not result in
7 independence.

8 It does occur to me, in one of my prior lives
9 where I was with an outside auditing firm and I remember Mr.
10 Casey raised an analogy of independent auditors. You have
11 inside auditors that have certain rules and accountancy
12 guidelines.

13 You had outside auditors and one of the firms had
14 a circumstance where an audit partner child received one
15 share of Disney stock from the grandparent and it was posted
16 in the kid's room, Mickey Mouse. This gave rights to a
17 Mickey Mouse independent issue. It had nothing to do with
18 the Disney audit, but it was a partner of someone, of
19 someone of someone who did the Disney audit.

20 So the firms all engaged in these independent
21 witch hunts where a whole lot of attention was focused on
22 where I come from, we call chasing coyotes and not focusing
23 on what the real issue was, which was, is there an
24 independent functioning of the professional responsibility
25 of the outside auditor.

1 It's a function of test. It's not a structural
2 test in my judgment. I would prefer to spend time on a
3 determination of what is actually functional independence
4 within the relationship between the monitor and the RTO as
5 opposed to obsession with the independence in terms of
6 employee versus contractor or with the contract
7 relationship. That's just my view on that.

8 In terms of the questions, the FERC views its
9 responsibility to the ultimate rate payers in terms of
10 accountability, there is a question to whom are you all
11 accountable. I would like to think that all rate payers are
12 high up on the list.

13 There has been some discussion of RTO expenses.
14 It seems to me that some degree of oversight with regard to
15 expenses, as opposed to market operations can be very
16 helpful. FERC can't monitor all those expenses. It's very
17 difficult for outside rate payer groups to get meaningful
18 input into the process.

19 To what degree, do you think, first of all, that
20 administrative overhead and other expenses is a relevant
21 concern of the monitoring unit? Secondly, what additional
22 tools would you need if the answer is yes?

23 MR. CASEY: Thank you Commissioner Spitzer. I
24 think the issue of RTO expenses, I'd like to address
25 concurrently, if the issue Commissioner Wellinghoff raised

1 about ISO best practices. Because I think it's important we
2 keep in mind the scope of the responsibilities of the market
3 monitoring unit and its limited resources for that, and that
4 we leverage to the extent possible the ISO itself because
5 the ISO itself or the ISO/RTO is independent. \

6 They have market design departments that are
7 looking at best practices across organizations. Their
8 management is looking at their operational expenses. So I
9 think there is a lot of important things this Commission
10 ought to be concerned about that can be addressed through
11 the ISO itself.

12 My own view is the market monitoring unit should
13 be focused on what are the big market efficiencies, market
14 manipulation issues out there that need our attention. I
15 would caution against an expended role of the market
16 monitoring unit, because I think it could create a lot of
17 unnecessary redundancy.

18 I'll stop there.

19 COMMISSIONER SPITZER: Does anyone else have a
20 view on expenses that may be different.

21 (No response.)

22 COMMISSIONER SPITZER: Okay. In discussion of
23 potential models, there was raised California's use of
24 external and the consensus seemed to be that there was a
25 well-viewed external function from not only the market

1 participants, but also government and there was faith and
2 confidence in that particular institution.

3 So I'll guess I'll start with Mr. Casey as to
4 what -- how that could be replicated elsewhere and then to
5 some of the other panelists, particularly to those in multi-
6 state. Is there a distinction between a single-state ISO
7 and a multi-state RTO that would make the external process
8 more difficult where you had seven or eight different
9 jurisdictions with more political constituencies to keep
10 happy as opposed to a single state?

11 MR. CASEY: I think the concept of an independent
12 market advisory group or a committee, I think is a fairly
13 easy one to establish. The difficulty often is finding
14 qualified people that have the prerequisite and don't have
15 conflicts.

16 It has proven to be a challenge in our case
17 that's resulted primarily in those key positions being held
18 by people in academia but I think they provide a very
19 distinct and important perspective on the market because
20 they're not involved in the day-to-day activities that we
21 are and can look at it from more of a global perspective,
22 not just looking at practices across the country, but also
23 looking at practices across the world.

24 And really detatch more from, I guess, being
25 captured by the stakeholder process and the day-to-day

1 deliberations on this stuff. They can kind of look at it
2 from a higher level.

3 I don't think it's a hard concept to set up. I
4 think as you do it you want to look at what you're trying to
5 accomplish, particularly if you're combining it with an
6 internal monitoring function and an external. Clarify the
7 rules and responsibilities and how those two roles
8 compliment each other. I think that's the important thing,
9 is to get that aspect right.

10 MR. BOWRING: I think PJM is the only RTO without
11 an external panel. I actually think an external panel along
12 the lines of California would be a good idea, but it's also
13 important to note that I don't believe it's a substitute for
14 an independent internal monitor or an independent monitor.
15 I won't use the word internal because I don't think it
16 really means anything but an internal employee, contract, or
17 whatever.

18 I think as Keith just said, clearly it
19 complements, clearly it would be good to have a group of
20 professionals whose job it was to regularly interact with
21 the market monitoring unit to do peer review of their work
22 and to serve as a sounding board and a source of expertise.
23 I think that would be a great idea but it is critical to not
24 say or not assert that that is a substitute for independence
25 for the basic monitoring function.

1 The external monitors while they do good work, do
2 not have access to -- it's not their job to have access to
3 the day-to-day data. They wouldn't know if they were
4 missing something on the day-to-day basis. It's not their
5 job. It would be the job of the independent monitor to do
6 that.

7 I would just add that in addition, things worked
8 pretty well at PJM for the first three or four years I was
9 there as well. I think it highlights an issue that someone
10 else had raised, which is ultimately there have to be
11 institutions to protect independence, regardless of whether
12 everyone is getting along well or not. It shouldn't
13 ultimately depend on personal relationships. It has to
14 ultimately depend on institutions that can provide a
15 framework for those.

16 COMMISSIONER SPITZER: One of the disquieting
17 statements in the prior panel was that the personality issue
18 can change. To again reiterate the audit model. The
19 insider auditors and the outside auditors are both
20 accountants, however, once their subject different
21 professional structures, they're accountable to different
22 institutions. Mr. Patton, why don't you describe a little
23 bit how MISO works with the external?

24 MR. PATTON: I would say that much of what Dr.
25 Hobbs described is a function that we perform and MISO being

1 an external entity, we do independent evaluations of market
2 design changes and market rules that MISO is proposing to
3 implement.

4 We meet with stakeholders and discuss those
5 rules. We meet independent of the RTO with the states in
6 the Midwest that is, I think, our interaction with the
7 stakeholders as an independent entity from the RTO, and with
8 the states it's very important.

9 Maybe particularly with the states, because we
10 are in partnership with them in a number of ways. We
11 provide them advice on how their regulations may inhibit the
12 efficiency of the market and response, how it may affect,
13 how regulated entities participate in these markets.

14 If any of those contexts being viewed as an
15 independent expert is very important.

16 COMMISSIONER SPITZER: Do you think that
17 communication might be different if those folks were
18 employees of the MISO?

19 MR. PATTON: I would speculate that it would be
20 more difficult to achieve the same level of independence
21 because basically, there is one lever that MISO can use to
22 try to influence us and directly oversee us.

23 Were we employees of the RTO, there are many,
24 many levers they can use and Joe listed a whole bunch of
25 them. While the tariff provisions would be useful in trying

1 to address those, it seems to me it would have to be a
2 pretty detailed tariff to try to make sure all of those were
3 basically out of the hands of the RTO.

4 MR. HARVEY: Commissioner Spitzer, your six
5 minutes is up.

6 CHAIRMAN KELLIHER: Commissioner Moeller:

7 COMMISSIONER MOELLER: First I briefly note,
8 Commissioner Spitzer, having grown up on a ranch with cattle
9 and sheep, chasing coyotes was actually not an insignificant
10 part of my duties.

11 (Laughter.)

12 COMMISSIONER MOELLER: I have appreciated the
13 discussion on independence, but I have a couple other
14 questions. The first relates to your monitoring functions
15 outside your market. What I have here says New York SPP and
16 California tariffs speak to monitoring outside the
17 geographical boundaries, but the other tariffs don't.

18 I guess specifically, Mr. Bowring and Mr. Chao
19 and Mr. Patton, is that a flaw in the tariff? In the
20 context last week we had a technical conference on the
21 eastern seams. We had one particularly good description of
22 going back to the granularity of the data of one transaction
23 that had originated in Louisiana, had penetrated somewhere
24 in a PJM seam and it seems to be a significant example. Can
25 you elaborate on that?

1 MR. BOWRING: Yes. It's an important point. We
2 have been looking at loop flow issues of the kind Andy Atlas
3 described to you last week and we've been looking at it for
4 some time.

5 It is critical that PJM and the market monitoring
6 unit have access to data on the entire eastern
7 interconnection so that we can see the impact of non-
8 transparent markets on PJM but I assume the same is true for
9 New York and MISO as well.

10 We've been working with MISO and we've been
11 working to get access to data from markets but having the
12 ability to see and understand the impact of those external
13 markets on PJM is critical.

14 COMMISSIONER MOELLER: Thanks. Mr. Chao.

15 MR. CHAO: I agree. From our experience in New
16 England, we are located, in terms of the network, roughly at
17 the end branch, so we don't experience as much of the
18 internal loop flow, but we do have interactions with the
19 Canadian system operation and in New York, our external
20 market monitor and also has a lot of direct knowledge of the
21 ISO New York.

22 We also have staff talking to New York staff, so
23 we deal with some of these single source contingency issues,
24 for example, that are well under control. So we don't have
25 significant issues at this point, but that's one thing on

1 our radar screen.

2 COMMISSIONER MOELLER: Thank you. Mr. Patton.

3 MR. PATTON: I believe the MISO tariff does
4 direct us to review some things outside the markets. It's
5 fairly clear that we are not primarily mandated to monitor
6 bilateral markets, for example, but it does say we need to
7 understand the impacts of actions in those markets relevant
8 to ours, or the impact on our market on them.

9 I know the states also find it very important
10 that we understand how the actions in the gas markets in the
11 Midwest effect the electric markets, because there are some
12 significant issues with certain pipelines in the Midwest.

13 So we do do a fair amount of work to evaluate
14 things happening outside our markets and in different
15 markets or fields, and we work intensively with adjacent
16 areas, for example, PJM to monitor the interaction between
17 our two markets and the market to market interface between
18 the two areas that you heard about last week.

19 COMMISSIONER MOELLER: Okay, the second question
20 then relates to another area where potential transmission
21 market power activities and only SPP's plan specifies that
22 the MMU was to monitor for potential transmission market
23 power activities. The rest of you, is that a glaring
24 omission?

25 MR. CASEY: I don't think it's an omission at

1 all. That's something we view as well within the scope of
2 our current functions.

3 MR. BOWRING: We also view it as within the scope
4 of our functions.

5 MR. CHAO: Agree.

6 MR. BOUCHEZ: Definitely.

7 MR. PATTON: It's a bit vague, but the term
8 "electric facilities" in most of our tariffs include
9 transmission facilities, so physical withholding influence
10 withholding of transmission.

11 COMMISSIONER MOELLER: Okay, Mr. Dillon. Not to
12 leave you out, any thoughts, given the new nature of that
13 role and what you've seen so far?

14 MR. DILLON: The transmission market tends not to
15 be as exciting as the energy market. So I feel it has ended
16 up with a lot less attention than it normally would. We
17 have found that it is very essential to monitor the
18 transmission market and to even make suggestions for
19 improvement in the transmission market itself.

20 It's fine to say I have sufficient capacity and
21 such, but you have to get it to a location if the
22 transmission market has so bound itself up that you can not
23 move energy from one location to another, especially from
24 outside the footprint into the footprint and you have
25 limited the market itself.

1 COMMISSIONER MOELLER: Well said. Thank you.

2 CHAIRMAN KELLIHER: Great. Thank you.

3 Commissioner Wellinghoff had some questions. Do my other
4 colleagues have questions?

5 (No response.)

6 CHAIRMAN KELLIHER: John.

7 COMMISSIONER WELLINGHOFF: Not to stand in
8 everybody's way of lunch, but I have an area that I want to
9 follow up on. It shouldn't take more than a couple of
10 minutes. Thank you for the accommodation. Mr. Chairman, I
11 appreciate it.

12 Mr. Casey, back to our conversation about the
13 issue of the scope of the market monitors' duties. I think
14 you indicated in your earlier response to me that you didn't
15 think it was appropriate for the market monitor to include
16 in that scope, baselining and best practices, is that
17 correct?

18 MR. CASEY: Not exactly. What I was saying was
19 that we should leverage to the extent possible, the business
20 functions that reside at ISOs and RTOs in those areas.

21 I'm not saying that a market monitoring unit
22 shouldn't pay attention to best practices when it comes to
23 market design, but they shouldn't be the first and foremost
24 entity you would go to to look at that. I think that in the
25 first place falls to the ISO/RTOs themselves to look at best

1 practices across their organizations.

2 I think our job is to participate in that and
3 focus in on the issues that we think matter most in our
4 primary area, which is, are there problems in the design
5 that are leading to big inefficiency issues or creating
6 potential market gaming or manipulation issues.

7 COMMISSIONER WELLINGHOFF: I'm glad you ended on
8 that. That's right where I want to go, big inefficiency.
9 Let me take you into the context of the conference we had
10 last month, we had on wholesale market competition and how
11 markets are functioning.

12 And practically every one of our panelists were
13 on those panels came forward and said that the big
14 inefficiency is not having enough demand response into our
15 markets.

16 As a market monitor in California, what have you
17 been doing in that area specifically?

18 MR. CASEY: It's something that we feel very
19 strongly about. Demand response is very important for
20 market efficiency and it's a tool for negating market power
21 concerns.

22 It's something that we are very involved in,
23 working with the ISO departments as well as the state
24 agencies in California that are looking at demand programs.
25 I think, the point I'm trying to make is, in that role,

1 we've tried to leverage to the extent we can, the ongoing
2 activities within the ISO as well as within the state and
3 provide our contributions.

4 COMMISSIONER WELLINGHOFF: I think I heard your
5 answer to say that you don't see it as your primary
6 function.

7 MR. CASEY: I don't.

8 COMMISSIONER WELLINGHOFF: In the sense that you
9 would put that in a box of things of you would leverage to
10 other departments outside the ISO and you wouldn't consider
11 looking at best practices of demand response and trying to
12 influence the ISO management to incorporate those as part of
13 your job.

14 MR. CASEY: I would consider that part of our
15 role.

16 COMMISSIONER WELLINGHOFF: Are you doing that job
17 right now?

18 MR. CASEY: I think we are, yes.

19 COMMISSIONER WELLINGHOFF: How are you doing it?
20 That was my question. I didn't think I got an answer
21 before.

22 MR. CASEY: It comes in being engaged and
23 understanding what the current demand programs we have in
24 California, following and participating in the activities to
25 further develop and promote those programs.

1 COMMISSIONER WELLINGHOFF: You think you
2 currently have enough resources to effectively do that?

3 MR. CASEY: I think on the issue of resources,
4 allocation of resources is always a challenge. All of us
5 are relatively small groups and we have a lot of important
6 functions to do, both in terms of looking for enhancements
7 to the market design that will improve things, as well as
8 the day-to-day monitoring functions.

9 It's a challenge. It will always be a challenge.
10 We just try to balance our efforts across all those
11 different important functions.

12 COMMISSIONER WELLINGHOFF: Getting those
13 resources as being a challenge, do you think it would be
14 less of a challenge for somebody like Mr. Patton in a
15 contract situation than it would be for someone who is
16 institutionalized inside the ISO and has to compete in
17 budgets, I assume, with everybody else's budget?

18 MR. CASEY: I don't think there would be a
19 significant difference there because at the end of the day,
20 the contract that you would have for an external monitor is
21 part of the ISO's overall budget and expenses. So there
22 will be just as much pressure, I would think in hiring the
23 external entity to keep that contract cost down, as it would
24 be with internal monitoring unit.

25 COMMISSIONER WELLINGHOFF: But if you come to us

1 and say, he doesn't have enough money in his resource
2 contract, you can't come to us and do that.

3 MR. CASEY: That's true. That gets to, are there
4 additional enhancements we could make to the internal market
5 monitoring function that would better ensure both
6 independence and sufficient resources.

7 I think there are tariff provisions that could
8 perhaps provide, as Chairman Kelliher described, an appeal
9 process if a market monitoring unit felt it was not getting
10 adequate resources, or is inappropriately having resources
11 taken away, it would have access to the Board of Governors
12 to review that so there could be safeguards put in place
13 within the Board structure to help them mitigate that
14 concern.

15 COMMISSIONER WELLINGHOFF: Are those safeguards
16 in place in California?

17 MR. CASEY: I think there is more that can be
18 done with regard to our tariff provisions in that area. So
19 as I mentioned, I think there is probably a number of areas
20 that we could enhance our tariffs to better facilitate our
21 role in monitoring the independence as well as ensuring we
22 have the resources that we need.

23 We do have a provision in our tariff that says
24 something to the effect that the ISO's CEO shall make sure
25 that the market monitoring unit has sufficient resources to

1 do its job. That's a good place to start, but I think more
2 could be done to enhance those provisions.

3 COMMISSIONER WELLINGHOFF: One final area, Mr.
4 Chairman if I may. Mr. Chao, you made a statement about the
5 two way communication. The Chairman indicated to you, and I
6 agree with him, that it can't be completely two way. There
7 are certain things that FERC obviously can not give
8 information back to the MMU, but you did indicate that you
9 thought some additional communication was necessary to help
10 you with respect to things like demand response.

11 If you could elaborate on that. What kind of
12 communication do you think you need from us? I'd be very
13 interested in that.

14 MR. CHAO: Thank you for the question. I don't
15 think I would be getting into the details. Let me just
16 report on other things.

17 COMMISSIONER WELLINGHOFF: If you want to submit
18 something in writing that's fine. We don't have to take
19 everybody's lunch time. That's fine too. If you wanted to
20 summarize it, sure.

21 MR. CHAO: I will do that too. I think at this
22 point we see that, as the marketing is evolving, we see that
23 multiple market documents are being developed, reserve
24 markets and capacity markets and demand response has a role
25 in those areas.

1 We are constantly monitoring the performance of
2 demand response in those areas and also see the interaction
3 among these markets. It would pose some new challenges for
4 identifying market manipulation and also this is a chance to
5 review on both sides how to grow the market and how to make
6 the market work based on what we have in the tariff.

7 COMMISSIONER WELLINGHOFF: Thank you Mr.
8 Chairman.

9 CHAIRMAN KELLIHER: I just have one question for
10 David and it will be short. A short question lends itself,
11 I think to a short answer. Part of the argument, well
12 relatively short question and hope for a short answer.

13 Part of the argument about independence is that
14 the market monitor's job in part is to look at market rules
15 and see which ones are work, well, which ones where there is
16 need for improvement and there is a possible that the RTO
17 might be resistant to change, might be unwilling to admit a
18 flaw in a current market rule and be resistant to change.

19 But some of the market rules reflect the market
20 monitor's imprimatur because part of your job is to propose
21 rule changes internally or even in some cases, directly to
22 the Commission.

23 So, doesn't the same notion of while the RTO will
24 resist admitting a rule is failing, if we invested in that
25 rule, doesn't that extend to the market monitor themselves?

1 Because part of your job is to propose rule changes. Those
2 rule changes end up getting incorporated in the rules.

3 It seems like you might have the same
4 hypothetical vesting issue, unless you are just cold-blooded
5 as a breed and have no problem admitting that a rule change,
6 that you might have actually sponsored ended up not working
7 that well.

8 MR. PATTON: I don't know how to answer that.

9 (Laughter.)

10 CHAIRMAN KELLIHER: Let me ask you, have you ever
11 proposed a rule change for being incorporated in RTO that
12 ended up needed further improvements down the road and you
13 have honestly admitted that?

14 MR. PATTON: Unfortunately most of them.

15 (Laughter.)

16 MR. PATTON: But let me comment. I think it's
17 less the market rules that there would be resistant to and
18 more the conclusions, how they're operating the market.

19 CHAIRMAN KELLIHER: The overall conclusion is
20 that the markets are operating well, badly?

21 MR. PATTON: Particularly what their employees
22 are doing and how the actions and the discretions of their
23 operators are affecting the markets, is by far the most
24 sensitive thing as opposed to whether a rule is optimal or
25 not.

1 CHAIRMAN KELLIHER: You don't see that same
2 concern that an RTO might resist a rule change, improvement
3 in a rule?

4 MR. PATTON: We've never. The only resistance
5 we've ever gotten from an RTO on a rule change is related to
6 them not having the IT resources to prioritize it very
7 highly but certainly the markets are complex enough. I
8 wasn't joking, although it sounded funny, most of the time
9 when you propose and put in place a rule, it doesn't do
10 everything you thought.

11 It might have unintended consequences, so it's
12 part of the monitoring process to continue to continuously
13 involve the market.

14 CHAIRMAN KELLIHER: thanks. That's something
15 that's bothered me. I always thought, why would an RTO
16 resist a rule change that would improve the RTO unless
17 somehow they're supposed to assume that rules are perfect
18 and can't possibly be improved. I don't know why.

19 MR. PATTON: That's not a concern.

20 COMMISSIONER KELLY: I was just going to add to
21 the point that you made and that David made that Dr. Hobbs
22 said the same thing. Monitoring the effect of operator
23 discretion or how the employees work is really one of the
24 most sensitive but it's one of the most important jobs that
25 a market monitor can undertake.

1 What's interesting to me is that I never thought
2 of that and I suspect that's because I'm not on the ground
3 with you monitoring the markets. But show us how important
4 that is.

5 CHAIRMAN KELLIHER: Thank you. I want to thank
6 this panel. It's been very interesting. We have eaten into
7 our lunch your. I think out of consideration for the future
8 panelists of the afternoon panelists, we need to resume at
9 one o'clock. I don't want to disrupt anyone's travel plans.
10 We need to resume at one o'clock and I thank the panel.

11 I always want to point out lunch for the
12 panelists is being provided courtesy of Commissioner
13 Moeller. We're operating under a continuing resolution.
14 There are certain economies and Commissioner Moeller has
15 intervened and he saved you from monopoly rents at Sunrise
16 Caf .

17 (Laughter.)

18 CHAIRMAN KELLIHER: Thank you.

19 (Whereupon, at 12:20 p.m., the
20 conference was recessed, to reconvene at 1:05
21 p.m., this same day.)

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1 A F T E R N O O N S E S S I O N

2 CHAIRMAN KELLIHER: I'd like to call Panel 2.2
3 up. Actually we're using the decimal system today, and
4 let's close the doors. I hope all of our panelists are
5 here. Yes they are; let's start with Karen Edson, Vice
6 President, External Affairs for the California ISO.
7 Welcome.

8 MS. EDSON: Thank you Chairman Kelliher,
9 Commissioners and Staff. I'm the Vice President for
10 External Affairs. As you indicated, I'm honored to appear
11 here before you. I'm here in place of our CEO who could not
12 make it. I think the most I can hope to do is fill one of
13 his shoes, but I will do my best.

14 The discuss so far today has really focused a lot
15 on independence of market monitors and I think a good
16 understand of the California market monitoring structure.
17 You already know that we have a department of market
18 monitoring led by Keith Casey who testified on the prior
19 panel.

20 We have a Market Surveillance Committee, a Blue
21 Ribbon Panel, and External Experts that inform many of our
22 market deliberations and report directly to our Board of
23 Governors.

24 In my comments, I'll be focusing on what we as
25 management view as other duties and benefits of the

1 Department of Market Monitoring. These are benefits
2 provided to the ISO itself.

3 First and foremost, are those benefits that
4 derive from the Department's day-to-day oversight of our
5 department's operations. They're able to move quickly to
6 mitigate prices and recommend market design changes because
7 of that day-to-day engagement in our organization.

8 In California, of course, we learned the hard way
9 about how important it is to move quickly to mitigate market
10 problems before they really go out of control. This is
11 something we value very highly and take very seriously.
12 This group is staffed by highly-trained, skilled experts.
13 They have of course ongoing access to market informationk,
14 and they are very well positioned to analyze and identify
15 and understand the problems as they unfold.

16 Furthermore, there role within the ISO staff
17 allows them to bring the issues quickly to the attention of
18 the CEO and our Board, as appropriate.

19 The second category of benefits that I wanted to
20 identify are those that derive from the expertise that the
21 Department provides to other aspect of ISO activities.
22 Those benefits come in the form of the review of ISO
23 transmission project assessment and their assessment of our
24 market design development and proposals.

25 I've been with the ISO a relatively short time,

1 about a year and a quarter, and already I've seen
2 circumstances where their independent review of analytic
3 material has been of great value and has helped us avoid
4 issues that might otherwise become problematic.

5 They also provide, of course, independent
6 analysis of market design proposals during the development
7 of those proposals and when they come before the Board's
8 deliberation.

9 This counsel has tremendous value to management
10 and our Board because of their combined independence and
11 level of expertise. Together, these two traits,
12 independence and expertise in my view are the foundation of
13 their credibility and their value to the internal activities
14 of the ISO.

15 MR. HARVEY: Ms. Edson, your time is up.

16 MS. EDSON: Let me just summarize by saying that
17 we as management watch ourselves more closely when the
18 Department of Market Monitoring is watching us.

19 CHAIRMAN KELLIHER: Thank you very much. I'd
20 just like to clarify, any written materials you all
21 submitted will be part of the record. Now I'd like to
22 recognize Audrey Zibelman, Executive Vice President and
23 Chief Operating Officer with PJM Interconnection.

24 MS. ZIBELMAN: I appreciate the opportunity to
25 speak with you today and to discuss what we think is a very

1 important topic.

2 As the Commission is aware, over the last year,
3 PJM has been looking at the issue of how market monitoring
4 and mitigation is done within our markets. It became an
5 important issue for us as we are looking at putting together
6 a strategic plan for the next five to ten years.

7 Since the way we look at monitoring the market is
8 really very much integral to the issue of what the RTO is
9 all about, which is administering an efficient marketplace
10 and making sure all the time the way you monitor and
11 mitigate is consistent with creating a good marketplace.

12 In terms of that, what I'd like to focus on this
13 afternoon is a little bit different. We've been focusing on
14 structural issues. What I'd like to do is focus on what I
15 think are the structuring issues that are really the
16 division of responsibilities between the FERC and its
17 judicative and legislative function.

18 Ensuring just and reasonable rates, the RTO in
19 developing a marketplace that allows for market efficiency
20 and the market monitor to basically monitor the behaviors of
21 the marketplace, both in terms of how the RTO administers it
22 and behaviors of individuals to provide further assurance
23 that the market is behaving as we want it to be.

24 In terms of that, I think the rules of the road
25 we think are important is, as we look at market monitoring

1 and we look at mitigation, it's a good ideal that we have a
2 consistent approach across all the organized market, that we
3 have an approach that can be peer reviewed, that can be
4 auditable, that is understood by all market participants
5 up front, so that it creates a great deal of certainty of
6 behavior. Those are sort of the basics I think we should
7 look at.

8 In terms of the role of FERC, we think in this
9 context of setting just and reasonable rates that we'd be
10 interesting to see what staff came up with. What we felt
11 was important is that we have never tariffed the definition
12 of what is market power. We've never tariffed the
13 definition of what is an abuse of market power. What do we
14 really mean by that?

15 And we have varying approaches across the Board.
16 We haven't looked at what type of level of concentration is
17 appropriate. Where are we going to get concern and see
18 where that can be tariffed so that it's understood.

19 We've also never tariffed or really adjudicated
20 what's the right way of determining market power. Should we
21 use a conduct and impact test that a lot of RTOs are using,
22 or should we use a structural test like is used in PJM?
23 That can have us great influence on the outcome of the
24 market as anything else.

25 We really need to step back and look at what is

1 the best practice there. Once you make that determination,
2 you can also look in that context as to how you set scarcity
3 pricing.

4 As a response to Commissioner Wellinghoff, market
5 power is necessarily determined by high prices. You need
6 scarcity pricing integrated in what you're looking at in
7 terms of abuse of market power because that's going to
8 affect your ability to get demand response as much as it
9 will affect your ability to get new generation investment
10 and other structural changes such as looking at what level
11 price information transparency you can provide to again
12 provide a structural fix against the potential abuse of
13 market power.

14 All those things we think should be adjudicated
15 by FERC and put into tariff. Once you make that
16 determination, then the role of the RTO is pretty clear.
17 It's to develop the rules to make sure that the marketplace
18 works. Those rules should also be adjudicated and reviewed
19 both by the market monitor and participants in FERC to make
20 sure they don't allow for manipulation that can be avoided.

21 Then the role of the market monitor is then to
22 monitor like the policeman on the beat. You set the rules
23 and they decide, well it looks like there is behavior that
24 we need to maybe ticket. Identify to FERC this needs to be
25 adjudicated if it's a problem.

1 They should also be looking at the market itself
2 and I'm concluding my comments and I look forward to your
3 questions. Thank you.

4 CHAIRMAN KELLIHER: Thank you very much. I'd
5 like to recognize David LaPlante, Vice President of
6 Wholesale Market Strategy with ISO New England.

7 MR. LAPLANTE: Good afternoon. Thank you for the
8 opportunity to discuss market monitoring. This discussion
9 has been very interesting so far. Market monitor perform a
10 critical role in ensuring that the markets run by ISO New
11 England are efficient according to rules and are free of
12 market manipulation.

13 The agreements making ISO New England an RTO
14 require both an internal market monitor and an external
15 market monitor. The internal market monitor serves two main
16 functions; an operational function and an assessment
17 function.

18 The external market monitor performs an
19 assessment and an evaluation function. Both market monitors
20 report to the Board of Directors. They are independent of
21 ISO management, providing the freedom to review ISO
22 operation, to assure that the ISO meets its objectives of
23 operating efficient markets to achieve reliability.

24 The ability of the internal market monitors to
25 fulfill its operational role is enhanced by its location in

1 the ISO. It has real time access to data and ISO personnel
2 to identify and understand operational market design issues
3 quickly and to take appropriate action.

4 The internal market monitor may also review
5 changes to market rules or the development of new market
6 designs before they are brought to stakeholders and
7 ultimately be commissioned to identify potential problems or
8 suggest improvements to the design.

9 The external market monitor focuses its efforts
10 on the effectiveness of the market, including the market
11 mitigation rules and also examines participant behavior for
12 attempts to manipulate the market or exploit flaws in the
13 market rules. Since the external market monitor does not
14 have operational responsibilities, he can focus his efforts
15 on analysis and reporting and perform detailed review of
16 market results.

17 In developing a governance structure that assures
18 the market monitor can function independently, I
19 think it's helpful to remember that the
20 ISO/RTO Boards are independent.

21 A governance structure has a market monitor
22 reporting to the Board of Directors and is
23 independent of ISO/RTO management, provides the
24 market monitor with the independence necessary to
25 perform its functions while providing the

1 regulatory framework within which authority can
2 be delegated.

3 So this framework, these types of arrangements,
4 have worked well for ISO New England. A healthy balance has
5 existed between ISO management. The internal market monitor
6 and an external market monitor under the supervision of an
7 independent Board.

8 This balance strengthens the independent market
9 monitoring function and has resulted in improved market
10 design and operational practices. Thank you.

11 CHAIRMAN KELLIHER: Thank you very much. And now
12 I'd like to recognize Mark Lynch, President and Chief
13 Executive Officer of the New York ISO.

14 MR. LYNCH: Thank you Chairman Kelliher, fellow
15 Commissioners. My remarks will address the role of the
16 NYISO's Board management in the market monitoring and
17 performance department, MMP interaction with the independent
18 market advisors, as well as with the Commission.

19 The NYISO's internal MMP reports up through the
20 organization to myself. The independent market advisor
21 reports directly to NYISO's independent Board of Directors.
22 A copy of the NYISO's org chart is attached to my filed
23 comments.

24 NYISO's MMP and independent market advisor
25 monitor for market power abuse and if necessary, apply

1 mitigation. They also assess whether the markets are
2 functioning properly to achieve the goal of supporting
3 investment in and the construction of new electrical
4 infrastructure that will support load growth and accommodate
5 facility retirement.

6 Since its inception in 1999, the NYISO has
7 encouraged a candid dialogue and cooperative mind set with
8 both federal and state regulators. The NYISO's MMP has
9 unfettered access to both the FERC office and enforcement
10 staff and the staff of the New York Public Service
11 Commission.

12 As noted by Dr. Bouchez, MMP participants
13 regularly schedule teleconferences with both the Offices of
14 Enforcement Staff and the staff of the PSC and responds
15 promptly to staff inquiries and data requests as they arise.

16 Since the MMP is an integral component of the
17 NYISO's organization that is able to assist us in developing
18 market rules involving our market design in addition to
19 monitoring the market and market participant behavior, the
20 NYISO MMP actively participates in the development of
21 modification of market rules, beginning with the conceptual
22 stage.

23 MMP personnel also participate in the quality
24 assurance testing for any software changes that impact
25 market rules and/or mitigation procedures.

1 Through the NYISO governance process, MMP has
2 regular direct contact with our stakeholders. The market
3 participants also have several forms for direct contact with
4 our independent market advisor.

5 Their state of the market reports prepared in
6 consultation with MMP are posted on our website. The
7 stakeholders have an opportunity to comment on their
8 conclusions and recommendations.

9 The NYISO's business model is proven and
10 effective in New York because it has enabled the NYISO's MMP
11 to work cooperatively with other NYISO departments to
12 develop new market rules and procedures, seeking input from
13 the independent market advisor.

14 Other NYISO departments assist MMP and the
15 independent market advisor in their mission to identify
16 market issues and work cooperatively with MMP in the market
17 independent advisor to solve any problems that have been
18 identified.

19 The MMP and the independent market advisor now
20 have over seven years experience in monitoring our markets
21 and two years experience with our new standard market
22 design.

23 Armed with this practical experience, MMP, with
24 the assistance of the independent market advisor, is
25 currently working to identify tariff and process

1 improvements in the market, monitoring area which may
2 require modifications to the market monitoring plans and/or
3 market mitigation measures.

4 Once the NYISO internal effort is complete, we
5 anticipate bringing in the proposed tariff changes to more
6 market participants into the Commission for approval. That
7 concludes my remarks. I look forward to your questions.

8 CHAIRMAN KELLIHER: Thank you. I'd like to now
9 recognize Richard Doying, Vice President of Market
10 Operations for the Midwest ISO.

11 MR. DOYING: Thank you very much for the
12 opportunity to address the Commission today on this
13 important topic. In the short time that I have available,
14 I'd like to focus my comments on the relationship between
15 the monitoring function and the RTO market operations.

16 It's an important relationship that's been talked
17 to a lot this morning, particularly in terms of, is it
18 internal, is it external, what are the reporting
19 relationships?

20 I think the balance that we've struck in the
21 Midwest ISO is a particularly good one. What I'd like to
22 describe is the benefits that we see from the way that the
23 market monitoring function has been established under our
24 tariff.

25 As was discussed earlier, the market monitor in

1 the Midwest ISO is an external entity. They report through
2 a contractual relationship directly to the Board of
3 Directors. That gives them a structural and functional
4 separation from both Midwest ISO staff as well as
5 participants in our market.

6 As our Board of Directors is also an independent
7 Board of Directors, there is really some specific and
8 substantive benefits that derive from the functional
9 separation and they all go into one way or another, to the
10 element of market confidence.

11 First for the monitoring and mitigation
12 functions, which has been referred to as an enforcement
13 function. As a practical matter, the Midwest ISO could
14 perform the analysis and that mitigation function ourselves.
15 We do have a staff. We do conduct analysis, although not
16 the identical analysis and we certainly have access to the
17 tools and data to perform that function.

18 There are clear benefits to having that function
19 perform by an external entity and specifically the benefit
20 of greater market confidence that market mitigation is
21 performed when its needed and the application of that
22 mitigation is justified and fairly and equitably delivered.

23 As was referred to earlier, or eluded to earlier,
24 we can't operate markets of this complexity without
25 intervention. There are appropriate exercises of

1 discretion. Unlike the concept of an invisible hand, here
2 we have a very visible hand in the market at all times.

3 The market mitigation function is a hammer, if
4 you will. It's beneficial to have that exercise by an
5 entity other than the market operator.

6 The second benefit in terms of confidence, is
7 confidence in market operations. Our Midwest Independent
8 Market Monitor does report directly to the Board of
9 Directors in open Board meetings on a monthly basis, on the
10 efficiency of the operational decision and actions taken by
11 the Midwest ISO.

12 It has certainly been the case that in not all
13 instances we appreciate the comments that are made, not in
14 terms of whether or not they are accurate, but whether or
15 not they highlight the areas where we are not operationally
16 effective or as efficient as we could be.

17 We benefit from that interaction nonetheless in
18 that it provides a clear signal that there are areas that we
19 can improve on and we work with the market monitor to better
20 understand those and work with him on a regular basis to
21 develop modified processes and procedures to develop the
22 inefficiencies that were identified.

23 Lastly, we do turn to the market monitor and the
24 specific expertise they have to help us evaluate changes to
25 market rules. They're able to help us evaluate both the

1 economic reasonableness or prudence of the change as well as
2 making sure that we got the balance right.

3 A lot of these rules come through the stakeholder
4 process. They're a balancing of stakeholder interests. The
5 market monitor helps us at the end of the day refine those
6 through comments that are provided prior to our filing those
7 with the Commission, such that by the time it is filed it
8 reflects the best interests of our stakeholders and the
9 judgment of experts in the field.

10 We've seen some very clear and tangible benefits
11 from that functional separation. I think it's a very good
12 model and that has worked well for us. Thank you.

13 CHAIRMAN KELLIHER: Thank you very much. I'd
14 like to now recognize Stacy Duckett, Vice President, Counsel
15 and Corporate Secretary with the Southeast Power Pool.

16 MS. DUCKETT: Thank you for having us today. At
17 SPP, much like some of the others, the market monitoring
18 function is fulfilled by both an internal unit and an
19 external unit. In both cases, the entire function actually
20 reports to the Board of Directors.

21 We do have a full independent Board of Directors,
22 comprised of six members plus our CEO. The Director
23 reporting on a routine basis is through the compliance
24 committee and the Board of Directors comprise of three of
25 those Directors. They meet at least quarterly and receive

1 reports both from the internal unit and the external unit of
2 their activities.

3 That would include anything from design issues
4 that may be raised, operational issues that may be raised,
5 inquiries that may have been submitted to us for
6 consideration.

7 Both the internal and external unit in addition
8 as far as independence goes, have ethical or code of conduct
9 requirements. The employees that are of the internal unit
10 must execute the SPP Standards of Conduct upon employment
11 and then annually thereafter.

12 The external unit has a code of conduct provision
13 in its contract and any employee within the company that
14 initiates business on behalf of SPP must execute that. The
15 external monitor's contract is part of our tariff as well.

16 As was discussed earlier, revisions to that
17 contract, including the dissolution of it would have to come
18 back before the Commission for consideration as a tariff
19 change. We think that works well as far as how we're
20 structured.

21 As far as the responsibilities of each of the
22 units, those have evolved a little bit. We've moved from
23 market design to market operation, which for us, we're 60
24 days in, but both units have been very involved in the
25 development and design of the market up to this point and,

1 of course, continue to be involved now with its operations.

2 We really look to the internal unit to focus more
3 on the day-to-day on the ground, as well as discussed
4 earlier operations and look for, and be available to
5 operators and stakeholders with things that may be going on
6 more immediately.

7 We look at the external unit and as far as for
8 longer term analysis and trending, we have and will continue
9 to look for them to do the state of the market report and
10 some of the other reporting to provide a broader oversight
11 in that reporting.

12 We think this balance has worked out very well
13 for SPP. Our stakeholders are pleased with it, our state
14 commissions are pleased with it and the outside provider are
15 pleased with it. We've seen this work well.

16 I would agree with some of the statements made
17 earlier, considering some flexibility in how this function
18 might be served to make sure that it is serving each market
19 in each region best. Thank you. I look forward to your
20 questions.

21 CHAIRMAN KELLIHER: Thank you. By my math, I
22 think we have six minutes each if we're strict about it, so
23 why don't we start on that basis and cut me off ruthlessly
24 at the end of six minutes.

25 I'd like to ask one question. I'll start off

1 with Ms. Duckett. You are the newest RTO and you have the
2 external and internal structure. Did you look at the other
3 models? Did you decide after looking at the other models
4 against other approaches? How did you end up with internal
5 and external?

6 MS. DUCKETT: We did look at other models.
7 Actually, originally we were looking at both an internal and
8 external. We were looking at the external to provide even
9 more of the inquiry and investigation service. We thought
10 that might be better suited to SPP and our culture in the
11 way that we work.

12 Subsequent to that, we had direction from the
13 Commission that that was going to be handled differently and
14 that would be handled here. So when we considered that, we
15 did look at it yet again but still determined there is a
16 role, we think an appropriate role, in our case for external
17 provision of some of the services.

18 For instance, we likened the provision of the
19 annual state of the market report to our financial auditors
20 that come in and do an annual audit on a regular basis. So
21 we do see a role for an external unit, but we do think the
22 internal unit can provide more immediate oversight, being
23 more immediately recognized when there are some issues
24 because they are right there.

25 We've already had instances of operators calling

1 them and asking them to come review something, to come see
2 something. We think that lends itself better with an
3 internal than it might with an external provider.

4 CHAIRMAN KELLIHER: Thank you. I'd like to ask
5 more of a question or two about potential for conflict
6 between a market monitor and an internal market monitor in
7 particular and RTO management.

8 It was something we started to get out in the
9 last panel. I got some reassurance that when it comes to
10 rule changes and improvements in RTO rules, that there is
11 not a lot of potential for conflict.

12 Maybe I'm drawing the wrong inference, but both
13 the market monitor and the RTO management really have the
14 same goal in mind. The RTO management may not be that
15 resistant to the notion of identifying rule flaws and rule
16 changes, but let me look at another area, and that's
17 decisions by the RTO operators. Decisions in the control
18 room.

19 Let's say the market monitor reaches the
20 conclusion that some decision made by, I'll just say the New
21 York ISO operator because I'm asking you the question,
22 resulted in either \$100 million -- it either depressed
23 prices by \$100 million or artificially inflated prices by
24 \$100 million for some period of time, and they think there
25 was no tariff violation, there was no bad behavior by market

1 participants, but that there was a mistake by RTO personnel.
2 The management just flat-out disagrees with the conclusion
3 drawn by the market monitor.

4 What would happen in the New York ISO if that
5 were to come to pass? You have a disagreement. Does the
6 internal monitor go to the ISO Board? How do you resolve
7 that kind of disagreement?

8 The monitor may be under the impression, well, if
9 this persists either it's going to result in unjust
10 enrichment or it's going to retard entry by new generators
11 into New York.

12 MR. LYNCH: First of all, we'd never do that.

13 (Laughter.)

14 MR. LYNCH: Second of all it never happened under
15 my watch either. I think what you're saying is an example
16 of my operators taking an action that basically affects the
17 market adversely, and the market monitor looks at that as an
18 inappropriate action. I think, obviously, we in New York,
19 our operators do not see prices, so the actions they take
20 are not ever warranted on prices or the financial outcome of
21 the marketplace.

22 Our operators strictly operate the system solely
23 on reliability. All the procedures, all the criteria, every
24 basic step that they take is all against assuring
25 reliability to the overall bulk system. So they don't have

1 any motivation, first of all, to basically manipulate the
2 market.

3 CHAIRMAN KELLIHER: but let's say -- I don't mean
4 to interrupt but, another way to ensure reliability.

5 MR. LYNCH: If we saw a procedure wasn't work or
6 providing ineffective market outcome, and we disagreed with
7 the market monitors, we also have the independent market
8 advisor who would come in and has a direct line to the
9 Board.

10 They would be consulted in part of this
11 conversation, obviously, if we did agree with the market
12 monitoring unit from my perspective, we would elevate that
13 to the Board.

14 A scenario that you've indicated, as egregious as
15 it is, would be very visible to our market participants
16 without shared governance that would be something that we
17 would talk in our Operating Committee and probably our
18 Business Issues Committee and work up to see if there is a
19 market rule that needs to be changed from an operational
20 procedure or in the market place or the market monitoring
21 unit itself.

22 So I think with the shared governance, with the
23 fact that we have an independent market monitor that would
24 be in consultation here and has direct access to our Board,
25 I think there would be a lot of checks and balances.

1 But if I personally was just unreceptive to this
2 change, there is a lot of other ways to get at other
3 individuals and have a governance that would provide the
4 correct outcome.

5 CHAIRMAN KELLIHER: Thanks. Do I have time?

6 MR. HARVEY: About a minute.

7 CHAIRMAN KELLIHER: Another area of potential
8 conflict, the market monitor determines that there should be
9 a referral. The market monitor believes some type of
10 manipulation has occurred in the market power exercise, PJM
11 management has a contrary view, there is a disagreement?
12 What happens? How is it resolved?

13 MS. ZIBELMAN: In the cases of actual referral,
14 the market monitor goes directly to the FERC through our
15 market monitoring plan. In that context, there wouldn't be
16 any opportunity. In fact, the information is pretty much
17 confidential from the RTO itself.

18 If I could add, our process would work very much
19 like the New York ISO. What normally happens in
20 opportunities is that the market monitor works with the
21 market group on the operation side. If they see an operator
22 is dispatching in such a way that's inefficient, one of them
23 will identify it and everyone is usually on the same page
24 trying to fix it.

25 In those events, where there is fundamental

1 disagreement and I can't think of one, but then the market
2 monitor would report it up through the competitive markets
3 committee of our Board, whom he meets with on his own when
4 they get together.

5 CHAIRMAN KELLIHER: Thank you. I think I'm out
6 of time. Colleagues? John.

7 COMMISSIONER WELLINGHOFF: Ms. Zibelman how are
8 you? I had an opportunity to read your testimony. I
9 appreciate an actually indicated to anybody else who wants
10 me to read their testimony, hopefully they'll do the same
11 that PJM did and send it electronically to me the day
12 before.

13 It's hard to read these when they come in the
14 morning. I appreciate getting them in advance. Thank you
15 very much for sending it in advance.

16 I found your written testimony to be very
17 provocative. What a concept. Let's have definitions before
18 we decide what we're doing, you know?

19 (Laughter.)

20 COMMISSIONER WELLINGHOFF: It's really a great
21 concept. In that, you specifically suggest that FERC should
22 look at developing a clear definition of what constitutes
23 the exercise of market power and indicate also that PJM is
24 in fact going to go ahead and undertake that review on its
25 own with its stakeholders.

1 I'd like to hear from you any advice you could
2 provide to us as to how you think we ought to undertake
3 that. You think we should initiate a rulemaking to do that?
4 I know that we do have a rulemaking pending on market based
5 rates, but my understanding is that there is not a specific
6 definition of market power laid out in that.

7 What would you suggest as to our best procedure
8 to do that? And also let me add on to that. I assume I
9 know your undertaking, but I assume you're saying there
10 should be a uniform definition for all RTOs and ISOs, not
11 just PJM.

12 MS. ZIBELMAN: Certain of the definitions such as
13 the definition of market power, abuse of market power, I
14 would hope that we wouldn't stray too far from the DOJ's
15 definitions. That's pretty much standard. Where I think
16 that we should look at is given that, how do you detect then
17 market power abuses in either an organized market or
18 bilateral market.

19 With that, what we found in our research is,
20 we've evolved. Some folks have used conduct and impact,
21 we're using structural. Both have implications as to
22 whether or not that's a good way to detect and monitor
23 markets, implement market power abuses.

24 To me that is an adjudicative legislative role
25 and I think it would be very helpful to the markets if th

1 FERC would take that on and we had a consistent approach.
2 Our intention is to use an outside economist to take a look
3 at what the other RTOs are doing to see what best practice
4 is, to the extent the FERC undertakes that endeavor and
5 decides to do a rulemaking to really look at this issue, see
6 how it works and how it affect the markets we'd want to
7 participate in.

8 I dare say we'd probably still hire a third party
9 economist to help us develop what our testimony would be.
10 But in the event, I think that kind of consistency would
11 then start setting up the rules of the market monitor so if
12 the structural issues really become second and it really
13 become within the tariffs we understand and people can
14 predict what behavior will be mitigated and when we do
15 mitigate, how do we mitigate, and the other issue I would
16 think that we see a lot of discretion being exercised.

17 Actually Commission Kelly pointed out in her Law
18 Review article as a determination of reference prices, that
19 really is a rate setting exercise that we think should be
20 vested with the FERC.

21 Anything we can do to eliminate discretion and
22 provide more explicit rules to the market participants I
23 think will instill market confidence and to allow the
24 monitors to really focus on the surveillance activities both
25 in the market themselves and the RTOs. Which is really

1 where I think they will be most useful in commenting on how
2 to make this thing work better.

3 COMMISSIONER WELLINGHOFF: Getting down to the
4 structural issue a little bit. Related to the question I
5 asked Mr. Bowring this morning, assuming that we do get to
6 the point where we develop some definitions and we decide
7 ultimately that we also need to restructure some of the
8 functions of the market monitors and some of the RTOs and
9 ISOs.

10 How would you propose that we do the transition.
11 In other words, I want to make sure that we don't lose
12 anything in the period going from the existing structure to
13 what would be a new and different structure.

14 MS. ZIBELMAN: It's a very, very difficult
15 management issue. All of us, as you know, companies face
16 this all the time when they make outsourcing decisions or
17 merger decisions. How do you retain people in the light of
18 uncertainty?

19 The processes that they've used are really the
20 best I think we can do. What we're intending to do is to
21 tell the employees it's under consideration, which we've
22 told our employees. You assure them that the normal
23 processes, in terms of if in fact a decision is made to
24 outsource and they wish to stay with the RTO and there are
25 jobs available, they should be there, and you put in

1 retention plans.

2 So to the extent that you are worried about
3 people migrating away, there's an economic reason for them
4 to stay till the end of the program so they understand there
5 may be a bonus if they stayed until the end, and just deal
6 with it as a management issue.

7 The challenge, of course, always is if somebody
8 feels that their job is uncertain and we have people who are
9 engineers, economists, etcetera, who are very attractive to
10 a lot of people these days. How do you retain them? That's
11 really the management challenge, but the best way you can do
12 it is to effectively ensure them that they will at least be
13 compensated for the risks they're taking of not looking for
14 another job while you're trying to make a decision.

15 MR. HARVEY: Half a minute left.

16 COMMISSIONER WELLINGHOFF: My final comment on
17 the half minute is, it's more than a difficult management
18 challenge, it's a critical issue, given that you have to
19 make sure that you've attained that functionality through
20 the transmission because --

21 MS. ZIBELMAN: Right. In the past when I've
22 confronted these issues and mergers where people were told
23 their departments were going to be moved to different
24 cities, it was the same issue. The best you can do is to
25 provide the right types of retention plan and assurances and

1 continue to work with staff.

2 COMMISSIONER WELLINGHOFF: Thank you very much.
3 Thank you Chairman.

4 CHAIRMAN KELLIHER: Commissioner Kelly.

5 COMMISSIONER KELLY: I'd like to turn to the
6 question of the role of market monitors. In responding to
7 RTO proposed initiatives, on the first panel that was listed
8 as one of the potential valuable contributions that a market
9 monitor could make.

10 I think about environmental impact statements
11 where you turn to an outside evaluator to tell you what the
12 environmental impact of your proposed action is going to be.
13 You decide whether to go ahead with it or not, but in doing
14 so, you understand the impact on the environment. You
15 perhaps take steps to alleviate some of the adverse impacts.

16 I think of the market impact statement in the
17 same way. Certainly, one of the goals of your markets is to
18 have them be here and efficient. Of course, other things go
19 in, it's not the exclusive goal. Other things have to play
20 in.

21 There also have to be affordable, etcetera,
22 etcetera, etcetera. But when you have a proposed
23 initiative, do you take advantage of your market monitor to
24 give you an independent market impact statement. And if you
25 do, how do you determine which initiative fall into that

1 category, requiring or benefitting from the market impact
2 statement. How do you take that information? Is it
3 confidential? Is it public? Does it just go to the Board?
4 Does it just go to management? Then is there any follow-up
5 on that?

6 MS. ZIBELMAN: The most recent process we used
7 was actually in the context of RPM. We're in the
8 development of a capacity market and one of the issues we
9 built in was how it will be mitigated.

10 Generally it's an iterative process. If we
11 identify new rules, such as the FTR rule or demand response
12 rule, one of the advantages that we have with our market
13 monitors familiar with our markets is that they're able to
14 work with the market people closely and identify potentially
15 areas where the rule can be improved.

16 And so we see it as actually part of the defining
17 process of how to develop the rules that you have to solicit
18 their input. If there is a disagreement, then there is an
19 internal process. So the disagreement can eventually be
20 aired in front of the Board and the Board can help make a
21 determination.

22 But generally, what we find is, once you have two
23 basically participants both trying to get to the same end,
24 there may be judgment calls or reasonable minds will differ,
25 but there is usually, at some point, a meeting of the minds

1 on what seems to work.

2 COMMISSIONER KELLY: So it's input, it's not a
3 separate independent report and it's interactive?

4 MS. ZIBELMAN: Right.

5 COMMISSIONER KELLY: How do you decide which
6 actions you're going to refer to the market monitor.

7 MS. ZIBELMAN: The market monitor actually is
8 involved in almost all rule development. It becomes an
9 automatic part of the development of new product that he is
10 aware that he is close to various stakeholder committees and
11 will comment and work. If there is disagreement, we try to
12 work it through.

13 COMMISSIONER KELLY: Is there anything else
14 besides a rule development that would impact the market?

15 MS. ZIBELMAN: I think the issue is the issue we
16 talked about, how the market is actually implemented. The
17 operator decisions, where the market monitor sees
18 opportunities to improve dispatch.

19 We had an issue recently about how operating
20 reserves are set and it was an issue that the market monitor
21 identified as a need for improvement that he's taken on as a
22 potential rule change. And so it's through those types of
23 processes.

24 COMMISSIONER KELLY: Mark.

25 MR. LYNCH: I was going to say that our

1 independent market advisor who works in collaboration with
2 our market monitoring unit, they get the state of the market
3 report, which not only goes to our Board, but they come here
4 to FERC and present.

5 They also present that to all of my market
6 participants in the management committee. In there they'll
7 identify inefficiencies in the market. As a result of that
8 report, what they'll do is go and identify those areas that
9 we feel are probably the highest priority, the ones that
10 produce, I guess the most egregious inefficiencies.

11 They sit down in consultation with the
12 independent market advisor, the MMU units and our internal
13 resources and actually look at ways to go in and develop
14 products that mitigate that.

15 I believe in my written testimony, I provided an
16 example of one where we're dispatching incorrectly. We were
17 just going light for the element output of the CT where it's
18 really limited by the ambient condition. That came out of
19 the result of David Patton identifying that in one of his
20 market reports.

21 We went back in and looked at the way they
22 actually facilitate to make sure we weren't over or under
23 committing, but actually we hitting the right target for the
24 CTs on hot summer days. We continually do that. He does a
25 summary assessment and it's a pretty innovative process and

1 he is very open with our market participants, usually
2 through the prioritization.

3 We do go through the shared governance and market
4 participants do have input into that. Obviously, our boy at
5 the end is the one that helps us prioritize the projects.

6 COMMISSIONER KELLY: Thank you. Karen.

7 MS. EDSON: I wanted to note in our case the
8 market monitor is very involved in the market design
9 development much like the other ISOs have identified here.

10 In addition, our market monitoring department
11 examines major investment projects that are going through
12 technical and economic analyses.

13 I view both of these functions as opportunities
14 for the market monitor to get ahead of market issues because
15 frankly, the infrastructure investments are ways of
16 mitigating market power, good market design, disciplined
17 market behavior.

18 We're doing what we should, I think, in trying to
19 avoid the market problem that they're monitoring against.

20 MR. HARVEY: Half a minute.

21 COMMISSIONER KELLY: Richard you mentioned it in
22 your testimony. Do you have a few details on how you do
23 that?

24 MR. DOYING: Sure. It comes from a couple of
25 sources. One is in the case of New York, we do have annual

1 reports that are done by the market monitor where they
2 identify specific recommended changes. We also have an
3 internal process to develop those and we certainly seek
4 input from the market monitor on those.

5 The market monitors staff attends our more
6 important stakeholder meetings. They're certainly aware of
7 any significant changes that are coming through the process
8 and would weigh in if they see fit at that time.

9 Then lastly, we do send things with a specific
10 request for comment to the market monitor. And in case, so
11 for example, the ASM filing was made on February 15th, we
12 went through a process of review of preliminary drafts,
13 review of final drafts, and suggested redlines to the tariff
14 to make sure that we had the correct monitoring and
15 mitigating provisions, included with that filing.

16 And overall, we solicited and took comments on
17 the efficiency, whether the rules were the right rules, and
18 we did make some refinements based on that review.

19 COMMISSIONER KELLY: Thank you. Colleagues?
20 Marc?

21

22 COMMISSIONER SPITZER: Mr. Chairman, thank you.
23 Commissioner Wellinghoff eluded to the distinction between
24 the sanction and the conduct and the sanction provides the
25 penalties disgorgement and the like they're further well

1 established, but given the immediate need to stop
2 misconduct, how would you characterize, generally in your
3 own situation, the relationship between the market monitor
4 and the RTO/ISO in terms of an intermediate step to cease
5 misconduct that is disrupting the market or causing damage?

6 MR. LAPLANTE: As was said on an earlier panel,
7 the most we generally can do, the mitigation rules allow us
8 to examine the impact of bids that don't seem correct, so
9 you do it before the fact.

10 After something's happened, we're really in a
11 position of having to refer it to the Commission. We really
12 can't change the outcomes of the market after the market has
13 completed. That really ends up down at the Commission, so I
14 don't know how we would be able to intervene after the
15 market has cleared, to change the outcome of the market.

16 MS. ZIBELMAN: The way we mitigate the market, we
17 use structural mitigation of three pivotal suppliers.
18 Actually in those areas, the mitigation is automatic. In
19 fact, if the market fails the structural test, the issue
20 though that I think you're getting at is what is in fact,
21 even apart from whatever structural test you have in place,
22 you see market behavior and market manipulation occurring.

23 The way we work it is that the market monitor
24 refers that conduct to the Commission for further
25 investigation, to determine, if in fact, some further fines

1 and penalties are warranted.

2 I would submit that's the appropriate role. One
3 of the things that occurs to me in response to Commissioner
4 Kelly, market monitors, as good as they are, well only as
5 good as we all are, they're not infallible and they're not
6 judges, they're not prosecutors, and we do need to have due
7 process.

8 Even if they do detect behavior that tends to be
9 factual in nature, the best we can do is ask them to refer
10 what they see as manipulative behavior to the Commission for
11 further investigation, where we can afford the right levels
12 of due process, which is the same issue we have with the
13 market monitor and the RTL. And the market monitor may
14 think there is a need for mitigation and the RTO thinks
15 there isn't, and that could be destructive.

16 At some time, we need to get the FERC referral
17 resolution.

18 COMMISSIONER SPITZER: Certainly, if there is a
19 reality that goes to this process. Asking about rule
20 changes, it's more of a generic perspective remedy. You're
21 comfortable with that?

22 MS. ZIBELMAN: The issue would be if the market
23 monitor were to say, somebody is issuing this and they think
24 they're withholding generation using uneconomic withholding.
25 Should the market monitor institute a penalty or should they

1 refer that type of observation to FERC for further
2 investigation?

3 What the market monitor should be is the fact
4 gatherer and get the information to the FERC for further
5 investigation. It may be what they didn't really happen and
6 there is rational explanations.

7 COMMISSIONER SPITZER: Mr. Doying.

8 MR. DOYING: There are actually several tools the
9 market monitor and the RTO have in their tool kit. There is
10 automatic mitigation on behavior that's competitive. That
11 happens automatically within our system, as implemented by
12 the IMM.

13 They talk to each other and when the threshold is
14 crossed, that mitigation occurs. The tariff also does
15 includes specific prohibition on some activities such as
16 physical withholding. While there is not automatic
17 mitigation of that activity, we have found that to be fairly
18 effective to have a conversation with the market
19 participants. We're supposed to be engaging in that to let
20 them know that we do view their activities as physical
21 withholding and their continuance of that behavior will
22 result in the referral to the Commission. And those types
23 of discussions leads to either want a better understanding
24 of what's going on and maybe we don't understand perfectly
25 the reason for why capacity is not showing up or in a couple

1 of cases, it has resulted in referrals.

2 I think we do have one final tool to address an
3 issue that was talked about this morning. What if we find
4 there is such an egregious flaw in the market design or rule
5 that people can just game the market and extract on economic
6 rents.

7 We do have the ability to file a one-day
8 effective notice tariff provisions to make emergency
9 changes. That puts little bit of a burden on you because
10 you have to review those and determine whether or not you
11 think that's a good idea.

12 But I think you do have a mechanism to allow
13 rapid changes to the tariff to be implemented.

14 COMMISSIONER SPITZER: In real world, how would
15 they arise? From your own initiative or would the market
16 monitor be observing these?

17 MR. DOYING: It could be either. As I said, we
18 have our own internal staff doing internal analysis of the
19 recommended changes that come through our system, that have
20 come through in the last 24 months. I would say maybe 20%
21 of those have come from the market monitor.

22 The vast majority come from internal evaluation.
23 So we would certainly observe things in the market on a day-
24 to-day basis that looked to be operations. If we didn't see
25 it and the market monitor did, they would certainly report

1 that to us.

2 MR. HARVEY: Half a minute.

3 COMMISSIONER SPITZER: Are there any structural
4 consequences that arise when you've got to balance it
5 between the single state and multi-state? Or is that a non-
6 issue?

7 MR. DOYING: It's a lot more complicated, the
8 more states you have.

9 (Laughter.)

10 MR. LYNCH: I consider it hard with one state.

11 COMMISSIONER SPITZER: Okay.

12 CHAIRMAN KELLIHER: The Empire State,
13 Commissioner Moeller.

14 COMMISSIONER MOELLER: Thank you Mr. Chairman.
15 I'll start with thanks also for your testimony. I always
16 like it when people focus on the big picture, like actually
17 getting the definitions right.

18 But I think we need to hear PJM's management
19 response to what was raised this morning about the lack of
20 independence of the market monitor.

21 MS. ZIBELMAN: We have an ongoing, from our
22 perspective, those two issues that we need to look at in
23 terms of independence. One is the question, is the market
24 monitor's ability to arrive at independent conclusions on
25 what is market power abuse, what rule changes need to be one

1 and what behavioral. In think in that context, that is the
2 role of the market monitor.

3 In terms of independence, the challenge that we
4 have is that if in fact the market monitor is an employee,
5 just like any other employee, they have to be subject to
6 certain auditability, accountability rules like all
7 employees are.

8 In terms of respecting codes of conduct,
9 respecting hiring practices, respecting budgeting rules,
10 budgeting guidelines, respecting goals, those types of
11 things. When you have an internal employee who is supposed
12 to be independent, there is a natural tension because what
13 one person might review as a quality issue, another might
14 review as an imposition of touching on independence.

15 As we've evolved, what we found is because of
16 concerns, if you have an employee, will they be independent
17 if in fact they can be reviewed by anyone in the
18 institution, though it may be better to look at structural
19 changes.

20 So as part of our strategic review, because of
21 the concerns that have been raised, we think it's time to
22 look at this. The Board had looked at it three years ago,
23 felt an internal market monitor is preferable from the
24 standpoint of looking at the quality of work.

25 We think that in looking at the other

1 experiences, whether RTOs, where they don't have some of
2 these issues of independence and how do you manage somebody
3 that you can't manage.

4 It's time to look at these structural changes and
5 so that's what we're doing. You know, there is always
6 reasons to disagree in terms of independence. We believe
7 that the market monitor is able, within PJM to identify his
8 views but at the same time, simply because someone has a
9 view doesn't necessarily mean their view is accurate and so
10 everybody needs to be subject to challenge, peer review,
11 accountability, quality of work product, etcetera.

12 COMMISSIONER MOELLER: Thanks for your answer. A
13 really general question for everyone, I guess. Mark you
14 answered it already in one sense but we have a new regime, a
15 new area of reliability that's coming on.

16 Hopefully with mandatory enforcement rules in
17 place this summer, that can have an impact just by the fact
18 that it's new, it's a new regime, even though people have
19 been focusing on reliability in the past, it's different
20 now.

21 I just wanted if you had any observations you
22 wanted to share in the three minutes we have left on how
23 that might impact, how that might change your perspective on
24 market monitoring. I'll start down the line with Karen.

25 MS. EDSON: I'm not sure changes on our view of

1 market monitoring. We take these requirements very, very
2 seriously. We've built our performance metrics around
3 operating the system around those requirements and will be
4 very rigorously working towards compliance, complete
5 compliance.

6 It's not so much a case of bad market behavior in
7 the event. I mean if there are market problems that give
8 rise to the reliability concerns, of course, our market
9 monitor would be involved.

10 But I think the way we're looking at this, this
11 is bringing a new rigor to reliability requirements in
12 general. We're handling this primarily through our normal
13 management channels.

14 MS. ZIBELMAN: I think all the other RTOs may
15 talk about this. All of us look to be in for 100%
16 compliance with your requirements and have been that way.
17 Part of this is just making sure that the rules are set up
18 right internally.

19 I think what's an important issue, and this is
20 what the markets are different perhaps, but outside of
21 organized markets, since we use bid-based security
22 constrained economic dispatch, the issue is, how do you make
23 sure that you're optimizing the dispatch as well as
24 optimizing reliability, and sometimes they do conflict.

25 One of the things PJM is looking at is that we're

1 actually looking at a new metric, perfect dispatch. We'll
2 actually run the market a day after to see, if in fact,
3 we've totally optimized the market, both for economics and
4 reliability.

5 What would have been the difference in the
6 dispatch protocol and then start looking at how we would
7 then measure our operators against what would have been
8 perfect dispatch, to see what the gap is, and like any other
9 gap analysis then to determine what changes could be made to
10 close that gap.

11 One of the things you know, if you can operate
12 the system very, very reliably and it cost people a lot of
13 money. Somewhere there is a crosshair between where it's
14 perfectly operated economically and perfectly operated
15 reliability. That's what we're going to be searching for in
16 this metric.

17 COMMISSIONER MOELLER: Thank you. David.

18 MR. LAPLANTE: Market designers has always had
19 two functions, one, it has to be efficient, but the other,
20 it has to give us a reliable system. Whenever we put rules
21 in place, we put them in place to make sure that they do
22 both. So that's something we've worked on quite a bit.

23 In 2001/2003, we had scarcity conditions but we
24 didn't have scarcity pricing. That was actually identified
25 by the market monitor. We changed our rules so that the

1 prices actually reflected the reliability situations.

2 The other thing we're doing now is, we're just
3 putting ancillary service markets to encourage peaking
4 units. We have a lot of out of merit commitment caused by
5 lack of peaking units.

6 So we need that out of merit limit for
7 reliability. We're trying to get peaking units built so the
8 prices will be better and we won't have to do that out of
9 merit commitment.

10 MR. LYNCH: I think the possible interrelation
11 between market monitoring and the new reliability standard
12 is going to be more educational. It's probably a corollary
13 to what Commissioner Kelliher asked me, that the operators
14 did something and there is this funky outcome that comes
15 out.

16 Market monitoring says, well this is wrong, but
17 it may be there is a new reliability criteria and a new
18 reliability rule that we're going to have to educate the
19 market monitoring in. It's not going to be intuitively
20 obvious.

21 The reason that an operator did something on its
22 own initiative basically to operate the system reliably, is
23 probably where it's going to come in. I don't have a
24 specific example on that, but onto itself, it should be
25 pretty much transparent unless there is something that we

1 usually talk to.

2 MR. DOYING: I tend to agree with all the
3 comments that were made. One slight variation perhaps on
4 Mark's comment. I think the education goes both ways. One
5 of the things we found is a new market starting up and
6 assuming responsibility for regional dispatch.

7 For the first time, at the same time, the market
8 started the highlights and makes it very clear that tension
9 between actions to preserve reliability and security and an
10 evaluation of the cost of those actions, to make sure
11 they're economically efficient.

12 It is a balance. A new reliability rules will
13 force all of us to again focus on making sure that we have
14 that interaction defined as well as it can be defined and
15 that we're monitoring it to assure that we are getting an
16 efficient an outcome as we can.

17 COMMISSIONER MOELLER: Stacy.

18 MS. DUCKETT: Again I would concur with what's
19 being said by the other panelists. We, of course, are very
20 interested in reliability, have been for over 60 years now,
21 and it has been an integral part of the market development
22 and market operations.

23 There has been a lot of education and will
24 continue to be a lot of education as more of the reliability
25 standards become mandatory. As to how all this fits

1 together, but it does fir together and part of our mission
2 statement is helping our members keep the lights on and so
3 we're going to be keeping the lights on about everything
4 else.

5 COMMISSIONER MOELLER: Thank you.

6 CHAIRMAN KELLIHER: I want to thank the panelists
7 for your help today. I'll dismiss this panel and ask Panel
8 2.3 to come up. I like the precision of the paneling.
9 Thank you for your help today.

10 (Pause.)

11 CHAIRMAN KELLIHER: While we resume here, I want
12 to thank Panel 2.3 coming up here today. Why don't we start
13 with our colleague Mark Christie, Commissioner of Virginia
14 State Corporation Commission and President of the
15 Organization of PJM States. Welcome.

16 MR. CHRISTIE: Thank you Mr. Chairman. Thank you
17 for lunch, whoever was responsible for lunch. We appreciate
18 that. I'll just get right into the substance, since I'm on
19 the clock here.

20 Like we do in the NFL direct, I represent the
21 Organization of PJM States, known professionally as OPSI.
22 We represent 14 states, 13 including the District of
23 Columbia. We are public officials with legal duties to
24 carry out. Just as you are public officials with legal
25 duties to carry out.

1 There are literally tens of millions of people in
2 the 14 state OPSI region affected directly by the PJM
3 regional transmission organization and the wholesale market
4 advantages.

5 I'm going to make two points that are sort of
6 global points. I won't go into detail, unless you want to
7 ask questions later. The first is, OPSI made two filings
8 last year, one of course asking for your review after you
9 turned down our first filing.

10 There are two main points where I want to
11 reiterate what we said last year. First, we believe
12 unanimously all 14 states that independent market monitoring
13 of PJM's wholesale markets is absolutely crucial to ensure
14 that those markets operate efficiently, competitively, and
15 without exercises of market power or the kind of market
16 manipulation we saw in California during the Enron scandal
17 or which was recently been alleged in Texas. I did say
18 alleged. Independent market monitor is essential.

19 There is a lot of arguments about regional
20 wholesale power markets. I'm not here to take aside either
21 way. Obviously, many people in FERC have been passionate
22 advocates of regional wholesale power markets.

23 I would suggest to you that if you are an
24 advocate of a regional wholesale power market, you should be
25 the most passionate advocate for independent market

1 monitoring because it goes to the credibility and ultimately
2 the survivability of regional power markets.

3 There is nothing in the U.S. Constitution that
4 says there shall be regional wholesale power markets. It's
5 a matter of statutory and regulatory policy. That policy
6 can change overnight.

7 So therefore, for its reliability, the regional
8 wholesale power markets have to have public trust and public
9 confidence. An independent market monitoring is essential
10 to engender an earn that public trust and confidence. For
11 that reason, OPSI believes very strongly in independent
12 market monitoring.

13 The second point, we do not believe that PJM
14 market monitoring is independent. We said that in our
15 filings last year. Interesting enough, in our rejection of
16 our petition for rehearing, you said that we had provided no
17 evidence to support initiation of section 206 proceedings.

18 We had providing no evidence and I'll read it.
19 "Parties have failed to offer sufficient evidence to support
20 their concerns that the market monitoring unit in PJM lacks
21 adequate independents and authority to carry out its
22 responsibilities."

23 Listening to Mr. Bowring today, the PJM market
24 monitor, I wonder whether it's too late to reopen that
25 record. You clearly had compelling evidence today. If you

1 find him credible and he is the market monitor saying he can
2 not operate independently.

3 That corroborated exactly what we stated to you
4 last year. We ask therefore that, first of all we
5 congratulate you on opening this conference. We believe the
6 evidence is, corroborated today by Mr. Bowring, but we
7 thought it was pretty persuasive before, that the PJM market
8 monitor is not independent, can not operate independently
9 and if you want to have credible and believable regional
10 wholesale markets that are going to be accepted by state
11 policymakers, as well as the public, independent market
12 monitoring is an absolute essential. Thank you very much.

13 CHAIRMAN KELLIHER: Thank you. I'd like to
14 recognize our other colleague, the Honorable Laura
15 Chappelle, Commissioner of the Michigan Public Services
16 Commission, representing the Organization of MISO States.

17 MS. CHAPPELLE: Thank you Chairman. I'm not
18 known for my brevity so I hope I can get through my three
19 pages quickly.

20 I am here as President of the Organization of
21 MISO States, as you know 14 states and the Province of
22 Manitoba. I am speaking off a three-page document that we
23 submitted today that has the unanimous support of all those
24 states.

25 I'm also a member of OPSI so those comments

1 certainly were unanimous amongst the states as well. Three
2 quick priorities for today that we want to leave you with.
3 First is the true independence of the market monitor. You
4 heard a lot of that today. We're going to reiterate that.

5 An increased elevated role for the states. We
6 said this in many different forms throughout the years and
7 we will continue to say it. I hope to talk today about the
8 oversight of operation and access to data.

9 Finally, increased transparency of reporting of
10 real issues to the states, not just to FERC, but also to the
11 states.

12 On true independence, quickly, the more
13 separation the better, practical functional. Whether it's
14 contract approval, hiring, firing, management, you name it.
15 It's kind of like you know it when you see it. The more
16 that you can put in there for the states the better.

17 We are particularly interested in the market
18 monitor being able to provide critical evaluation of the RTO
19 without fear of retribution. That's something that we
20 watch. Through OMS, we are pleased that the MISO Board and
21 management has respected the independence of David Patton,
22 the market monitor.

23 Secondly, very importantly, states will continue
24 to assert state-based statutorily recognized oversight of
25 instate market functions and access to data.

1 Very quickly, we've been referred throughout the
2 years as co-regulators and we certainly are. Obviously,
3 there is a lot of talk today on your jurisdiction. We
4 appreciate that. Your role, your oversight, your help in
5 any of these RTO matters are always appreciated.

6 But it shouldn't come at the expense of the
7 states. Obviously, we're back home with the state traffic
8 cop. States have not seen their jurisdictional authority
9 over crucial oversight. As to access to date, we're hoping
10 some time in the future that our access to crucial data can
11 be as seamless as it is for you at FERC.

12 The more paperwork, the more cumbersome, the less
13 access we have.

14 Finally, we're looking for transparency of
15 reported issues to the states. For the hypothetical of
16 physical withholding is there is physical withholding, it
17 was mentioned that it would threaten to be reported to the
18 Commission, meaning you. It should also be reported to the
19 state, meaning us.

20 So, we can appropriately sort out our retail
21 issues where that may be affected. Thank you.

22 CHAIRMAN KELLIHER: Thank you very much. I'd now
23 like to recognize David Klepinger with McNeese Wallace and
24 Nurick, Counsel to PJM Industrial Customer Coalition.

25 MR. KLEPINGER: Thank you Chairman and

1 Commissions for allowing us to participate in this very
2 important issue today. Frankly, I'd like to pick up on two
3 terms that Commissioner Spitzer used earlier today that was
4 faith and confidence.

5 There has been an erosion in faith and confidence
6 in the electric markets throughout the region. Witness the
7 activities going on in the states of Illinois, Massachusetts
8 and Connecticut with respect to attempts at potential
9 restructuring, yet again, ne fact re-regulation.

10 The Industrial Customer Coalition, along with a
11 group of 20 other PJM stakeholders has agreed upon a list of
12 recommendations which were distributed to you earlier today
13 to provide for structural independence of the market
14 monitoring unit.

15 We view the market monitor unit as a protector of
16 the consumer. We need to capitalize on this opportunity to
17 stop erosion in that faith and confidence and begin to
18 restore it.

19 Such faith and confidence will not be restored
20 through mis-characterization of positions as had to be
21 responded to by the Joint Consumer Advocates. In the fact
22 that they in fact oppose an external market monitor and
23 support an internal market monitor.

24 That filing was made yesterday. It will not be
25 restored through the depreciation of resources and personnel

1 assigned to the market monitoring unit.

2 It will not be restored unless the market monitor
3 can directly impact and protect customers from markets
4 better capable of undue market power. There are many
5 examples in that.

6 In every year the state of the market report that
7 has been issued since the inception of the MMU, nor will it
8 be restored without this Commission assuring compliance with
9 the PJM tariff, attachment M to that tariff, which is the
10 market monitoring unit plan itself.

11 That plan calls for the appropriate staffing and
12 resources of the MMU. It calls for an MMU comprised of full
13 time employees of PJM having experience and qualifications
14 to implement the plan.

15 For the first time in my involvement, since PJM's
16 inception after hearing this morning's testimony, I'm not
17 sure that the tariff is now being complied with.

18 In that state of affairs, this group of 20
19 stakeholders has arrived at a set of principles that we
20 unanimously endorse. The list of endorsers is attached to
21 the list. Clearly it puts a capital "I" back in
22 independence and internal market monitoring unit.

23 However, it would not exclude the additional of
24 an external market function in addition to that internal
25 market function, as we've heard earlier today.

1 Unimpeded access to the data is absolutely
2 critical and a direct report to the Board and not to PJM
3 management is absolutely essential. I think from what we
4 heard today, the interplay of the market monitor and having
5 management function between the monitor and the Board is an
6 unacceptable confining of the MMU's independence.

7 With those basic principles, perhaps we can begin
8 to restore confidence and I'll cede my last three seconds to
9 Dr. Anderson.

10 (Laughter.)

11 CHAIRMAN KELLIHER: I'd like to now recognize
12 Gloria Ogenyi, Vice President Energy Policy, Conectiv
13 Energy. Welcome.

14 MS. OGENYI: Mr. Chairman and Commissioners,
15 thank you for the opportunity to speak today on behalf of
16 Conectiv Energy. Conectiv Energy supports market monitoring
17 in organized markets.

18 In that regard, we offer the following
19 suggestions on how the Commission can improve the
20 effectiveness of MMUs in organized markets. Guidance on
21 appropriate market monitoring philosophy.

22 The Commission should provide guidance to market
23 monitors on the appropriate philosophy of market monitoring
24 and organized markets.

25 FERC should clarify that the role of the market

1 monitor is not to ensure low prices at all costs. An
2 inordinate focus on ensuring low prices can lead to market
3 intervention that could disrupt price formation in organized
4 markets.

5 Put simply, market monitors must let the markets
6 work. Appropriate tests of market power; the Commission
7 should convene technical conferences to revisit the market
8 power tests that have evolved in various regions of the
9 country to evaluate the underlying assumptions and ensure
10 that the tests that are implemented in any region are
11 consistent with and not in excess of the FERC's market power
12 test. It is important that companies not having consistent
13 outcomes between the regional and the FERC test.

14 FERC shall require not only that the MM justify
15 the test, but also evaluate various implementation
16 mechanics, impacts, and alternatives. FERC should reject
17 artificial limitations and flawed implementation mechanics.

18 Mitigation mechanisms. The Commission should
19 evaluate and provide guidance on best practices among
20 regions regarding mitigation mechanisms and measure the
21 impact on the goals of market monitoring.

22 FERC should scrutinize mitigation mechanisms to
23 ensure that they do not take away the value of prudent
24 investment or diminish legitimate investment signals and
25 incentives. Certain mitigation mechanisms may mis-diagnose

1 prudent investment choices as market power or work to
2 eviscerate incentives to make prudent investments.

3 Market maturation; we believe that effective
4 market monitoring without overmitigation is the hallmark of
5 the mature market. Indeed the best protection against
6 market power is a robust market. Good market design, new
7 market entry opportunities and viable demand side
8 participation are critical.

9 Mitigation must not become a regulatory crutch or
10 substitute for good market design. RTO rules must clearly
11 distinguish between scarcity pricing, mark-ups, and the
12 exercise of market power.

13 The Commission should reject confiscatory
14 mitigation rules that force resource owners to provide
15 needed products and services without compensation. To help
16 RTOs guard against overmitigation, Conectiv Energy
17 recommends that RTO market services be integrally involved
18 and sign off on market monitoring and mitigation rules and
19 mechanisms, and that RTO boards periodically hire an
20 independent agency to audit the market monitoring plan and
21 its implementation.

22 Transparency: we believe that market monitoring
23 and mitigation rules should be transparent, both in design
24 and in the market monitor's application of those rules. We
25 oppose venture activities, appropriations or vesting of

1 significant discretion of the market monitor.

2 The MMU should provide regular timely and
3 detailed information about markets including the application
4 of the market power test. He should put the test results
5 and the resulting mitigation. MMUs must respect all
6 applicable region full and confidentiality protocols.

7 Lastly, the MMUs should have the authority to
8 monitor the RTO market operations, operational decisions by
9 RTOs can have a huge impact on price formation and market
10 outcomes. Therefore the MMU should have the ability to
11 oversee the actions of the RTO itself. At a minimum, there
12 should be annual operational audits of the RTO's
13 implementation of market rules.

14 Once again thank you for the opportunity to
15 speak. I look forward to your questions.

16 CHAIRMAN KELLIHER: Thank you. I'd like to now
17 recognize Gary Sorenson, Consultant to PSEG Companies, while
18 formerly Managing Director of Energy Operations at PSEG
19 Energy Resources and Trade.

20 MR. SORENSON: Thank you. Internal MMUs can be
21 expected to be more cost effective and responsive than
22 external MMUs, an unfettered access to bidding information,
23 market clearing prices, model used by the RTOs, internal RTO
24 procedures, planning information, and operational practice.

25 The MMU will not be able to perform its function

1 when the MMU needs data it should be able to access the same
2 data over the same systems used by the RTO's operators
3 without confidentiality concerns that may be present when an
4 outside entity without other clients seeks the same
5 information.

6 Since the internal MMUs only have a single
7 client, the RTO/ISO, it is reasonable to expect an internal
8 MMU to develop an intimate understanding of the operation of
9 that particular RTO/ISO, without the distraction of serving
10 other clients.

11 The operation of an internal MMU should be more
12 cost effective than having the same functions performed by
13 an external entity. Deficiencies flow from the ability of
14 an internal MMU and other ISO departments to share some of
15 these services.

16 The cost of contracting for services of an
17 external MMU operating on a full profit basis are likely to
18 be higher than the salary and overhead cost of an internal
19 MMU not seeking to earn any profit.

20 An internal MMU that reports to the ISO/RTO Board
21 or an external oversight Board have equal or greater
22 autonomy than an external MMU providing service under
23 contract.

24 It's critical for the MMU to be perceived to have
25 autonomy by market participants and from the manager of the

1 ISO/RTO. If the proper oversight structure is implemented
2 an internal MMU can have as much or more autonomy than an
3 external MMU supplying the service under a contract
4 relationship.

5 The independence must be maintained in three
6 basic areas, budget, scope of work, and performance
7 evaluations. An internal MMU can operate
8 independently if it reports to the ISO Board or to an
9 external oversight Board. I do not agree that an external
10 MMUs the recognized best practice. It is true that a number
11 of ISO/RTOs have external MMUs or have hybrid structures
12 with both internal and external groups, but the number of
13 adopters of the practice is not the measure of it being the
14 best practice.

15 As markets develop, MMUs should expand their
16 focus from narrow issues of power abuse to include broader
17 issues affecting long term market viability. For the
18 electric markets in the early stages of development it is
19 expected that MMU efforts would be mainly focused on bidding
20 behavior and preventing economical and physical withholding
21 of resources. For markets such as PJM that have achieved at
22 least a degree of maturity, the MMU should devote
23 additional attention to market design issues that affect
24 long term viability of the markets. At this time, two
25 important areas that warrant MMU attention in the regions

1 with developed markets are scarcity pricing and improvements
2 in generator dispatch.

3 CHAIRMAN KELLIHER: Thank you. I'll now
4 recognize an alumnus of the Commission, Derek Bandera,
5 Director of Federal Regulatory Affairs with Reliant Energy.
6 Welcome back.

7 MR. BANDERA: Thank you Chairman Kelliher and
8 thank Commissioners for allowing me the opportunity to
9 participate. I just wanted to focus my point on some of the
10 particular issues that have been brought up in passing a few
11 times before. That's talking about the rule of pricing and
12 reliability and the impacts that the RTO operators have in
13 that process.

14 We look back at last summer and some of the
15 incidents during the severe heat wave that occurred in the
16 Midwest ISO and in the California Iso and we saw situations
17 where there were severe shortages and emergency calls, lack
18 of generation and demand response resources that were needed
19 for reliability.

20 But when you took a step back and saw what the
21 market price signals were that were consistent with that
22 time period, you really didn't see the alarm that was there
23 on the reliability basis.

24 The pressures in that time period didn't reflect
25 the shortage conditions that were out there. It wasn't the

1 fault of any particular person but the fact is that when the
2 operators of these RTOs are in the position of maintaining
3 the reliability, they're forced to use their discretion in
4 actions to call units to make dispatch decisions and out of
5 market calls that are going to impact the pricing that the
6 market sees in the transparent framework.

7 One of the best things that the RTOs have in
8 terms of what a benefit customers through competition is
9 allowing a transparent price signal for people to react to.
10 To see the prices, look at them and make their investment
11 decisions, make decisions on whether there should be demand
12 response.

13 When they think about like a load serving entity,
14 when it's contracting, whether it's potential load and
15 trying to work out how it can negotiate a best deal for
16 them, to tell them like well, we see there are going to be
17 high prices in some short period, let's try and work out
18 demand response actions that can save you money and save me
19 money as the provider.

20 Those things are all dissipated when we see some
21 of the lack of coordination between actions on the operator
22 side and its integration with the pricing. I think one of
23 the key functions that the market monitor can do is have
24 access to the operational information and how those
25 operators are acting and being able to coordinate those

1 actions and make sure that they are consistent with the
2 market pricing signals that come out, whether that be
3 through restraint in unnecessary reliability commitment or
4 through revising some of the tariff rules or implementation
5 on how those prices are actually set. A lot of time is
6 spent in stakeholder processes in developing these rules.

7 A lot of people complain about how much time and
8 effort is put into the stakeholder processes but it's almost
9 a waste of people's efforts if all that time and effort go
10 into trying to get these pricing rules correct and then when
11 you take a step back, in that critical situation where you
12 want to see those pricing signals put out there and operator
13 actions in the name of reliability, which are needed,
14 undermine all that work that's been done in the past.

15 So I think that is one key focus. In conclusion,
16 I would like to add one thing. As we step back and look at
17 our discussions of MMUs here, in RTO regions, it's sort of
18 interesting when we talk about the internal versus external
19 debate on whether there is a conflict there. When you look
20 at the non-organized markets and the lack of market
21 monitoring that occurs in both paces.

22 As the Commission goes forward in its sort of
23 review of market monitoring policies, it might be worth
24 while to reflect on how some of those policies are being
25 implemented in non-RTO areas as well.

1 CHAIRMAN KELLIHER: Thank you. I'd like to
2 recognize Dr. John Anderson, the President and Chief
3 Executive Officer of the Electricity Consumers Resource
4 Council.

5 MR. ANDERSON: Thank you Mr. Chairman and
6 Commissioners. I do appreciate being here. When I was here
7 on February 27th one of the participants were very effective
8 in getting more time by asking the timekeeper not to start
9 the clock until he had done the preliminary, just because it
10 was the Chairman that was doing that. Well I'd better get
11 busy.

12 (Laughter.)

13 MR. ANDERSON: I do get three more seconds
14 because Dave granted me three more seconds. ELCON believes
15 that when or if the organized markets are largely
16 unconstrained on a systemwide basis and local market power
17 concerns are adequately mitigated, the potential for a very
18 competitive wholesale market is greatly enhanced.

19 The need for market monitoring overall would be
20 minimized if the structure and operation of the ISOs and
21 RTOs were fixed, thus we could at least get an overarching
22 objective of what policy should be when that structural and
23 operational performs, it minimizes the need for the MMU.

24 But as long as you either can't or choose not to
25 fix these markets, then we think the market monitoring unit

1 is absolutely critical and we urge you to take this as one
2 of the highest priorities.

3 We were very pleased in your policy statement in
4 2005 with a statement that's in there that says, "since
5 these markets ultimately exist for the benefits of
6 customers, the MMU's focus on how effectively the markets
7 are responding to the customers needs for reliability and
8 electricity supply at the lowest level and cost to
9 customers."

10 We really appreciate that. We think the focus
11 should be on customers. Unfortunately, thought, it is our
12 observation that that has not been the focus and we feel the
13 RTOs and ISOs or the market monitoring unit due to their
14 advocating two-tiered marketing structure a model you've
15 heard quite a bit about today.

16 First an independent market monitoring unit
17 operating within the ISO/RTO and not subject to ISO/RTO
18 management in any way. The internal MMU should have an
19 impeded access to all ISO/RTO data and personnel. They
20 should monitor operations on a 24/7 basis and publish all
21 kinds of things with it.

22 It should monitor the operations and structure of
23 the ISO/RTO, should control IT functions, it should perform
24 real time screening and analysis to identify circumstances
25 that require further investigation. It independently

1 proposing release testimony and reports for the existence of
2 the external market monitoring committee, which I'm going to
3 mention in a minute, that works closely with them and not
4 duplicate efforts of the MMC.

5 It's real important though that that market
6 monitor should be hired by a subcommittee of the Board that
7 includes no ISO or RTO managers or staff. It should be
8 dismissed only for good cause, which would include FERC
9 approval and it should develop the MMU budget subject to
10 Board subcommittee approval, again with no ISO or RTO
11 managers or staff and FERC approval.

12 Also RTO management should have no direct or
13 indirect authority over the MMU. The independence includes
14 employee decision staffing and all the things that were in
15 the joint applicants letter.

16 Secondly, we think that you need an independent
17 external market monitoring committee or call it whatever you
18 want, operating outside the ISO and RTO, not subject to ISO
19 or RTO management in any way.

20 The Committee should identify just market design
21 flaws, prepare analyses of potential harm to customers,
22 propose efficiency, enhancing market rules, determine what
23 market activity should be temporary suspended, the broad
24 picture, the big picture.

25 The members of the Committee should be appointed

1 by a subcommittee of the Board that includes no ISO or RTO
2 managers or staff. It should have only part time
3 responsibilities within the ISO or RTO. It should be
4 dismissed only for good cause, which would include FERC
5 approval and develop an approve the budget that has been
6 approved by the Board and sent to FERC.

7 Either the internal nor the external MMC should
8 take enforcement actions as we've heard today. That's your
9 responsibility. Retroactively change prices, except maybe
10 for software glitches or something, monitor compliance with
11 local reliability functions or be advocates for any
12 structure or type of operation.

13 I conclude that it is up to you. You are charged
14 to protect customers. You can fix the markets and minimize
15 the need for MMUs or you can implement very strict MMUs.
16 Anything between those two extremes pose harm for the
17 customers. Thank you for the opportunity to be here.

18 CHAIRMAN KELLIHER: Thank you very much. I think
19 we have six minutes each, thirty divided by five is six. I
20 turn to the economists. Let me respond fist. Let me just
21 respond to Commissioner Christie.

22 Actually I think that the order last year was
23 decided entirely correctly. I don't have any questions, at
24 least from my point of view that it was decided correctly.

25 What we did in May 2005 was a policy statement

1 where we provided some guidance on the role of market
2 monitors. PJM followed and initially only PJM followed up
3 on our policy statement. They made a filing to conform
4 their market monitor with our policy statement.

5 It did that. I don't really think there is much
6 question that their proposal was consistent with our policy
7 statement. I thought we actually should approve a filing
8 that is consistent with our own policy statement.

9 There were issues raised by parties, including
10 the State Corporation Commission that went outside the scope
11 of the policy statement and I think it's entirely within our
12 discretion to not deal with issues outside the scope of the
13 policy statement.

14 Mr. Bowring has raised certain allegations. I
15 saw them for the first time this morning. I think he might
16 have given them to us late last night or this morning at
17 some point.

18 I like Mr. Bowring. I respect him. But I don't
19 feel comfortable assuming that his version is the complete
20 story, it's the whole story. I think one thing we have to
21 do here, and I think as State Commissions, you do this, I
22 believe, is listen to more than one perspective before you
23 make a decision.

24 I have reviewed his comments and I think we'll
25 listen to more than one version of events though.

1 With respect to independence, I'm just curious
2 when you say independence. You don't mean external, you
3 mean independence in the sense of not being subject to any
4 management control? Being able to set your own budget?
5 Being removed only for cause? Are those the attributes of
6 independence?

7 COMMISSIONER CHRISTIE: First of all Mr.
8 Chairman, let me say my rouge efforts to reopening the
9 proceeding was sort of facetious. After hearing his
10 comments today, that proceeding is over, obviously, and I
11 understand that.

12 With regards to independence, the key is not so
13 much the legal status. Commissioner Spitzer made the point
14 that from the standpoint of whether it's a contract employee
15 or an internal employee, it's really significant only from
16 the standpoint of a tax standpoint.

17 There are also some employment laws used but
18 that's not before you. The important thing is, whatever the
19 structure is, whether it's contracted or employee, with the
20 market monitor having freedom to, in effect like an umpire
21 in baseball, call the balls and strikes the way he sees them
22 and not be subject to undue influence in how he calls the
23 balls and strikes.

24 CHAIRMAN KELLIHER: Independence then means
25 having some ability to appear to either the RTO Board or to

1 the Commissioner itself.

2 COMMISSIONER CHRISTIE: To reference back our
3 comments last year, OPSI made some very detailed suggestions
4 on how we thought the market monitoring function in PJM
5 could be restructured to guarantee independence or at least
6 to move toward a much more significant independence.

7 I won't restate that entire pleading for you
8 because it was quite detailed. The point was, and the
9 purpose was, to give the market monitor the kind of
10 flexibility and freedom of operation to in effect, do his
11 job or do her job in the way he or she saw fit.

12 Certainly people who disagreed with the call he
13 makes or the conclusions he reaches, should have the
14 opportunity to appeal that to a higher authority. That goes
15 to the issue of transparency, by the way.

16 Another issue we have a very strong emphasis on
17 is the issue of making the data available. No market
18 monitor is obviously infallible and I wouldn't suggest that.
19 Independence doesn't mean achieving infallibility.

20 Now with transparency though, people should have
21 the opportunity to have the data to see what they see for
22 which the market monitor reach this conclusions.

23 You mentioned, I think, you used the term, "peer
24 review," absolutely. An economic conclusion should be
25 subject to peer review. If the data is transparent, outside

1 parties can look at the same data and determine whether the
2 market monitor came to the right conclusion.

3 CHAIRMAN KELLIHER: Let me ask Commissioner
4 Chappelle a question, and I promise it won't be about the
5 bid conspiracy. We both have an interest in the Lincoln
6 assassination and the boot conspiracy. I thought maybe I'd
7 break it up a little bit by asking you a question along
8 those lines, but that would be too self-indulgent.

9 So I'll ask you a Commission within scope, since
10 we're talking about the scope of this meeting. That's the
11 confidentiality of data. It's one that has existed from a
12 while. From our point of view, one of the issues is
13 maintaining the confidentiality that data if it were made
14 available to our state colleagues.

15 I think there is a problem in some states, in
16 that the confidentiality of data can not be maintained in
17 certain states under state law. I think that's why in some
18 cases some state officials have not been able to sign non-
19 disclosure agreements because if they were to receive, if
20 they were to sign a non-disclosure, they couldn't truthfully
21 say we can enter into a non-disclosure agreement and
22 maintain the confidentiality of data because it becomes a
23 state record. It can be disseminated to other state
24 officials who then may release the data.

25 I just wanted to point out it's not an arbitrary

1 act. Part of it is this data is important that its
2 confidentiality be maintained and in some cases it can't be
3 maintained under some state laws.

4 COMMISSIONER CHAPPELLE: You're running out of
5 time, can I respond?

6 (Laughter.)

7 CHAIRMAN KELLIHER: I can't see the clock. That
8 wasn't deliberate to leave five seconds for you.

9 COMMISSIONER CHAPPELLE: You took up the majority
10 of that time.

11 CHAIRMAN KELLIHER: Sure.

12 COMMISSIONER CHAPPELLE: Any my name is Mudd.
13 You and I still have some talking to do. Let me say this
14 quickly, it's an understandable concern from FERC's
15 standpoint, if I were you I would have the same concern for
16 confidentiality of information, no question.

17 But I also think we states, individually and
18 collectively, I think we have a long history of working with
19 FERC and sharing information. We've worked on pipeline
20 matters, mergers and acquisitions and so it's hard for me as
21 an attorney to really see what new structure has popped up
22 in the RTOs that all of a sudden it's more paperwork for
23 states than it has been in the past.

24 You have to take my word for it, it is. When you
25 give us more paper, we have attorneys on staff too. You

1 have attorneys, we have attorneys. It's going to take
2 longer. You frame a question right and it will make our
3 attorneys nervous. We deal with confidential data on behalf
4 of the state, day in and day out, proceeding after
5 proceeding.

6 We have state FOIAs, you have federal FOIAs. I
7 think this is more dialogue. I think instead of taking a
8 few states that might have problems and say, look, through
9 MISO, you states are really going to have to pass a higher
10 hurdle to get data.

11 You know, again, we want to get confidence. The
12 more problems you give us, we can turn around and have more
13 confidence in the market, then I think we are all better
14 served.

15 So I'm going to continue to plead to you guys to
16 give us an honest chance on handling some information. I
17 think we're up to the task.

18 CHAIRMAN KELLIHER: Thank you very much.
19 Colleagues? Commissioner Spitzer.

20 COMMISSIONER SPITZER: Thank you Mr. Chairman. A
21 couple observations. First the issue has come up a couple
22 of times with respect to California. I'm very careful
23 always not to disagree with the Chairman. The Chairman
24 suggested the problem was one of failure of law.

25 I would agree there was a failure of law, but the

1 "but for" clause of all of the mischief in California was
2 inadequate generation and insufficient transmission. I
3 think we ought to look at the root cause and there were many
4 consequential problems that arose from that.

5 Imperfect market structures and insufficient
6 remedies exasperating the problems that already existed.
7 But the federal and state regulators together, need to work
8 to ensure that we don't have the root cause problem of
9 generation and transmission and nothing inherent in an RTO
10 or market monitoring function obviates the need for adequate
11 generation and adequate transmission.

12 Hence a collective responsibility, but we ought
13 to assign the fault I think where it truly lies. I would
14 say to Commissioner Christie, when I was in Arizona, we lost
15 a couple of cases at FERC. I feel your pain.

16 (Laughter.)

17 COMMISSIONER SPITZER: You now have the onerous
18 burden of regulating Mrs. Spitzer's rates. As part of the
19 Arizona Public Service case I had a big provision with
20 demand response and energy efficiency and we had inserts go
21 out in the billing statements.

22 I was very proud of the steps that we'd taken.
23 Mrs. Spitzer opens up the door and sees the insert, the
24 stuffer and says, not apocryphally, "What idiot wrote this?"

25 (Laughter.)

1 COMMISSIONER SPITZER: I'm also mindful of those
2 problems.

3 CHAIRMAN KELLIHER: That was in Arizona she said
4 that.

5 COMMISSIONER SPITZER: It's true. It was in
6 Arizona. You'll have your chance later.

7 (Laughter.)

8 COMMISSIONER SPITZER: We have on this panel and
9 it's a little field, but the issue of cost. The market
10 monitors suggested their plates are full. We've got
11 customer groups. We've got state regulators who are
12 constituent, who although not huge amounts, they're not
13 inconsequential.

14 And as part of this faith and confidence, it's
15 important that the customers have faith and confidence.
16 What can be done in your view with respect to RTO costs
17 productively Mr. Anderson?

18 MR. ANDERSON: Let me say that as far as the
19 overall cost go, the costs, the dollars that are extracted
20 from customers from the operations of the market far exceed
21 any of the cost we're talking about here.

22 I haven't run the numbers, but I'll be glad to do
23 that. It's that kind of thing. It's the flaws in the
24 market that are causing artificially high prices that are
25 really causing the real problem. That's where the cost

1 problem ought to be. As far as cost for market monitoring
2 goes.

3 COMMISSIONER SPITZER: Administrative overhead,
4 more generally than just the market monitor.

5 MR. ANDERSON: Ultimately the annual budget is
6 going to come to you and I think you can look at it. I
7 would urge you to look and see what the customers are
8 saying. The customers are the ones that are paying the
9 bills. What are they saying about these things?

10 Customers have been saying quite a few things,
11 not about administrative and overhead costs by the RTOs but
12 things like capacity market and RPM and things along that
13 line. They've been giving you all kinds of indications.
14 They come to you and you haven't been listening to them.

15 I urge you to listen to the customers on what
16 they have to say about costs. They're the ones that
17 ultimately pay the bills.

18 COMMISSIONER SPITZER: Mr. Klepinger.

19 MR. KLEPINGER: Just trying to relay the cost
20 saving element. In today's discussion, which is on the MMU,
21 with respect to PJM, I think customers feel they've bought
22 and paid for tremendous amount of intellectual capital
23 that's been built up in the MMU over the last seven years.

24 To discard that intellectual capital in favor of
25 a different structure, if you will, it seems to me to be a

1 waste of the rate-payer dollars as it relates to the MMU
2 function.

3 COMMISSIONER SPITZER: Mr. Anderson. You
4 suggested that an either/or as you point out have markets
5 that don't require an MMU or have an MMU that is more fully
6 empowered. However, markets are not self-executing and
7 there are occasions when there are matters that will affect
8 markets that are not obvious that do require some
9 investigation.

10 Government is not omniscient. One just story I
11 heard from an Iowa legislator. There was a problem that the
12 farm bureau brought to his attention. The restaurants in
13 Iowa were not able to find garnishments for the hamburgers,
14 parsley I think in this particular case.

15 Was there some conspiracy dramatically increasing
16 the cost of parsley to a point where it was not only very
17 dear prices or completely unavailable? The answer was
18 completely, unintuitive.

19 The farmers didn't want to go to the meetings and
20 brag about how much parsley they had. It was not a macho
21 thing for a farmer, so parsley wasn't getting grown.

22 No one could have anticipated this. The point is
23 that the markets aren't necessarily self-executing.
24 Sometimes they need a hand in an area that's unregulated
25 like agriculture.

1 So given that we can't expect electricity markets
2 to be self-executing, doesn't that really cry out for the
3 need for an MMU that's functional?

4 MR. ANDERSON: Absolutely, and what I thought I
5 said and if I didn't I certainly meant to say, was that a
6 well-functioning market minimizes the need for an MMU while
7 a faulty market increases the need for an MMU, makes it
8 critical for the MMU to be much greater, much bigger, much
9 more costly and all that because there are so many things
10 they have to monitor.

11 COMMISSIONER SPITZER: There is no market that is
12 completely self-exercuting.

13 MR. ANDERSON: Absolutely. It could be that we
14 do more under antitrust and things along that line than we
15 do under the traditional strong arm of regulation. So I
16 think we would feel that no market is going to be completely
17 unregulated with respect to operations, certainly not the
18 electricity market.

19 CHAIRMAN KELLIHER: Colleagues? Commissioner
20 Kelly.

21 COMMISSIONER KELLY: I'd like to start out by
22 saying that I agree with Joe when he said that PLM's filing
23 to revise its market monitoring plan did conform with the
24 principles set forth in the Commission's May 2005 policy
25 statement on market monitoring.

1 However, at this point, I'm going to disagree
2 with Joe. I also have to disagree with Marc who said that
3 he is always careful not to disagree with Joe.

4 (Laughter.)

5 COMMISSIONER KELLY: He is sadly not so careful,
6 but Joe and I disagree on many, many things, but on this
7 point, I did disagree and I think the Commission should have
8 taken you up on your suggestion that we initiate a 206
9 Investigation.

10 Not that what PNM filed was in any way wrong, but
11 you point out, correctly I believe, that we need to go
12 further in the evolution of our market monitoring policies,
13 tariff provisions and regulations to more of a degree of
14 specificity in order to ensure that we do have the
15 independence in the market monitoring that we need.

16 I think that's in large part why we're having
17 this technical conference today. It's more acute of an
18 issue for PJM in large part because PJM doesn't have outside
19 contractors, they have in-house, and they were one of the
20 first to do in-house solely and they just didn't put the
21 details in the tariff.

22 However, MISO has outside contractors and it's in
23 the contract and it's in the tariff. So I think that we
24 should have, and I think in a sense we're doing that now, to
25 determine whether, as we look across the market monitoring

1 operations, across the United States, to decide whether or
2 not we need more specific rules regarding MMUs independence
3 and authority.

4 But I think we are all on the same page that we
5 believe that they do have to have independence and the
6 authority to carry out their jobs.

7 You raised number of recommendations that I
8 thought we should have pursued and I think we are pursuing
9 now. What is your position now? Do you think that we can
10 eliminate some of the questions about independence if we
11 pursue a policy that's more specific about how to maintain
12 that independence?

13 COMMISSIONER CHRISTIE: First of all Commissioner
14 Kelly, OPSI didn't need Mr. Bowring's testimony today to
15 know that there is a lack of independence. So our filings
16 last year were not dependent on what you heard today.

17 What we heard today with you, the structure is
18 obviously not conducive to independence because of the
19 reporting relationships and the employment relationship.

20 What OPSI suggested last year and our position
21 remains the same, we may tweak it a little bit in the
22 future, but what OPSI suggested last year were structural
23 changes that were filed in our pleading and again I'm not
24 going to bore you by going over those seriatim.

25 But they would have led to a different reporting

1 relationship, moving the direct reporting relationship of
2 the PJM market monitor outside from under the prevue of
3 PJM's management, at a minimum, to a committee of the Board
4 and PJM management would not have any role in sitting on
5 that Board Committee and therefore could not be in a
6 position to hire and fire the PJM market monitor.

7 We thought that was self-evident from the
8 structure of the relationship, not because of what we heard
9 today, because we obviously believed that last year.

10 COMMISSIONER KELLY: Thank you. John Anderson
11 has presented a recommendation that goes into quite a bit of
12 detail about how to achieve an independent market monitor,
13 whether it is an in-house market monitor or an outside
14 contracted-for market monitoring operation.

15 I wonder if the rest of you had an opportunity to
16 review that and if you had any comments on it. Or, if you
17 didn't have an opportunity to review it in writing, to the
18 extent that you recall what he said in his testimony, if you
19 had any comments.

20 MR. KLEPINGER: Actually at PJM Industrial
21 Customer Coalition works closely with ELCON. I don't know
22 if you had a chance to look at the bullet list we
23 distributed this morning and there appears tremendous
24 consistency between that and Dr. Anderson's comments.

25 The only exception being the external oversight

1 Board which is certainly capable of being added on to the
2 position that we distributed today.

3 MR. SORENSON: In these two extreme cases that
4 you said you either needed the hammer of market monitoring
5 or let the markets work, you have to remember in somewhere
6 like PJM where you have constrained areas, where I came from
7 Northern PFs, you could actually end up in this market with
8 both.

9 You have a totally constrained area in Northern
10 PFs where there is a huge concentration of ownership of the
11 generation, you have to mitigate the prices. You have to
12 step in, you have to have, where you have the big wide area
13 where you have a market that works, a competitive market,
14 you need to step back.

15 I think some of the things Audrey talked about
16 where you sit down and talk about are you going to use
17 conduct and impact test or are you going to use structure
18 tests? That's the first step you've got to decide. You've
19 got to decide which of these are markets and which aren't.

20 You have to be flexible in that way. It isn't an
21 either or, you're going to need both.

22 MR. ANDERSON: Just a quick comment. First of
23 all, I did open by saying that if we had an organized market
24 that was unconstrained. So I agree with you completely on
25 what you just said in today's markets there is tremendous

1 constraints.

2 Secondly, one thing in the interest of time I
3 left out, but it was absolutely critical and I apologize,
4 but Commissioner Kelly you talked about the independence.
5 We think that one of the most important things for
6 independence for either the internal or the external or
7 whatever else, is a code of conduct.

8 That is a very rigid and a very strict code of
9 conduct that is actually put into the tariff and therefore
10 it is under your jurisdiction. That should come before the
11 rules, just like whatever but I think it's extremely
12 important to have a code of conduct and it's in my written
13 testimony. I will be submitting this to you very shortly.

14 I apologize I didn't have it sooner and then
15 third, I want to repeat what Dave Klepinger was saying, I do
16 urge you. I know you just got it. It was the filing of the
17 Joint Consumer Advocates, just of yesterday and I urge you
18 to look at that.

19 Again I'm saying what Dave would say, their
20 attachment is very consistent with our internal. All we did
21 was add a layer then of the external, which is very much
22 like the California markets Surveillance Committee and we
23 think two working together is really the way to go.

24 CHAIRMAN KELLIHER: Commissioner Wellinghoff.

25 COMMISSIONER WELLINGHOFF: I'm not going to

1 disagree with everybody.

2 (Laughter.)

3 COMMISSIONER WELLINGHOFF: I would agree with
4 Commissioner Spitzer. In his characterization I think some
5 of the what the other panelists have said as well. There
6 isn't any difference between contract employee outside
7 employee internally. It's how you treat them and how you
8 structure them separately.

9 But as I understand it, we have Commissioner
10 Christie and Mr. Klepinger, Mr. Sorenson and Dr. Anderson
11 were all more or less on the same page in this model they've
12 given us for PJM or are suggesting for PJM.

13 I understand we don't have any place, at PJM
14 certainly it's not in place in any other ISO or RTO. What
15 I'd like to ask you all is how do you see this model or do
16 you see this model as being any better than the current
17 model in MISO. The second question is, do you see the model
18 being any better than say, the market monitoring unit being
19 a FERC employee, if you'll contrast your model with those
20 two, please. To start down the line.

21 MR. SORENSON: Being on both sides of an employee
22 and a consultant, I'm sure you people rely on consultants.
23 Although we say we did structure them the same, there is a
24 difference between outside the RTO and being inside.

25 I think there is a difference. The model is not

1 that far out of play as OPSI said. We need to change the
2 reporting structure. OPSI is not saying we build PJM from
3 scratch, there is a whole lot of investment into this.
4 They're saying change the reporting structure.

5 Commissioner Spitzer keeps talking about money.
6 Why would you duplicate all these services if you go to an
7 outside consultant. Why would you go to a for profit thing?
8 So most of the model is in play in PJM.

9 COMMISSIONER WELLINGHOFF: It would be even
10 cheaper if it were a FERC employee.

11 (Laughter.)

12 MR. SORENSON: There is the option in my written
13 comments. Read that. We talk about, do you need the
14 external? Do you need the California model, which is not a
15 bad thing, that outside Board. It's fairly new. It is
16 FERC.

17 COMMISSIONER CHRISTIE: I would just say, Mr.
18 Wellinghoff, the point of reference for OPSI is really what
19 we proposed, it's not whether it's been in MISO. Many of
20 our states are not in MISO. Out point of reference is
21 whether it's put into the existing structure of PJM and it
22 immeasurably is.

23 COMMISSIONER WELLINGHOFF: I understand that, but
24 I'm saying, would it be any different to you if it was an
25 outside contractor versus an employee inside, given the same

1 parameters that you've listed otherwise?

2 COMMISSIONER CHRISTIE: Speaking for OPSI, we
3 also saw the proposal that was being proposed by PJM about
4 three days ago. We don't have a 14-state position on that
5 yet. Again, the point that Commissioner Spitzer made, if I
6 can speak individually, independence is not a matter of
7 whether you're a contract employee or an outside consultant
8 or an FTE.

9 It only matters to your tax accountant.
10 Independence is much different in terms of operational and
11 daily functionality. What OPSI is saying, is it needs to be
12 independent. PJM's is not.

13 COMMISSIONER WELLINGHOFF: Assuming MISO is
14 independent.

15 COMMISSIONER CHRISTIE: I can't speak for MISO.
16 We're just not in MISO.

17 COMMISSIONER WELLINGHOFF: I understand that.
18 What I'm saying is, speaking for PJM when you have any
19 preference whether it be a contract or an internal employee?

20 COMMISSIONER CHRISTIE: Again, Commissioner I
21 have to speak for OPSI and that's who I'm here to speak for.
22 OPSI's position is what we expressed in our pleading last
23 year.

24 COMMISSIONER WELLINGHOFF: Fine. Do we have
25 anybody else who wants to speak on the issue? John.

1 MR. ANDERSON: I would just like to say that the
2 model, what we think we are doing is proposing an improved
3 version of what is in California. In California you have
4 the internal market monitor unit and you have that market
5 Surveillance Committee.

6 We think there is just a couple of things that
7 can be added to that that would make it even better. So we
8 think there is an advantage. The kind of thing we also
9 think, these are not duplicative, they are very
10 complementary.

11 The Market Monitoring Committee or the
12 Surveillance Committee does the big picture items. It looks
13 at broad issues and that sort of thing.

14 The Internal Committee is looking at the day-to-
15 day 24/7, all the data collection, all the things that are
16 absolutely critical to be doing and that sort of thing. In
17 essence though, the internal market monitoring unit is going
18 to report to the Market Surveillance Committee both under
19 the direction of the subcommittee of the Board without any
20 of the staff of the ISO or RTO.

21 These are the kinds of things that we're adding
22 to the California model and the whole thing, it is protected
23 with a firewall. That's the code of conduct.

24 COMMISSIONER WELLINGHOFF: Do you have any
25 comment on the third model. I'm not recommending --

1 MR. ANDERSON: The employees?

2 COMMISSIONER WELLINGHOFF: Yes.

3 MR. ANDERSON: When I first saw the EPSA case
4 some time ago, I thought what the courts were requiring is
5 that you put people in every one of the ISOs and RTOs. I'm
6 not sure that's the best idea.

7 We need something that is going to be able to be
8 flexible over time and I really think that this idea of a
9 subcommittee on the Board on all that will be better than
10 actually having staff. It's ultimately going to come to
11 you anyway. You're going to get the bite on it.

12 Anyway, I don't think it's a good idea for you to
13 be right down there in the trenches while all this is going
14 on and then have it come to you for review later. I think
15 it's better to do it the other way.

16 COMMISSIONER WELLINGHOFF: Mr. Klepinger, do you
17 have any comments on this?

18 MR. KLEPINGER: I just sort of harken back to a
19 prosecutorial advisory role or putting the same entity in
20 that position, if it's a FERC employee and then the ultimate
21 actions come to FERC. I just think the messiness and the
22 codes of conduct that will be necessary for FERC would
23 complicate it unnecessarily.

24 Again, it seems to me you have to retrain people
25 to do that function when you have people there that are

1 trained already.

2 MR. HARVEY: About half a minute.

3 COMMISSIONER WELLINGHOFF: One last question for
4 you Dr. Anderson. You said, I believe that the market
5 monitor should not be advocates for any structure or type of
6 operation. Would that include not advocating more
7 integration of demand response in the markets?

8 MR. ANDERSON: That's a very good question,
9 Commissioner.

10 (Laughter.)

11 MR. ANDERSON: I guess what I'd really like is
12 for it to be an advocate for what I want it to be an
13 advocate for, not an advocate for things I don't want it to
14 be an advocate for.

15 (Laughter.)

16 MR. ANDERSON: If it has to be one or the other,
17 we've been quite concerned about some of the market monitors
18 whose job seems to be to defend what's there. Defend the
19 status quo. They point out a few minor things. There are
20 problems that they say we're going to fix them and that sort
21 of thing. That the kind of advocacy that I just don't think
22 that we want.

23 It was said this morning, we want someone who's
24 key job, and we think the Market Surveillance Committee in
25 California's key job is to bring the bad news and because

1 they're part time, if they lose this job they're not losing
2 their full time job and that's their charge and their
3 motivation in their independence and we think that's the
4 kind of thing they should be doing.

5 COMMISSIONER WELLINGHOFF: Thank you.

6 CHAIRMAN KELLIHER: Commissioner Moeller.

7 COMMISSIONER MOELLER: John, just to follow up.
8 Does your passion extend to non-organized markets as well?

9 MR. ANDERSON: Well, Commissioner, we're close to
10 saying at this time, if it ain't broke, don't fix it. So
11 let's leave the unorganized markets, which I'd rather call
12 them the unrestructured markets.

13 Let's focus on where the problem is. The
14 problems today are in the organized markets, from where we
15 are coming from. I do think there should e some
16 surveillance over those. There is absolutely no doubt about
17 it. You all have responsibility to approve just and
18 reasonable rates, no matter where they happen to be and
19 certainly in the unrestructured markets you have that
20 responsibility just like any other.

21 So data and information will be it but I guess
22 right now the focus for us is 150% on the restructured
23 market rather than on the unrestructured markets.

24 COMMISSIONER MOELLER: thank you. Commissioner
25 Chappelle, thanks for being here. I just want to make sure,

1 other than the issue of increased data sharing, do you have
2 any other thoughts or do you want to expound on how we can
3 build a better relationship between this Commission and our
4 staff and the various, not just state Commissions, but state
5 Commissions in the context of your role as State Commissions
6 in a particular market?

7 COMMISSIONER CHAPPELLE: I appreciate that
8 question. Let me just say, I'm having a hard time keeping my
9 poker face. No offense Commissioner Wellinghoff, but I'm
10 speaking personally here. But I think again states will get
11 a bit nervous.

12 If FERC were to propose staff taking that extra
13 step to be the market monitor, or be that closely integrated
14 with the market monitor.

15 COMMISSIONER MOELLER: You mean FERC staff.

16 COMMISSIONER CHAPPELLE: Because the same issue
17 would be there for you. Just like again, if we said trust
18 us folks, we'll take it from here, we'll send our guy in and
19 it would be our guy that they report to on behalf of the
20 states.

21 I think the theme of today, really from all your
22 speakers is true independence from anybody really, from the
23 RTO from FERC, from states. The market monitor should have
24 just as much confidence that the can come to FERC, he or she
25 can come to FERC with an issue without fear of retribution.

1 So I think trying to answer your question, you
2 know, MISO is unique. We have retail choice states for we
3 the regulated states, Michigan a hybrid state, maybe we'll
4 stay retail choice, maybe we won't. But western states,
5 North Dakota, South Dakota, completely integrated. It's
6 really taken us some time to build up the trust amongst
7 ourselves.

8 They too, let's not forget, day two was really,
9 really tough for the various states. Regardless of what you
10 think. There is some level of distrust to FERC. We don't
11 know if we trust this MISO thing. We don't know if we can
12 trust the market monitor. So collectively we as an
13 organization have come a long way.

14 I think to the extent that you can continue to
15 keep states involved, not simply, no offense folks, but as a
16 stakeholder because again we have statutory responsibilities
17 to our rate payers. We have to have information on cases.
18 We have to have information on potential abuses or else I
19 can't help John and the other folks. So I think that's our
20 prevailing message. I think it is through OPSI as well.

21 The more you all can at least try to work with us,
22 streamline your paper route just a little bit, the more you
23 can work with us the more we get comfortable and then I
24 think we all can help each other. Does that answer your
25 question? I hope it did.

1 COMMISSIONER MOELLER: I did. Now give Mark a
2 last chance to make any additions.

3 COMMISSIONER CHRISTIE: I agree with Laura on
4 that. I think that ultimately thought what counts is what
5 happens. OPSI represents 14 states but I'm going to use the
6 word "sovereign" being from Virginia, but there are 14
7 states being part of our federal constitutional structure.
8 We have told you that we see significant problems with
9 independence in the PJM market. Were' asking for action to
10 address those issues.

11 So I would say in terms of working together, we
12 can be all the touchy feelies we want, but ultimately at the
13 end of the day we're looking for action in those areas under
14 which you have jurisdiction. As Laura said, we have areas
15 under our state laws and constitution in which we have
16 jurisdiction and we have legal duties to carry out.

17 That's why we are here pursuant to our own legal
18 duties, asking you to use you legal authority to address
19 issues that we've brought to you.

20 COMMISSIONER MOELLER: thank you.

21 CHAIRMAN KELLIHER: Let me just follow up on that
22 and just make a few closing comments really on that same
23 train of thought. Some closing on my behalf, nothing to do
24 with John Wilks Booth or Samuel Mudd.

25 They're actually three Georgetown graduates

1 involved in the Lincoln conspiracy. I'm a Georgetown
2 graduate. None of the buildings on campus are named after
3 them. So it's probably no surprise.

4 We've been talking about independence a lot today
5 and we've been talking about accountability a little bit to
6 some extent there is a balance between the two of those
7 things. Independence also is a continuum. It's indicia of
8 independence but I think we actually could vest so much
9 independence in the market monitor conceivably that they're
10 accountable to no one.

11 Because they're not Commission employees, we
12 don't license them, we don't hire them, we can't fire them
13 and RTOs are accountable to us. I think the natural
14 relation would be market monitor should be accountable to
15 RTO Board or management to some extent because they really
16 can't be accountable to us.

17 I think we could invest so much in dependence
18 into a market monitor that they're accountable to no one.
19 To me it's not clear with having that kind of balance. We
20 have tremendous independence and not accountability is
21 really the perfect outcome.

22 We were at the point here where we're looking at
23 should we initiate a generic proceeding to provide more
24 clarity than we did in the 2005 policy statement on what the
25 role and structure of the market monitor should be.

1 I think we had a really good discussion on
2 external and internal and I would agree with a lot of what
3 my colleagues have said and the panelists have said. It's
4 not apparent that internal or external is more independent
5 than the other.

6 They can be equally independent or equally not
7 independent but I think we really have to address some basic
8 questions as to, should we initiate a proceeding, what
9 should it focus on? Should it focus on the role? Should it
10 focus on the structure? If it focuses on the structure, we
11 have to be careful about some of the legal limits on us. We
12 have another court decision that we lost, the Cal ISO
13 decision. We reported out there some limits to the extent
14 we can't affect the governance of a public utility and RTO
15 is a public utility.

16 So I think it's been a very good discussion.
17 I've enjoyed it. I just wanted to make those comments. I
18 think there is a balance. There is a relationship between
19 accountability and independence and I think we can actually
20 go too far but we need to maintain confidence in the markets
21 in the organized markets.

22 I think we have a lot to talk about internally
23 and I think my colleagues and I are going to have to consult
24 with each other and see what our next steps should be.
25 Colleagues any other comments?

1 (No response.)

2 CHAIRMAN KELLIHER: thank you very much. Thank
3 you for coming out.

4 (Whereupon, at 3:05 p.m., the Technical Conference
5 was concluded.)

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