

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

Market Monitoring Units in Regional
Transmission Organizations and
Independent System Operators

Docket No. PL05-1-000

POLICY STATEMENT ON
MARKET MONITORING UNITS

(Issued May 27, 2005)

1. The purpose of this policy statement is to provide guidance on the role of market monitoring units (MMUs) associated with Independent System Operators (ISOs) and Regional Transmission Organizations (RTOs). MMUs perform an important role in assisting the Commission in enhancing the competitiveness of ISO/RTO markets. Competitive markets benefit customers by assuring that prices properly reflect supply and demand conditions. MMUs monitor organized wholesale markets to identify ineffective market rules and tariff provisions, identify potential anticompetitive behavior by market participants, and provide the comprehensive market analysis critical for informed policy decision making. This policy statement provides guidance on the coordinated roles and responsibilities of the Commission and the MMUs.

2. In order to achieve the stated purpose of enhancing the competitive structure of the ISO/RTO markets, MMUs perform several valuable tasks:

- To identify ineffective market rules and tariff provisions and recommend proposed rule and tariff changes to the ISO/RTO that promote wholesale competition and efficient market behavior.
- To review and report on the performance of wholesale markets in achieving customer benefits.

- To provide support to the ISO/RTO in the administration of Commission-approved tariff provisions related to markets administered by the ISO/RTO (e.g., day-ahead and real-time markets).
- To identify instances in which a market participant's behavior may require investigation and evaluation to determine whether a tariff violation has occurred, or may be a potential Market Behavior Rule¹ violation, and immediately notify appropriate Commission staff for possible investigation.

3. Good market rules are essential to efficient wholesale markets in which competing suppliers have incentives to meet the customers' needs for reliable service at the least cost. ISO/RTO markets are operationally complex. MMUs should have access to data and other resources to evaluate participant behavior and responses in these markets. As such, MMUs should evaluate the market-specific responses of individual market participants to existing or proposed market rules and tariff provisions. It is therefore critical that the MMU consistently and impartially evaluate the existing ISO/RTO rules and tariff provisions, including mitigation and their effects on the economic signals sent to market participants. However, it is the responsibility of the ISO/RTO to make section 205 filings, rather than the MMU.

4. Wholesale market design flaws can present perverse incentives that may result in unintended inefficient or unreliable operations, but which may not be manifested for many months or years. It is critical that the MMU provide the ISO/RTO and the Commission with its perspective and expertise in the development of market rules and tariff provisions. It is also essential that the MMU work proactively in identifying market design flaws, and provide assistance to the ISO/RTO in developing appropriate rule changes that will promote reliable and efficient operation of the wholesale markets. While the Commission is responsible for ensuring just and reasonable rates, the Commission does benefit from the expertise of the ISO/RTO to provide the tariff filings to the Commission that help ensure that the market rules in place work effectively and to ensure that customers receive the full benefits of competitive wholesale markets. In response, the Commission makes every effort to act in a timely manner on such filings, and has recently announced procedures to

¹ *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 105 FERC ¶ 61,218 (2003), *order on reh'g*, 107 FERC ¶ 61,175 (2004).

assure expeditious Commission action when necessary to ensure smooth functioning of wholesale markets.²

5. Organized markets work best to benefit customers when the market rules and tariff provisions governing ISO/RTO-administered markets and contained in the ISO/RTO tariff are clearly understood by and followed by market participants. MMUs should therefore vigilantly monitor participant behavior. For this reason, the Commission has determined that ISOs/RTOs may administer compliance with tariff provisions only if they are expressly set forth in the tariff; involve objectively identifiable behavior; and do not subject the seller to sanctions or consequences other than those expressly approved by the Commission and set forth in the tariff, with the right of appeal to the Commission.³ Such penalties, however, must be designed to be a clear deterrent to unwanted behavior, without being so high as to be unnecessarily punitive.⁴

6. Beyond the objectively identifiable, Commission-approved tariff provisions that are administered by the ISO/RTO, there may be situations in which actions of a market participant require investigation and evaluation to determine whether a violation occurred, or in which the provisions of the tariff do not specifically address undesirable market behavior. If, in the course of monitoring participant behavior, the MMU finds that an action by a market participant may require investigation and evaluation, or may be a potential violation of a market rule contained in an ISO/RTO-filed tariff, or may be a violation of the Market Behavior Rules, the MMU should notify the Commission staff.⁵ In this way the Commission will act in cases where

² See *Guidance Order on Expedited Tariff Revisions for Regional Transmission Organizations and Independent System Operators*, 111 FERC ¶ 61,009 (2005).

³ In *California Indep. Sys. Operator Corp.*, 106 FERC ¶ 61,179 (2004), the Commission stated that as long as there are appeal rights to the Commission, MMUs may administer certain objective behavior-related tariff provisions and to charge specified, Commission-approved penalties for such tariff violations. However, where policy issues are implicated or the question of whether a tariff violation has occurred cannot be determined objectively pursuant to Commission-approved tariff provisions, it is the Commission's statutory responsibility to address the question.

⁴ See *California Indep. Sys. Operator Corp.*, 106 FERC ¶ 61,179 (2004), *order on reh'g*, 107 FERC ¶ 61,118 (2004); see also *California Indep. Sys. Operator Corp.*, 109 FERC ¶ 61,087 (2004), *order denying reh'g*, 109 FERC ¶ 61,089 (2004).

⁵ See Appendix A for protocols MMUs should follow in bringing referrals to the Commission.

market participants' behavior falls outside of the limited area of objectively identifiable, specific penalty rule violations the ISO/RTO may administer.⁶

7. The MMU should monitor and regularly report on performance and structure of the electricity market within the ISO/RTO region. Since these markets ultimately exist for the benefit of customers, the MMU should focus on how efficiently the markets are responding to customers' needs for reliable electricity supply at the lowest long run cost to customers. An in-depth review should include an evaluation of market prices of ISO/RTO-administered products (e.g., real-time and day ahead energy markets, locational marginal prices, and ancillary services) and specifically determine the extent to which the prices reflect competitive outcomes, not market power abuses. The MMU should also be responsible for providing an analysis of the structural competitiveness of the wholesale markets and a determination of effectiveness of bid mitigation rules to remedy potential exercise of market power. In addition, the MMU should evaluate the effectiveness of the markets in signaling needed investment in generation, transmission, and demand response infrastructure. Market signals for additional investment are only valuable to customers to the extent that the signals can reasonably result in the needed market investment response. Thus, it is imperative that the MMU also identify any potential barriers that may impede the market's ability to provide needed investments. In all instances, the MMU should be proactive in recommending changes to the ISO/RTO.

By the Commission.

(S E A L)

Linda Mitry,
Deputy Secretary.

⁶ Where the Commission undertakes the enforcement of matters referred to it by the MMU, the Commission will exercise its discretion to determine the appropriate remedy for violations, applying the policies and principles set forth in *Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations*, 105 FERC ¶ 61,218 (2003) (Market Behavior Rules Order), *order on reh'g*, 107 FERC ¶ 61,175 (2004).

APPENDIX A

Protocols on MMU Referrals to the Commission for Enforcement

1. In the Market Behavior Rules Order, the Commission concluded that it is appropriate for ISOs/RTOs to administer certain matters that concern market behavior (with appeal rights to the Commission) if the behavior is objectively identifiable and set forth in the ISO/RTO tariff and for which the violations have clear Commission-approved sanctions that are set forth in the tariff.⁷ All other aspects of tariff related enforcement, as well as enforcement of the Market Behavior Rules,⁸ are the responsibility of the Commission.⁹ The Commission also stated that it is the obligation of the MMU to inform the Commission of potential Market Behavior Rule violations and any violations of the ISO/RTO tariff that the Commission has not allowed the ISO/RTO to resolve in the first instance.¹⁰ In that regard, the Commission further noted that the Commission Staff would develop “appropriate triggers for referring compliance issues to the Commission.”¹¹

2. In addition to providing that the Commission will enforce the Market Behavior Rules, the Market Behavior Rules Order placed a 90-day time limit on responding to allegations of violations of the Market Behavior Rules.¹² The Commission must act, by initiating an investigation, within 90 days “from the date it knew of an alleged violation of its Market Behavior Rules or knew of the potentially manipulative

⁷ Market Behavior Rules Order at P 182.

⁸ *See id* at Appendix A. The six Market Behavior Rules adopted in the Market Behavior Rules Order address: (1) unit operations; (2) market manipulation; (3) communications; (4) reporting; (5) record retention; and (6) tariff-related matters.

⁹ *Id* at P 185. If, however, the Market Behavior Rules overlap with clearly stated tariff provisions for behavior which is objectively identifiable and for which the violations have Commission-approved sanctions, then the Commission will defer to the MMU in the first instance, subject to possible review.

¹⁰ *Id.* at P 184.

¹¹ *Id.* *See also California Indep. Sys. Operator Corp.*, 106 FERC ¶ 61,179 at PP 44, 101 (2004).

¹² *Id.* at P 148.

character of an action or transaction.”¹³ Knowledge on the part of the Commission is defined as including a call to the Commission’s Hotline alleging inappropriate behavior or communication with the Commission’s Enforcement Staff.

3. The following protocols are for the purpose of implementing and effectuating referrals by the MMUs to the Commission of: (1) alleged tariff violations that the Commission has not allowed the ISOs/RTOs to administer and resolve in the first instance; and (2) alleged violations of Market Behavior Rules.¹⁴ It is important to understand that the referral protocols set forth below are not intended to affect, and should not affect in any manner, the regular and ongoing communications and dialogue that the MMUs have with Commission Staff about a variety of market-related matters and issues, including the status of the markets and activities of the market participants.¹⁵ In addition, ongoing communications between the ISO/RTO staff and Commission Staff who are on-site at the various ISOs/RTOs, as in the case for California ISO, Midwest ISO and Southwest Power Pool, should not be affected. These protocols are solely addressed to referrals to the Commission of Market Violations. As is the case with any matter that may be the subject of an investigation, the Commission will determine whether and to what extent to conduct an investigation.

Protocols:

4. Protocol No. 1. An MMU should make a referral to the Commission in all instances where the MMU has reason to believe that a Market Violation may have occurred. While the MMU need not be able to prove that a Market Violation has occurred, the MMU should provide sufficient credible information to warrant further investigation by the Commission. Once the MMU has obtained sufficient credible information to warrant referral to the Commission, the MMU should immediately refer the matter to the Commission and desist from independent action related to the alleged Market Violation[s].¹⁶

¹³ *Id.*

¹⁴ We will, hereinafter, refer to both these alleged tariff violations and alleged Market Behavior Rules violations as “Market Violations.”

¹⁵ *Id.* at P 184.

¹⁶ It is noteworthy that the Commission’s 90-day time period in which to open an investigation regarding a Market Behavior Rule violation may begin with a communication other than a referral from the MMU since, as noted earlier, a call to the Hotline or *any* communication with the Commission’s Enforcement Staff alleging
(continued...)

5. Protocol No. 2. All referrals to the Commission of alleged Market Violations should be in writing, whether transmitted electronically, by fax, mail, or courier. The MMU may alert the Commission orally in advance of the written referral, but the Commission will not act without a written referral.
6. Protocol No. 3. The referral should be addressed to the Commission's Director of the Enforcement Division of the Office of Market Oversight and Investigation, with a copy also directed to both the Director of the Office of Market, Tariffs and Rates and the Commission's General Counsel.
7. Protocol No. 4. The referral should include, but is not limited to, the following information:
- (a) the name[s] of and, if possible, the contact information for, the market participants that allegedly took the action[s] that constituted the alleged Market Violation[s];
 - (b) the date[s] or time period during which the alleged Market Violation[s] occurred and whether the alleged wrongful conduct is ongoing;
 - (c) the specific Market Behavior Rule[s] and/or tariff provision[s] that were allegedly violated;
 - (d) the specific act[s] or conduct that allegedly violated the Market Behavior Rule or tariff;
 - (e) the consequences in the market resulting from the act[s] or conduct, including, if known, an estimate of economic impact on the market;
 - (f) if the MMU believes that the act[s] or conduct constituted manipulative behavior in violation of Market Behavior Rule 2, a description of the alleged manipulative effect on market prices, market conditions, or market rules;

a Market Behavior Rule violation will start the 90-day time period. (*See* Market Behavior Rules Order at P 148). If, however, the triggering communication was from the MMU, the MMU should make a referral, to the extent it determines one is warranted, as soon as practicable so that Enforcement has the benefit of the referral prior to the time it must take action - i.e., within the 90 days of the initial communication.

(g) any other information that the MMU believes is relevant and may be helpful to the Commission.

8. Protocol No. 5. Following a referral to the Commission, the MMU should continue to notify and inform the Commission of any information that the MMU learns of that may be related to the referral, but the MMU should not undertake any investigative steps regarding the referral except at the express direction of the Commission Staff. However, this does not mean the MMU cannot continue its monitoring functions and make recommendations to the ISO/RTO, stakeholders, and the Commission on tariff changes that may be necessary.