

ENSURING CONSIDERATION OF THE PUBLIC INTEREST IN THE GOVERNANCE AND ACCOUNTABILITY OF REGIONAL TRANSMISSION ORGANIZATIONS

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Synopsis: Regional Transmission Organizations (RTOs) have become an integral element of the Federal Energy Regulatory Commission's (FERC) encouragement of wholesale electricity markets. These organizations operate regional electricity transmission systems for two-thirds of the load in the United States. Yet years after the first RTOs were approved by the FERC, the adequacy of their governance structures and the ways in which they are held accountable for their actions are significant areas of debate and controversy.

Using ISO New England (ISO-NE) as a primary example, we begin by outlining the current RTO governance structure and highlighting some pitfalls inherent in that structure. We go on to more closely question to whom RTOs are held accountable. Finding severe limitations in how the current structures protect the "public interest," we outline several strategic and tactical recommendations to ensure that considerations of the public interest are reflected in RTO governance. The most important of these is a clear affirmation by the FERC that it will not approve market-based pricing for wholesale power transactions in organized markets in the absence of an RTO governance structure that is adequate to ensure that the RTOs will design, monitor, and manage such transactions to produce just and reasonable rates within the meaning of the Federal Power Act's requirements.

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I. INTRODUCTION

A. *Public Interest Accountability*

The sale of electricity in wholesale transactions has vital implications for the security, the economic stability, and the environmental health of the United States. Those transactions were important even in the 20th century, when sales for resale made up a relatively small portion of America’s energy system.³ They have become essential in the 21st century, as bulk transmission increases and “approximately 2/3 of U.S. electricity flows through grids managed by six RTOs.”⁴

3. ENERGY INFO. ADMIN., THE CHANGING STRUCTURE OF THE ELECTRIC POWER INDUSTRY 2000: AN UPDATE, http://www.eia.doe.gov/cneaf/electricity/chg_stru_update/update2000.html (last visited Oct. 2, 2007).

4. ROBERT J. MICHAELS, ELECTRICITY MARKET MONITORING AND THE ECONOMICS OF REGULATION (2007), <http://ssrn.com/abstract=964308>; ISO/RTO COUNCIL, PROGRESS OF ORGANIZED WHOLESALE

Our nation relies upon the FERC to ensure that those wholesale transactions will lead to “just and reasonable rates” that further the public interest.⁵ As the United States Supreme Court held more than thirty years ago, the reference to the public interest in the Federal Power Act “is not a broad license to promote the general public welfare,” but it does give the FERC the authority, and the duty, to consider some matters going beyond the direct financial interests of buyers and sellers in wholesale transactions.⁶ As the Court said, “[f]or example, the Commission has authority to consider conservation, environmental, and antitrust questions.”⁷ In addition, the FERC may consider other national policies, such as the prevention of employment discrimination and unfair labor practices, not in an effort to eradicate them, but to the extent necessary to ensure that such bad acts are not reflected in rates, terms, and conditions set out in the tariffs filed by parties regulated by the FERC.⁸ The FERC, in current proceedings such as its future-capacity dockets, is considering other matters beyond the direct interests of buyers and sellers in wholesale transactions. These include long-term reliability and future capacity, environmental impacts, and the economic concerns of non-participants who are indirectly, but heavily, affected by wholesale power and transmission transactions.⁹

For most of the 20th century, the FERC relied on cost-of-service regulation to determine whether wholesale power transactions met the statutory standard. However, for well over a decade, the FERC has increasingly relied on market forces rather than cost-of-service regulation to provide the “just and reasonable” rates, terms, and conditions of service that the Federal Power Act requires it to enforce in wholesale electricity and transmission markets.¹⁰ In doing this, the FERC has relied on a two-part strategy: allowing bilateral wholesale power

ELECTRICITY MARKETS IN NORTH AMERICA at 1 (2007) (“Two-thirds of the United States . . . [is] supplied wholesale electricity through markets run by ISOs or RTOs.”).

5. The “just and reasonable” standard for wholesale and transmission transactions is set out in the Federal Power Act of 1935 § 201, 16 U.S.C. § 824(a) (2000) (stating that “[i]t is declared that the business of transmitting and selling electric energy for ultimate distribution to the public is affected with a public interest, and that Federal regulation of matters relating to generation . . . and of that part of such business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest . . .”).

With regard to retail electricity sales, the nation has relied upon—and to a large extent still relies upon—state utility commissions to apply a similar standard. *See, e.g.*, VT. STAT. ANN. tit. 30, § 212d (2006) (stating that “[u]pon a finding by the board that the retail sale will promote the general good of the state . . .”); TEX. UTIL. CODE ANN. § 31.001(a) (Vernon 2007) (authorizing the Public Service Board “to protect the public interest inherent in the rates and services of electric utilities.”); FLA. STAT. ANN. § 366.01 (West 2007) (stating that “[t]he regulation of public utilities . . . is declared to be in the public interest and . . . for the protection of the public welfare . . .”).

6. *National Ass’n for the Advancement of Colored People v. Fed. Power Comm’n.*, 425 U.S. 662, 669-70 n.6 (1976).

7. *Id.* at 670 n.6.

8. *See generally NAACP*, 425 U.S. at 664-65 (affirming the Court of Appeals’ holding that the Commission does have “power to take into account, in the performance of its regulatory functions, including licensing and rate review, evidence that the regulatee is a demonstrated discriminator in its employment relations”).

9. Proposed Rule, Wholesale Competition in Regions With Organized Electric Markets, 72 Fed. Reg. 36,276, 36,278 (2007) (to be codified at 18 C.F.R. pt. 35) [hereinafter Wholesale Competition ANOPR].

10. Federal Power Act, 16 U.S.C. § 824(e) (2000). In 1996, the FERC passed Order No. 888, opening the transmission system to more generation providers. *See* JOSEPH P. TOMAIN & RICHARD D. CUDAHY, ENERGY LAW IN A NUTSHELL 276-77 (Thomson West 2004).

transactions in some parts of our nation, and encouraging the growth of “organized markets” in most of the United States.

In both cases the FERC has recognized that open access to transmission facilities is an essential part of healthy wholesale markets. In areas with organized markets, it has relied significantly on RTOs to provide the market rules, the market monitoring, the transmission terms, and recently the resource planning functions necessary to support a conclusion that cost-of-service regulation is not needed to ensure “just and reasonable” rates and terms that promote the public interest.¹¹ The FERC’s orders have now recognized RTO status for several regional organizations. Indeed, “[m]ore than half the United States’ load is now served by RTOs or ISOs” and tens of billions of dollars are now paid and received under the rules that the RTOs design, file at the FERC, and administer.¹²

Almost a decade after the opening of multi-state pooled markets, critiques of RTOs still abound.¹³ Indeed, their overall effectiveness and value are still far from fully accepted (both beyond and within the parts of the United States where they have been established).¹⁴ The FERC is well aware of these concerns and has suggested some paths toward progress on the matter in its July 2, 2007 advance notice of proposed rulemaking on Wholesale Competition in Regions with Organized Electric Markets (ANOPR).¹⁵

As the recommendations in this article suggest, we believe that the FERC is entirely correct in designating wholesale competition in regions with organized electric markets as an important matter. In addition, for the reasons set out below, we believe that several of the specific suggestions that the FERC has mentioned in the ANOPR warrant recommendation of adoption.¹⁶ However, one concept—the Hybrid Board upon which the ANOPR seeks comments—may well be a case in which the cure is worse than the disease.

Fundamentally, there are two specific concepts the FERC has not addressed in the ANOPR that are particularly important for it to explicitly recognize. The first is that the administration of wholesale markets and transmission should routinely consider the larger public interest, in addition to the direct financial interests of those that buy, sell, and transmit power under each RTO’s rules.¹⁷

11. See *infra* Part I.B (regarding RTOs and their predecessors, Independent System Operators (ISOs)).

12. Wholesale Competition ANOPR, *supra* note 9.

13. These concerns are not new. See, e.g., Letter from Vermont Public Service Board to Pat Wood, III, Chairman of the FERC at 5 (Jan. 17, 2002) (stating that “Governance of an RTO should rest upon three important principles: (1) true independence from market participants; (2) technical competence (including secure and adequate financial and personnel resources); and (3) an explicit expression (filed at FERC and included in its articles of incorporation) of its fiduciary responsibility to the general public good.”) [hereinafter Wood Letter].

14. The FERC developed RTOs via Order No. 2000 in 1999. Order No. 2000, *Regional Transmission Organizations*, F.E.R.C. STATS. & REGS. ¶ 31,089 (1999), 65 Fed. Reg. 810 (1999) (to be codified at 18 C.F.R. pts. 18, 35) [hereinafter Order No. 2000].

15. Wholesale Competition ANOPR, *supra* note 9.

16. *Id.*

17. This has been a difficult issue for at least half-a-decade. See Wood Letter, *supra* note 13, at 11-12. As stated by the Vermont Public Service Board in 2002, “[f]irst, we believe public interest representation, of some sort, is warranted on an RTO board since any regional regulatory body should be charged with protecting the interests of *all* the consumers in our state, both large and small. The board should have a fiduciary duty (expressed in its Articles of Incorporation and filed at the FERC) solely to the public interest. Meaningful

The second is that the FERC make clear that, because it relies on each RTO's rules to ensure that wholesale markets produce just and reasonable results, it is prepared to withdraw its approval of market-based rates if it cannot be sure that the RTO is sufficiently independent, functional and effective to ensure the health of wholesale market transactions. Unless the FERC make this point clear, those entrusted with the governance of RTOs will be unable to make sure that the interests of direct participants in market transactions are balanced with the interests of those affected by, but not parties to, those sales and purchases.

B. RTO Governance

A serious assessment of RTOs must begin with consideration of the purposes for which RTOs were created and the tasks that they should perform—dispatching electricity, overseeing the operation and discipline of the markets, transmission scheduling, system planning, and creating incentives for future investment. Their decisions define the long-term generating capacity and transmission capabilities of electricity grids upon which tens of millions of Americans rely.

Whether or not “today's restructured electricity markets with their regulatory overlay yield greater net benefits than the old administrative regulatory system did or than some improved version of it would bring” is still an unanswered question.¹⁸ We leave this question for another time, assuming for the purposes of this article that RTOs as currently constituted will maintain a substantial place in our nation's electric system. If so, we believe most will agree it is vital to make sure these organizations function well and earn the respect of those they serve both directly and indirectly.

We embark on this discussion of RTO governance with the knowledge that, to paraphrase one state commissioner in the midst of governance discussions in 2003, “it's not over when everything has been said, it's over when everyone has said it. When it comes to [RTO] governance, it's over when everyone has said it at least a dozen times.”¹⁹ Here, we try to bring a perspective that considers RTOs, not through the lens of one individual issue (e.g., market monitoring or the stakeholder governance process), but from a holistic view of the organizations, their benefits, and their pitfalls, and in this way, add a new perspective on the important issue of RTO accountability.

Fundamentally, expectations about how RTOs should be governed are directly related to the RTOs' duties and responsibilities. As mentioned above, RTOs perform several tasks. Here, as in great architecture, form needs to be designed to follow function.

participation by public interest representatives on the RTO board is critical. Public interest representatives on the RTO board will at least give a voice to those who are most affected by its actions. We are not wedded to any particular proposal for choosing such public interest representatives although we would suggest that a significant minority of the members (e.g., one-third) be selected from a pool of nominees designated by state governments (whether by legislative, executive, or regulatory bodies.)” *Id.*

18. Alvin K. Klevorick, *The Oversight of Restructured Electricity Markets*, in *ELECTRICITY DEREGULATION: CHOICES AND CHALLENGES* 297, 314 (Griffin and Puller, eds., 2005). See *infra* note 36 (regarding congressionally requested GAO reports on RTO benefits and costs) [hereinafter Klevorick].

19. *Remedying Undue Discrimination Thru Open Access: Hearing on RM01-12-000 Before the FERC*, (2003), at 104-05 (statement of Steve Diamond, Former Comm'r, Maine Public Utility Commission (MPUC)).

One of the problems with describing RTO governance is that how the organizations are defined has often been in the eyes of the beholder. Thus, one can think of an RTO as the elephant, from the ancient fable, which is being described by a committee of the blind, or perhaps in our case, just the severely near-sighted. Each person touches one part of the animal. The person touching the leg thinks quite rightly that an elephant is like a tree. The person touching the tail correctly describes the elephant as a strand of rope. Meanwhile, the person touching the tusk accurately suggests that the elephant is similar to a sword. Each is describing precisely what their limited experience evidences, but none captures the essence of the elephant.

In the same way, differing observers may each see an RTO as similar to a commodities exchange, to an entity delegated regulatory power from the FERC, or to a monopoly that must itself be closely regulated. Seeing only one of these elements obscures the whole. This article suggests that proper governance and accountability for an RTO can be assessed only if we first form the image of the "elephant" that recognizes its disparate elements. In other words, defining the governance and accountability functions of an RTO can successfully be addressed only if we recognize the multitude of tasks assigned to RTOs. This approach also requires assessing the regulatory structures into which the RTOs have been born. These regional entities are often in a world that is larger than states but smaller than nations, and take a form that is between government and business, thus creating serious accountability problems.²⁰ Neither the states nor the federal government have demonstrated the ability to hold these organizations accountable to the public. Even though RTOs have corporate boards, structural issues make it hard for those boards, alone, to protect the public interest.

To compound these difficulties, RTOs are required to provide many public goods that are not valued in the financial markets they oversee. The way that RTOs have been set up, the powers they have been delegated, and the RTOs' own self-interests militate against taking these public goods and the public interest into full account. In addition, their status as institutions without reducible profit margins makes it exceedingly difficult to hold RTOs accountable.²¹

The first section of this article outlines the problem of holding RTOs accountable, describes RTOs and their purposes from several different perspectives, and considers where an RTO's power is derived. An RTO owes multifaceted obligations to diverse stakeholders, therefore creating complicated incentives for both the RTO and its governing bodies. Regulators and stakeholders must be aware of these incentives as they structure an RTO governing scheme to optimize the organization's ability to operate the electric grid, manage the market, and safeguard against both malfeasance and inefficiency.

After introducing RTOs, their responsibilities, powers, and the crisis of confidence in RTO governance in section one, we describe in detail one RTO's

20. It is true that several RTOs, including California ISO (CAISO) and New York ISO (NYISO) operate within individual states. FERC, REGIONAL TRANSMISSION ORGANIZATION REGION MAP, <http://www.ferc.gov/industries/electric/indus-act/rto/rto-map.asp> (last visited Oct. 2, 2007).

21. See *infra* note 292 (regarding the current question of whom to hold accountable when an RTO is in violation of the FERC's reliability rules).

governance structure, highlighting several pitfalls and issues with the current structure in the second section. For two reasons, we have chosen to use ISO-NE as an example RTO, though we refer to other organizations for contrast and emphasis. First, selecting one RTO to use as a prime example allows a level of in-depth analysis that tests the merits of initial assumptions. With so much variation across organizations, and so many details associated with each one, we want to make sure we focus on the issues related to governance and not the detailed differences between individual organizations.²² Second, because of its history of collaboration among transmission owners and utility generators on transmission issues, New England was a prime candidate for RTO status. Its cooperative history as a firm power pool allowed the New England RTO to develop more quickly than RTOs in some other regions.²³

In the third section, we consider the groups and individuals to whom these organizations are accountable. This includes a discussion of how individual end-users are represented in the RTO governance process. This section considers the involvement of government and of other representatives of the public interest in the RTO governance process. Of particular interest are the agency relationships that RTOs have with multiple parties and to whom RTOs are accountable. We particularly focus on the RTO-FERC and RTO-state relationships, considering both the role states actually play and the role they should play in the RTO decision-making and regulatory process.

In the fourth section, we consider strategic improvements to the current system. Because of the difficult agency problems inherent in these regional non-governmental organizations, regulation via a regional compact or a joint FERC-state regulator board might provide more effective oversight and representation of the public interest. However, because RTOs have been established, and to some extent the path of RTO governance has already been worn, we also examine several limited tactical enhancements that could improve each RTO's accountability to the public interest.²⁴

RTOs are an experiment in wholesale transmission markets and resource planning. This system provides energy services to millions of Americans. It is vital that RTOs, enabled by the FERC and supported by stakeholders, legitimately fulfill the current and future needs of the people they serve. They can do this only through governance and accountability structures that take into account RTO responsibilities and the need to secure the public interest in RTO decision-making.

22. In addition, the FERC has created an excellent database that can be used to compare ISOs/RTOs. See FERC, RTO-ISO HANDBOOK (2006), <http://www.ferc.gov/industries/electric/indus-act/rto/handbook.asp>.

23. See *infra* note 181 (regarding NEPOOL).

24. These tactical enhancements are of a similar nature (though certainly not the same) as the FERC's recent suggestions in its ANOPR. Wholesale Competition ANOPR, *supra* note 9, at 36,275. In its ANOPR, the FERC has begun to address four separate issues: "(1) The role of demand response in organized markets, including greater reliance on market prices to elicit demand reductions during power shortages; (2) increasing opportunities for long-term power contracting; (3) strengthening market monitoring; and (4) the responsiveness of RTOs and ISOs to customers and other stakeholders." Wholesale Competition ANOPR, *supra* note 9, at 36,276.

II. INTRODUCTION TO RTOS

RTOs are made up of complex structures with diverse and divergent stakeholders and responsibilities. Thus, in analyzing the intricacies inherent in RTO governance, it is important not to lose sight of the forest for the trees. As one commentator wrote, “[a]lthough the entity should be attentive to the concerns of all its stakeholders and willingly receive input from them, the RTOs *charter responsibility should be to further the public interest of providing system reliability through efficient, competitive markets.*”²⁵ Furthering the “public interest of providing system reliability through efficient, competitive markets”²⁶ is our forest. In this section, we briefly introduce the wholesale electricity system and RTOs in general.

A. Why is Providing Efficient, Competitive Markets in Electricity Difficult?

Several important attributes of the electricity industry are worth highlighting here. One such attribute is that for most customers using traditional technologies,²⁷ short run demand for electricity is relatively inelastic.²⁸ The FERC and several regional organizations have begun to take steps that ease this problem, but it is unlikely to be eliminated.²⁹ A second characteristic is that—except for pumped storage at hydroelectric projects (which are rare for geological reasons)—we presently cannot provide an economical and efficient means of storing electricity. By and large, supply must meet demand at any (and every) given moment in time. Most of the country does not have any way of storing electricity to ensure that the peak needs for energy can be met. Third, for technical reasons, the transmission of electricity—the transition from supply to demand—must be tightly managed to avoid outages or damage to the transmission system. Because of engineering considerations, transmission of electricity continues to be a “natural monopoly” even if other elements of the electricity system once thought to be natural monopolies (such as generation) may not be.³⁰

25. Klevorick, *supra* note 18, at 308 (emphasis added).

26. *Id.*

27. Note that technology now exists and is beginning to be deployed by a very small numbers of users, allowing more readily predictable price response reductions of demand. This current demand response is not insignificant and the potential for higher capability may well exist. However, as the FERC notes in its Wholesale Competition ANOPR, the nation’s present capability is less than 5% of peak demand, leading the FERC to assert, “[w]hile the Commission and the various RTOs and ISOs have done much to facilitate demand response in organized power markets, more can be done.” Wholesale Competition ANOPR, *supra* note 9, at 36,281. However, RTO programs to bring this resource into dispatch and planning decisions have to date achieved few results on the scale adequate to defer construction of new facilities, and only occasionally at a level that would defer operation of existing units.

28. See ALFRED E. KAHN, *THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS* (MIT Press 1988); Alvin K. Klevorick, *supra* note 18; ALEXANDRA VON MEIER, *ELECTRIC POWER SYSTEMS: A CONCEPTUAL INTRODUCTION* (John Wiley & Sons Inc. 2006).

29. One of the issues in the FERC’s recent proposed rulemaking is demand response. Wholesale Competition ANOPR, *supra* note 9, at 36,276. See also Jon Wellinghoff & David L. Morenoff, *Recognizing the Importance of Demand Response: The Second Half of the Wholesale Electric Market Equation*, 28 ENERGY L.J. 389 (2007).

30. Robert J. Michaels, *The Governance of Transmission Operators*, 20 ENERGY L.J. 233, 240 (1999) (stating that utilities in the past were invariably monopolies because “coordination of electrical flows was

A significant part of the price responsiveness problem has been a failure to empower energy users with the ability to respond to prices.³¹ Professor Alvin Klevorick, Professor of Economics and John Thomas Smith Professor of Law at Yale University and Board member of ISO-NE, in an article on RTO governance, lists several concerns about the lack of price responsiveness: “severe distributional impacts, inefficient production of electricity to meet the load requirements, and a general undermining of confidence in the market.”³² Ineffective (or nearly nonexistent) price responsiveness results in over-building of generation and transmission in the regulated system because demand is too high. It also results in increased air emissions due to over-demand, increased capital costs because of perceived risk, and geographically misplaced capital investment.³³

B. What are RTOs?

It is necessary to discuss the origins of RTOs to be able to address their governance and accountability. FERC Orders 888, 889, 2000, and 890 are at the heart of the restructuring of the electricity transmission system.³⁴ Order Nos. 888 and 889, published concurrently in 1996, were the foundation of the current electricity system³⁵ and “required each utility that operates transmission lines to allow any other utility in the interstate energy market to use its transmission lines on the same terms applicable to the operating utility itself.”³⁶ Order No. 888 established the principles for establishing voluntary Independent System Operators (ISOs).³⁷ The commission followed Order Nos. 888 and 889 with

critical for reliability,” however but recent “[c]hanges in technology and law allowed the development of competitive generation markets”) [hereinafter Michaels].

31. An additional issue is exposing consumers to the dramatic price volatility that they are by and large sheltered from in the current structure. Wellinghoff, *supra* note 29, at 393 (“These variances in wholesale prices were not (and still generally are not) immediately reflected in retail rates, leading to a disconnect between the volatile wholesale prices seen in the markets where utilities purchased some power to meet peak demands and the average retail prices paid by consumers.”).

32. Klevorick, *supra* note 18, at 301.

33. For example, adding price-responsiveness to an electricity system can decrease peak demand for electricity, decreasing the amount of generation required. AHMAD FARUQUI ET AL., BRATTLE GROUP THE POWER OF FIVE PERCENT: HOW DYNAMIC PRICING CAN SAVE \$35 BILLION IN ELECTRICITY COSTS 2 (2007), http://www.brattle.com/_documents/UploadLibrary/Upload574.pdf. (stating that “[i]f a way can be found to shave off some of this peak demand, it would eliminate the need to install generation capacity that would be used less than a hundred hours a year. Such generating capacity is often gas fired and consists of combustion turbines, which is expensive since these turbines are idle for almost the entire year.”).

34. As the precursor to these Orders, the Energy Policy Act of 1992 “gave the Commission new powers to order transmission (wheeling) for wholesale transactions, but not for final consumers of power, who remained under state regulatory jurisdiction.” Michaels, *supra* note 30, at 235.

35. ELECTRIC ENERGY MKT. COMPETITION TASK FORCE, FERC, REPORT TO CONGRESS ON COMPETITION IN WHOLESALE AND RETAIL MARKETS FOR ELECTRIC ENERGY: PURSUANT TO SECTION 1815 OF THE ENERGY POLICY ACT OF 2005 (2006), <http://www.ferc.gov/legal/maj-ord-reg/fed-sta/ene-pol-act/epact-final-rpt.pdf> (stating that “[t]ogether, Order Nos. 888 and 889 serve as the primary federal regulatory foundation for providing nondiscriminatory transmission service and information about the availability of transmission service.”).

36. Public Util. Dist. No. 1 of Snohomish Cty. v. FERC, 471 F.3d 1053, 1064 (9th Cir. 2006).

37. Order No. 888, *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, F.E.R.C. STATS. & REGS. ¶ 31,036, 61 Fed. Reg. 21,540 (1996). See, e.g., California Indep. Sys. Operator Corp. v. FERC, 372 F.3d 395, 404 (D.C. Cir. 2004) (stating that “ISO membership . . . is merely a

Order No. 2000, instituting the opportunity for regions to establish RTOs.³⁸ The FERC recently established Order No. 890, to “strengthen the *pro forma* Open Access Transmission Tariff, or OATT, to ensure that it achieves its original purpose of remedying undue discrimination.”³⁹

Despite reams of paper describing RTOs (and their precursors, ISOs), these organizations elude clear definition, perhaps because of the multitude of tasks many of them perform. ISOs were originally established to operate independent transmission networks so that access to transmission could be less discriminatory than if transmission owners maintained control over the grid. The FERC fleshed out the idea and tried to give more impetus to transmission independent of utility control in Order No. 2000.⁴⁰

Although the language describing RTOs in Order 2000 has remained constant, these organizations’ responsibilities have grown over time.⁴¹ According to the FERC, RTOs are independent regional organizations that operate transmission facilities and are responsible for short-term reliability, congestion management, and expansion of the grid.⁴² In theory the FERC allows RTOs to be either for-profit or non-profit, however, as yet all RTOs (except PJM)⁴³ have been either non-profit or the functional equivalent, and it

method jurisdictional entities can use to comply with Order No. 888’s mandate for those entities to file nondiscriminatory [open access] tariffs.”); *see also* John S. Moot, *Whither Order No. 888?*, 26 ENERGY L.J. 327, 327 (2005) (stating that “Order No. 888 required vertically integrated utilities to provide transmission service on an unbundled basis pursuant to a *Pro Forma* Open Access Transmission Tariff (OATT). The purpose of this remedy was to place competitors on the same footing as vertically integrated utilities in obtaining access to the transmission grid and thereby facilitate increased competition in bulk power markets.”).

38. Order No. 2000, *supra* note 14.

39. Order No. 890, *Preventing Undue Discrimination and Preference in Transmission Service*, [Regs. Preambles 2007] F.E.R.C. STATS. & REGS. ¶ 31,096 (2007), 72 Fed. Reg. 12,266 (2007) (to be codified at 18 C.F.R. pts. 35, 37).

40. Order No. 2000, *supra* note 14.

41. The difference in terminology and substance between “Independent System Operators” and “Regional Transmission Organizations” is sadly confusing. Ironically, each of the two terms, read literally, seems to describe the key elements of the other; i.e., a regional transmission operator’s key characteristic is “independence” and an ISO serves as a given region’s designated “transmission operator.” Historically, the FERC allowed ISOs to operate markets before becoming RTOs. However, the success of those early efforts to ensure healthy markets was far from clear, which highlighted the need to expand the functions of ISOs to more than merely managing transmission. Since Order No. 2000, the FERC has required that RTOs possess both independence and the capacity to perform functions that go beyond merely operating transmission grids for RTO status. With increasing acceptance of the need to expand functions beyond transmission management alone, the rising issue has been responsibility for the planning and incentive functions to ensure adequate resource capacity for mid-term futures, i.e., three to five years in the future. Underlying these disputes is the question of what bundle of functions is necessary in order for the FERC to rely upon the managers of organized markets to generate just and reasonable rates within the meaning of the Federal Power Act.

42. Order No. 2000, *supra* note 14, at 811.

43. For example, PJM, though officially for-profit, has no assets. And while PJM’s corporate form is a limited liability company (and therefore “for profit”) it “operat[es] at a zero profit margin.” Bruce W. Radford, *The Nation’s Grid Chiefs: On the Future of Markets*, 144 PUB. UTIL. FORT., Oct. 2006, at 42 [hereinafter *Future of Markets*]. According to Phil Harris, PJM’s recently retired CEO:

We recognize the fact that we have no owners per se. We’re a limited liability company; the company is the owner, the only way to get our resources back is that we liquidate. And that isn’t a good corporate model. You don’t have the direction; you don’t have the clarity of decision-making. You don’t have all those good governance things that even a municipal like Jacksonville or MEAG or Nashville has. We don’t have our own cash. We don’t have our own equity. Those factors create a problem with governance that needs to be resolved some time in the future. So, recognizing that

appears likely that it will remain this way for the foreseeable future.⁴⁴ So, while difficult to define precisely what RTOs are, there are several things RTOs as currently constituted are *not*: “these independent entities own no transmission assets, have no linemen or helicopters to maintain transmission lines and respond to outages, and are not directly responsible for the costs of operating, investing in, or the ultimate performance of the transmission networks they ‘manage.’”⁴⁵ These gaps make it difficult to hold RTOs accountable for their actions.

The ambiguity about accountability becomes a serious problem because of the multiple roles that RTOs must play in close contact with each party of highly diverse interest. In addition to operating the OATT, RTOs perform some, if not all, of the following tasks:

- Dispatch—the commands to turn on, turn off, hold in readiness, or repair significant generating units;
- Transmission scheduling—the decisions to open, close, or reserve transmission lines and to schedule, implement or defer desired maintenance;
- Planning—the projection of expected demand and potential and preferred ways of meeting that demand;
- Market management—conducting auctions which give participants the price signals to match scheduled load with expected demand;
- Market monitoring—maintaining market discipline based upon monitoring for and enforcement of sanctions for that abuse; and
- In the case of non-profit RTOs, the collection of billions of dollars through charges on the use of monopoly wires to be distributed to transmission owners in ways that will compensate past and incentivize future investment.⁴⁶

we're only half-way there, we hardwired three principles into the operating agreement of the limited liability company, as a fiduciary duty for the board of directors:

- Operate a safe and reliable interconnection;
- Create and operate robust, nondiscriminatory power markets; and
- Ensure that no member or group of members has an undue influence over the interconnection.

Of course, as a corollary to that, to carry out those objectives, we have decided that we must ensure a well-trained, professionally qualified work force.

Id.

44. In an October 2006 interview with Bruce Radford, Phillip Harris, recently retired President and CEO of PJM, stated that he did not think we would see RTOs operating as a publicly traded entity in his lifetime. *Future of Markets*, *supra* note 43, at 43.

45. Paul Joskow, *Transmission Policy in the United States* 30 (Cambridge Working Papers in Economics CWPE, Working Paper No. 54, 2004).

46. See the FERC's list of RTO functions:

- Tariff Administration and Design;
- Congestion Management;
- Parallel Path Flow;
- Ancillary Services;
- OASIS and Total Transmission Capacity (TTC) and Available Transmission Capacity (ATC);
- Market Monitoring
- Planning and Expansion; and
- Interregional Coordination.

For many years throughout much of the United States, several of these functions were performed either within a few large holding companies or on a multi-company basis through power pools, including those which, like the New England Power Pool (NEPOOL), were described as “tight” power pools because they had significant control over dispatch and transmission scheduling on an operational basis.⁴⁷ For regions that had tight power pools, and in some cases high-level planning roles, RTOs add the tasks of market and incentive functions to their previous operational responsibilities. For areas that did not have tight power pools, the multi-company implementation of these tasks is a new development.

Part of the problem with RTO governance is that although they are supposed to play the role of “value neutral” dispatchers and market administrators, RTO actions have policy and real-world consequences, creating winners and losers, many of whom participate in RTO decision-making processes as stakeholders.⁴⁸ The need for accountability, especially in the absence of market discipline, shows that a discussion of RTO governance is vital.

C. How to View an RTO

While helpful, merely emphasizing lists of RTO responsibilities fails to capture the essence of the RTO elephant. Rather, it is more critical to grasp the intricate interplay between each RTO’s many and varied tasks and the many and varied entities for which the RTO must perform these tasks. Indeed, the FERC appreciates that precise challenge, as this July, in the Wholesale Competition ANOPR, the Commission declared:

Order No. 2000, *supra* note 14, at 811. Each item in this list can be incorporated into one of the categories mentioned. Most recently, the FERC articulated this comprehensive summary of the RTOs’ responsibilities:

[1]An RTO or ISO has the primary responsibility to operate the regional transmission system safely in accordance with good utility practice and reliably in accordance with Commission-approved reliability standards. [2] It is responsible for providing open and non-discriminatory transmission access under a regional transmission tariff. The provision of open-access transmission service in itself requires that many subordinate functions be carried out, such as [3] maintaining an efficient transmission reservation system, [4] scheduling transmission services, [5] managing congestion on the grid, [6] coordinating local transmission system enhancements, and [7] developing the region’s long-term transmission plan. RTOs and ISOs typically [8] have adopted innovative transmission pricing mechanisms such as locational pricing with allocations or auctions of financial transmission rights that hedge transmission congestion . . . An RTO or ISO is also responsible for [9] administering the organized energy markets. Depending on the region, there are day-ahead and real-time energy markets, markets for various ancillary services, and forward capacity markets, with provisions for [10] ensuring that demand response resources can participate in these markets. It is [11] responsible for all aspects of operation of these markets and for [12] providing an independent market monitor. The RTO or ISO [13] may also have responsibilities regarding resource adequacy. Every RTO or ISO must maintain a reliable system for [14] metering and measuring power flows and customer services systems for [15] billing and settling accounts for many large financial transactions.

Wholesale Competition ANOPR, *supra* note 9, at 36,294.

47. Order No. 2000, *supra* note 14, at 815.

48. For example, when they address future capacity markets, RTOs make decisions that are fundamental to implementation of policy in the electricity system, such as: what the planning horizon of the network should be; where the back-stop provider of last resort’s duty falls when reliability concerns seem acute; which “solutions” will have their costs pooled (or “socialized” to use a term preferred by those that oppose a specific pooling arrangement); and which will be directly assigned to specific users.

Given the size and complexity of RTOs and ISOs today, it is not surprising that tension has arisen between the goals of independence and responsiveness. An RTO or ISO cannot satisfy every group on every issue This natural tension between independence and responsiveness is compounded by the number of functions that an RTO or ISO performs and for which it is ultimately held accountable by these several types of entities.⁴⁹

One method for trying to see RTOs as the sum of their parts is to consider the lenses through which they may be viewed. In this section, we consider several lenses through which to view RTOs: as agents of the FERC, as monopolists or private regulated entities, as “hybrid” organizations, as similar to commodities trading markets, as agents of some of the market participants, and as planning processes.

A first lens, which might highlight some aspects of RTOs, is as agents of the FERC in a conventional sense. RTOs set rules approved by the FERC that determine which plants will be turned on and off, they make short and long-term planning decisions, they ensure reliability, and they monitor the market for abuses. The FERC, through its general orders and rulings on specific issues, sets the parameters for RTO actions and implements the FERC’s directives. In this sense, an RTO is a regional representative of the FERC, acting as an agent for non-regional governmental sectors. Furthermore, as agents, RTOs often act in an advisory role with the FERC, suggesting solutions to problems based on their on-the-ground knowledge. Like traditional utilities or load serving entities (LSEs), RTOs are often given deference by the FERC, are able to set agendas, and suggest solutions.⁵⁰ However, unlike governments, which must answer, either directly to the electorate, or to the people’s representatives, RTOs are not subject to elections or legislative confirmation processes. Again, because non-profit RTOs do not fall squarely within the traditional definitions of either a corporation or a government, there is some flexibility in the lenses we select.

Focusing this time on its more private sector features, a second way to consider RTOs, in part, is as monopolists. In other words, the RTOs are private entities that must be regulated—similar to the utilities and transmission owners that came before them. RTOs have a monopoly over the use of transmission of electricity in their region, and via tariffs set by the FERC, pass along the costs of that transmission service to consumers. Thus, the American Public Power Association (APPA) has urged the FERC “to view RTOs for what they are—regional monopolies that it must vigorously regulate, not regional extensions of the Commission itself.”⁵¹ In this sense, RTOs could indeed be characterized as modern-day transmission monopolists. However, unlike traditional monopolies, RTOs do not own that which they manage, operating the transmission lines with little or no profit motive. The lack of assets and reduced profit motive for RTOs reduce stakeholders’ ability to hold the RTO’s feet to the fire. In the terminology of litigation, RTOs have become close to judgment-proof.

As discussed above, a problem with defining the non-profit RTOs is that they are outside our traditional definitions of corporation or government. An

49. Wholesale Competition ANOPR, *supra* note 9, at 36,294.

50. Of course, the FERC does not always give deference to RTOs.

51. AMERICAN PUB. POWER ASS’N, RESTRUCTURING AT THE CROSSROADS 17 (2004), <http://appanet.org/files/PDFs/APPASWhitePaperRestructuringatCrossroads1204.pdf> [hereinafter RESTRUCTURING AT THE CROSSROADS].

interesting thought experiment, therefore, is to consider RTOs as agents of the FERC, in as much as they are “hybrids” or quasi-governmental organizations.⁵² When viewing RTOs through this lens, it is important to highlight some political science background on the governance of non-profits and quasi-governmental organization.

In public policy parlance, these organizations are created “to deliver some public good in place of a government agency.”⁵³ Like an RTO, a hybrid is “an entity created by the federal government (either by act of Congress or executive action) to address a specific public policy purpose. It is owned in whole or in part by private individuals or corporations and/or generates revenue to cover its operating costs.”⁵⁴

Of course, RTOs do not fit simply into this categorization. While they exist at the pleasure of the FERC, RTOs are created neither by Congress, nor by executive action, but via a combination of FERC regulation and the voluntary actions of market participants in regions. As mentioned earlier, these hybrid firms do not have the mechanisms by which either companies or governments are held to account.

Accordingly, though more complex, these quasi-governmental RTOs may actually experience many benefits that provide them with increased power when compared with private or governmental organizations. For example, Professor Koppell of the Yale School of Management argues that hybrids have power because they are able to complement their private-side resources with public-based influence.⁵⁵ Analogizing Koppell’s analysis of hybrids, we see that because RTOs deal with public goods and the public interest, their governance structures become even more important with this enhanced power.

The frameworks set out above are traditional ones—government, private sector, and a combination of the two. There are also specific entities that can aid in conjuring a complete view of what an RTO is and does. Thus, through a fourth lens, one might conceive of a commodities trading market. Each RTO provides a venue in which sellers and buyers can meet each other and find mutually beneficial deals. Here, the RTO is not really acting in the same regulatory capacity as agent for the FERC; instead, within the rules set out by the FERC, it oversees the transactions on a mechanical level.

Another way to conceive of this is to consider RTOs as agents, not of the FERC, but of the transmission owners in a region. This is the position that NEPOOL’s transmission owners took for many years, and can be analogized to the perception of the Commissioner of Major League Baseball as the agent of the team owners—tasked with convincing the product buyers (fans and network advertisers) about the legitimacy of the teams, leagues, and systems. Ultimately,

52. This use of the term “hybrid” should be differentiated from the discussion of hybrid boards. In this context, “hybrid” means a quasi-governmental organization that bears elements of both government agency and private company. *See generally* JONATHAN KOPPELL, *THE POLITICS OF QUASI-GOVERNMENT: HYBRID ORGANIZATIONS AND THE DYNAMICS OF BUREAUCRATIC CONTROL* (Robert Gooden ed., Cambridge Univ. Press 2003) [hereinafter KOPPELL].

53. *Id.* at 9. As the FERC’s Wholesale Competition ANOPR notes, thus far a heavy focus has been on promoting investments in new facilities. Wholesale Competition ANOPR, *supra* note 9, at 36,278-80,288.

54. KOPPELL, *supra* note 52, at 12 (emphasis removed).

55. *Id.* at 101.

however, the commissioner of major league baseball is the servant of the owners, rather than of the general public.

A final lens would show the RTO as a regional planning process. The RTO provides a broad means of channeling both public and private concerns regarding planning and long-term markets. The process is similar to an extremely complicated legislative process,⁵⁶ one in which different groups of stakeholders are electorally represented and their voices are heard through various public and semi-public fora. Through each RTO's own stakeholder processes and administrative FERC procedures, planning decisions taking into account all of these stakeholder perspectives emerge.⁵⁷

The problem, of course, is that RTOs are all of these actors, though none of them fully describes the RTO. Thus, discussing their governance and accountability mechanisms is extraordinarily difficult. Unlike typical hybrids, RTOs do not have one clear principal-agent relationship with a federal agency. Unlike the monopolist, RTOs are not purely rent-seeking. And while RTOs now play a large role in the planning process, planning does not completely describe RTO responsibilities.

Even though these categories of "lenses" do not fully define RTOs, they are helpful in finding a three-dimensional view of these complex organizations. This is particularly important when considering the arguments put forth by varying stakeholders regarding RTO jurisdiction and decisions because considering the lens will also lead to a greater understanding of the argument. In addition, these lenses help elucidate the complex relationships that dictate RTO governance and accountability. As we consider the questions of accountability, it will be important to refer back to these lenses. Hopefully, such lenses can provide the visual tools necessary for our fabled myopic committee to gain a more comprehensive picture of its mammoth RTO.

56. In fact this is exactly one of two reasons why Suedeen Kelly objects to the notion of hybrid boards in her ANOPR dissent (see more of our discussion on this *infra*, but for now):

Additionally, a hybrid board composed of independent and non-independent board members could needlessly complicate the board dynamic and make cooperative decision-making more difficult and time consuming A stakeholder board, even a hybrid one, would be more akin to the legislative model with no overarching independent judge making the final calls. Such a model requires constant negotiation and can often lead to stalemate or decisions that address only the lowest common denominator rather than the ideal approach.

Wholesale Competition ANOPR, *supra* note 9, at 36,298.

57. Consider, for example, ISO-NE's epic LICAP experience, which required considerable attention from the FERC and the stakeholders. For a review of the procedural history of the LICAP proceedings, see Clinton A Vince et al., *What is Happening and Where in the World of RTOs and ISOs?*, 27 ENERGY L.J. 65, 88-92 (2006). The LICAP proposal eventually failed and was replaced via settlement by a Forward Capacity Market (FCM). *Report of the Electricity Regulation Committee*, 28 ENERGY L.J. 267, 267 (2007). Efforts to deal with future capacity markets have proven quite contentious and complex because the short-term markets have not reflected long-term concerns to the degree that had been expected by market proponents. Moreover, short-term markets do not reward generators for avoiding the risk of future capacity shortages; in sharp contrast regulators and policy makers are unwilling to accept the risk of power outages inherent in the short-term markets as they stand. This imbalance in risk-acceptance underlies a structural advantage in price-setting (whether by market or by regulation) and leads to an inclination for regulators and system operators to defer to generators' expressed concerns.

D. The Power Dynamics of an RTO.

RTOs glean power from several sources. First, and most clearly, RTO authority comes directly from the FERC. In Order 2000, the FERC issued a call for voluntary organizations that would provide transmission services on a regional basis and establish a free market for wholesale electricity.⁵⁸ Stakeholders were given certain parameters, and in exchange for fulfilling these requirements, they may be able to trade power in an organized wholesale market.⁵⁹ The FERC oversees these markets, approving tariffs and market rules, and because RTOs are regulatory animals, the FERC can actually take away approval for their operation. In this sense, RTOs are the FERC's agents, because that is where their power is derived. For example, at the establishment of MISO, it appeared to some participants that the RTO's staff saw their primary stakeholder as the FERC itself.⁶⁰ However, because the FERC has chosen to treat RTOs as voluntary, they are established via a complex dance between transmission owners, market participants, states, and the FERC.⁶¹ Several RTOs were established only after years of wrangling among interested parties. Of these parties, the transmission owners are the most important. Without them, RTOs could not be established because the owners need to give up a property right—management of the transmission lines—for an RTO to be able to fulfill its duties. Regarding this division of responsibility, each RTO's duties include authority over control centers and transmission facilities. The RTO has the ability to “approve and disapprove requests for scheduled outages of transmission facilities.”⁶²

In practice, however, the FERC often requires agreement from more than just transmission owners, or even the market participants as a group to establish RTOs. At the origination of ISO-NE, for example, the FERC required consensus (or at least a feeling of consensus) among many parties, including state

58. See Order 2000, *supra* note 14.

59. Not all RTOs require organized markets by definition. For example, Southwest Power Pool operates mostly through a bilateral market and a real-time energy imbalance service (EIS) market. FERC, MARKET OVERSIGHT: ELECTRIC POWER MARKETS: SOUTHWEST POWER POOL (2007), <http://www.ferc.gov/market-oversight/mkt-electric/spp.asp#rto>. The current use of the term means a person with something at stake. This is the opposite of the traditional use of “stakeholder” which means a neutral party who “held” what was at stake while contenders resolved their differences. Stakeholders have come to be parties with more than mere contractual rights; instead, they have a kind of standing with regard to issues considered by RTOs. The FERC appears to conflate the terms “stakeholder” and “market participant.” See Order No. 2000, *supra* note 14, at 842 (discussing, at great and careful length, its definition of market participant, finally arriving at a fairly broad use of the term). According to the FERC,

[m]arket participant means: (i) Any entity that, either directly or through an affiliate, sells or brokers electric energy, or provides transmission or ancillary services to the Regional Transmission Organization, unless the Commission finds that the entity does not have economic or commercial interests that would be significantly affected by the Regional Transmission Organization's actions or decisions; and (ii) Any other entity that the Commission finds has economic or commercial interests that would be significantly affected by the Regional Transmission Organization's actions or decisions.

18 C.F.R. § 35.34(b)(2) (2006).

60. Telephone Interview with Roy Thilly, President and Chief Executive Officer of Wisconsin Public Power, Inc. (Mar. 26, 2007) (notes on file with author); RESTRUCTURING AT THE CROSSROADS, *supra* note 51.

61. The FERC thus treated RTOs as voluntary, rather than being necessary preconditions to reliance on wholesale markets to deliver “just and reasonable rates.”

62. Order No. 2000, *supra* note 14, at 875.

regulators. In requiring consensus among the stakeholders and leaving the structure of RTOs up to the proposing groups, the FERC was abdicating responsibility for the details of the new organizations. In one sense, this flexibility was good, but in another sense, dissent of various individuals and groups was often swallowed up in the process, and some state regulators felt that they had no power to really affect the outcomes.⁶³ While state regulators were able to voice their opinions in the consultative process, they were not necessarily involved in the actual resolution of the issues they raised.

E. A Crisis in Confidence – Beyond California

When it introduced RTOs in Order 2000, the FERC emphasized “both the perception and reality of [their] independence.”⁶⁴ Because confidence in the RTOs is vital to their success, stakeholders and members of the public needed to see them as independent actors dedicated to the public interest. Suffice it to say that confidence in the RTO is vital to its success. As the FERC has concluded, “perceptions of undue discrimination can also impede the development of efficient and competitive electric markets.”⁶⁵ The reality of RTO performance is important, but the FERC’s political reality is that perception is also significant.⁶⁶

Given that current RTOs operate with consultation and consensus and perception counts as much as it does, their effectiveness depends not only on the “level of acceptance by the different stakeholders and external audiences,” but also “on the ability of the process to engage the stakeholders in a meaningful dialogue in which they feel ownership and the possibility to derive benefits.”⁶⁷ This is particularly difficult with something like electricity transmission and reliability, since these are public goods, with every user a potential participating stakeholder.⁶⁸

There has been a chorus of questions regarding RTOs, their efficacy, and their governance. Thus far, these have culminated in the Advance Notice of Proposed Rulemaking suggesting several governance changes.⁶⁹ In early 2007, the FERC initiated a series of conferences “to examine the state of competition in wholesale power markets.”⁷⁰ Several reports, including one published by the APPA and one published by stakeholders in PJM, argue that the current

63. See, e.g. Technical Conference, *Remedying Undue Discrimination Thru Open Access*, Docket No. FM01-12-000 at 104-05 (F.E.R.C. May 20, 2003). According to then-Chairman Wood, “I’d like to know that their [stakeholder’s] concerns got better and thought-through and balanced the first time so that we don’t have to do that de novo and be [an] ivory tower.” *Id.* at 128-129.

64. Order No. 2000, *supra* note 14, at 855.

65. *Id.* at 824.

66. Judge Mark Christie stated, “those who are passionately supportive of wholesale markets should understand that the credibility of the wholesale markets is the key to their sustainability.” Transcript of Technical Conference, *Conference on Competition in Wholesale Power Markets*, Docket No. AD07-7-000, at 191 (F.E.R.C. May 8, 2007).

67. NANCY VALLEJO & PIERRE HAUSELMANN, INT’L INST. FOR SUSTAINABLE DEV., GOVERNANCE AND MULTI-STAKEHOLDER PROCESSES (2004), http://www.iisd.org/pdf/2004/sci_governance.pdf.

68. RICHARD COWART, REGULATORY ASSISTANCE PROJECT, EFFICIENT RELIABILITY: THE CRITICAL ROLE OF DEMAND-SIDE RESOURCES IN POWER SYSTEMS AND MARKETS (2001), <http://www.raponline.org/Pubs/General/EffReli.pdf>.

69. Wholesale Competition ANOPR, *supra* note 9, at 36,726.

70. Notice of Conference, *Conference on Competition in Wholesale Power Markets*, Docket No. AD07-7-000 (F.E.R.C. Jan 9, 2007), <http://www.ferc.gov/EventCalendar/Files/20070109163555-AD07-7-000.pdf>.

accountability structure of RTOs is not working.⁷¹ The Energy Consumers Resource Council, a consortium of large industrial users, also produced a white paper questioning the ability of current RTO structures to provide real market solutions and claimed that “governing structures of the organized markets are skewed to benefit suppliers.”⁷² It is important to note that many of these “large consumer” groups were originally supportive of restructuring and the RTOs.⁷³

The APPA argues that RTO boards often make decisions that run counter to the interests of industrial customers.⁷⁴ FERC Commissioner Joseph Kelliher responded to these concerns by stating “that while stakeholders do have some voice at the RTO board, it is ‘not as loud’ as it needs to be,” and by suggesting that FERC should consider “hybrid” boards that include both stakeholders and independents.⁷⁵ Through all of these discussions, it has become clear that confidence in the established structures has been wavering.

The press has also picked up the issue. The New York Times ran an article series “examining the decade-long effort to overhaul the nation’s electricity system.”⁷⁶ In addition, Congress has requested two separate reports regarding RTOs from the General Accountability Office (GAO). First, Senators Joseph Lieberman (I-Conn.) and Susan Collins (R-Me) have asked the GAO to make “an investigation into ISO and RTO costs, structure, processes, and

71. ELECTRICITY CONSUMERS RES. COUNCIL, PROBLEMS IN THE ORGANIZED MARKETS (2005), <http://www.elcon.org/Documents/Publications/SpecialReportFAQs.pdf>; RESTRUCTURING AT THE CROSSROADS, *supra* note 51; PJM INDUSTRIAL CUSTOMER COALITION (“PJMICC”) WHITEPAPER: WHAT LARGE COMMERCIAL & INDUSTRIAL CUSTOMERS NEED FROM THE PJM MARKETPLACE (2004), <http://www.ksg.harvard.edu/hepg/Papers/PJMICC.white.paper.0904.pdf>. (noting that there needs to be closer scrutiny that market participants play by the rules, that resulting prices are free from the influence of market power and, most importantly, that in the near-term, ultimate end-use customers receive truly “just and reasonable” prices for reliable electric service).

72. ELECTRICITY CONSUMERS RES. COUNCIL, TODAY’S ORGANIZED MARKETS—A STEP TOWARD COMPETITION OR AN EXERCISE IN RE-REGULATION? (2006), <http://www.elcon.org/Documents/Publications/12-4piom.pdf>.

73. AMERICAN PUB. POWER ASS’N AND THE ELEC. CONSUMERS RES. COUNCIL, RESPONSE TO THE NINE FERC COMMISSIONERS’ OPEN LETTER I (2007), <http://www.appanet.org/files/PDFs/APPAELCONresponsetoFERC%20comm61207.pdf> (stating that “APPA and ELCON strongly support open access transmission service as a platform to support wholesale market competition. We supported Order Nos. 888 and 889 ten years ago. We have supported Order No. 890, the Commission’s current initiative to update and improve the Order No. 888 open access transmission tariff regime.”).

74. *Markets: ‘We Need to Listen,’ Kelliher Says of Concerns About RTO Markets; Wood Calls Worries Valid*, ELECTRIC UTILITIES WEEK, Jan. 17, 2005, (“In its report, APPA said independent RTO boards ‘can lack direct accountability to the industry participants’ in a region and their customers. ‘APPA members have seen RTO boards vote to take actions that a very substantial majority of industry stakeholders in their own regions vehemently opposed,’ the report said. ‘When such events occur repeatedly, there is a loss of confidence in—and ‘buy in’ to—RTO actions by industry participants. This can be very damaging for the RTO itself in the long run. RTOs will only be able to operate effectively if they are accountable and have the respect of all industry participants that must deal with the RTO.’”) *Id.* at 3 (citations omitted).

75. *Markets: ‘We Need to Listen,’ supra* note 74, at 3. Indeed, hybrid boards are the first of two alternative board-related recommendations to improve RTO responsiveness that the Commission proposes in its July 2007 Wholesale Competition ANOPR. See Wholesale Competition ANOPR, *supra* note 9, at 36, 295.

76. NYTimes.com, http://www.nytimes.com/ref/business/powerplay_index.html. Titles include, *Flaws Seen in the Markets for Utilities; In Deregulation, Plants Turn into Blue Chips*; and *Competitive Era Fails to Shrink Electric Bills* (questioning the benefits of restructuring).

operations.”⁷⁷ Second, Representative James Oberstar (D-Minn.) and former Senator Mark Dayton (D-Minn) have asked questions about price setting in MISO. They have asked the GAO to report to Congress on “whether ISOs and RTOs have actually reduced, or even increased the costs of wholesale electrical power throughout our country.”⁷⁸

It is important to keep these complaints about governance in perspective. According to Gordon Van Welie, ISO-NE’s CEO, calls for changes in the governance process are by those who

wish to control the independent decision-making process of the ISO An entity is either independent and will act in a transparent way and make decisions in accordance with its mission—and that would be to ensure reliability and efficient markets—or a different type of entity would be created, which would be controlled by those that have a vested interest in the outcome.⁷⁹

Furthermore, many of the comments to the FERC’s ANOPR show significant support for some of the RTO structures.⁸⁰ However, it is possible that independent organizations act in non-transparent ways or in ways that go against their stated mission. These are real concerns that many stakeholders have expressed.

Moreover, RTOs are a regulatory construct, and if federal elected officials are unhappy with restructuring, they can withdraw the FERC’s capacity to allow RTOs. Meanwhile, stakeholders, including states and utilities can withdraw from RTOs with FERC approval.⁸¹ It appears that the legitimacy of these structures, from the perspective of some stakeholders and some regulators is at risk.

III. THE GOVERNANCE OF RTOs

As stated above, it would require a different paper (or perhaps a book) to consider the governance structures of each of the RTOs individually. This is particularly true because each RTO and ISO has its own power and governance structure and each relies on its own particular language and terminology. Instead, we focus here on general considerations of governance, with many examples provided by ISO-NE. Where possible, we include contrasting examples from other RTOs. This section is meant to establish an underlying understanding that will lay a basis for the analysis in sections three and four.

A. Independence & Board Structure

The first step in analyzing an RTO’s governance is considering structure. Structure determines who makes decisions, how to hold responsible parties accountable for those decisions, whose voice is heard in the decision-making

77. Letter from U.S. Senators Susan M. Collins and Joseph Lieberman to GAO (May 21, 2007) (on file with authors).

78. Brian Wingfield, *Oberstar Orders GAO Review of MISO Operations*, ENERGY DAILY (Jan. 4, 2007), available at 2007 WLNR 2214946.

79. *Future of Markets*, *supra* note 43, at 40.

80. See generally Comments of The New England Conference of Public Utilities Commissioners et al., *Wholesale Competition in Regions with Organized Electric Markets*, Docket Nos. RM07-19-000 & AD07-7-000, at 25 (F.E.R.C. Sept. 14, 2007).

81. See *infra* Part III.C.

process, and whether the decision itself is a good one. These elements, in turn, can either lend credibility and good decision-making to the process, or can corrode those same essentials. Structure protects organizations from personality variations by establishing a process that does not allow favoritism or ideology to dictate decisions.⁸² Relying on individual actors to provide accountability for the RTO can have an effect on the RTO's management or decisions; however, electricity consumers should not have to rely on such discrete actions by individuals to protect their interests.

"Independence" has become a mantra for those who consider RTO-related issues. In Order 2000, the FERC stated, "we have stressed the importance of a decision[-]making process that is independent of control by any market participant or class of participants."⁸³ Note that "independent of any market participant" means "independent of any stakeholder" or "independent of any affected party" if, and only if, it is true that market participants are the only stakeholders or are the only affected parties. Regardless, there is a tension that comes with this independence—the ability of outside individuals and participants to hold the RTO accountable *both to their own individual interests and to the public interest*. This theme is set out throughout this sub-section.

1. The RTO Self-Interest

An RTO may be non-profit, but that does not mean that it has no institutional self-interest. While discussions about the stakeholders in the RTO regime have been accorded reams of paper, much less effort has been expended enunciating (or even asking) what the RTO's institutional interests might be. These interests are the first component of the accountability equation.

Like any other organization, an RTO will be interested in self-preservation. Its management wants the organization to stay a functioning entity, with management in control. In order to do this, it has several priorities: it must juggle several conflicting goals. First, it must keep the lights on. It must make decisions that allow it to keep the grid functioning. Second, it must avoid sky-high prices or extreme volatility. If prices rise enough to instigate severe political action against it, the RTO may not survive the political process. Third, it must maintain relationships with its stakeholders, particularly regulators or others who can slow down or totally disrupt the decision-making process and/or complain to the FERC.

2. Budgeting

Control over the budget is another place where independence is vital. Different RTOs have different budgeting structures; ISO-NE's budgeting process begins with submittal of the capital budget proposal to NEPOOL Budget and Finance Subcommittee and then to NEPOOL Participants Committee (NEPOOL is New England's stakeholder group associated with ISO-NE) and

82. This issue was expressed by the Honorable Frederick Butler, Commissioner of the New Jersey Board of Public Utilities regarding market monitoring issues: "You can set up a system that may work well with the personalities involved today, but what happens in two years or five years when the personalities may change?" *In re* Review of Market Monitoring Policies, Docket No. AD07-8-000, at 39 (F.E.R.C. Apr. 5, 2007).

83. Order No. 2000, *supra* note 14, at 850.

NECPUC (New England Conference of Public Utilities Commissioners).⁸⁴ The Participants Committee then votes on the budget and the results of that vote must be reported to the Board of Directors.⁸⁵ However, the Board has “sole authority to approve the final ISO capital budget.”⁸⁶ The approved budget is filed with the FERC and is subject to review under Federal Power Act § 205.⁸⁷

If the participants do not agree with the Board’s final budgetary decision, ISO shall request that the [FERC] expedite its review of the [budget] and shall provide with its filing such factual and other information available to ISO as is necessary to permit the Commission to address expeditiously those issues that were raised during the Participants Committee meeting at which ISO’s proposed budget was considered and were identified by the Governance Participants . . . as reasons for opposing such budget.⁸⁸

Thus, the FERC must be able to consider NEPOOL’s perspective on ISO-NE’s budget if there is any discord. This makes consensus-building between the RTO and the NEPOOL participants more likely before the issue ever reaches the FERC.⁸⁹

3. Board Composition

The composition of the Board can take several shapes and is important in the structure that the RTO takes. When it established RTOs, the FERC highlighted the problems inherent in both stakeholder and non-stakeholder boards.⁹⁰ In the realm of non-stakeholder boards, the dominant structure is two-tiered—a non-stakeholder board has most of the final decision-making power, with a second tiered advisory committee that can advise the RTO and its board and may have other powers as well.⁹¹ The idea is that the board should be “accountable to all stakeholders, and to market participants in particular, for its actions, but the board should not be beholden to any particular set of stakeholders.”⁹² As we will see below, because of the difficulty in representing

84. *See infra*, Part III.B. Note that though NEPOOL and NECPUC are given access to the budget before it is presented to the FERC, “it can be difficult to judge the appropriateness of various ISO-NE spending levels and to gauge the effectiveness of its programs.” Comments of The New England Conference of Public Utilities Commissioners et al., *Wholesale Competition in Regions with Organized Electric Markets*, Docket Nos. RM07-19-000 & AD07-7-000, at 25 (Sept. 14, 2007).

85. ISO NEW ENGLAND, INC., PARTICIPANTS AGREEMENT AMONG ISO NEW ENGLAND, INC. AS THE REGIONAL TRANSMISSION ORGANIZATION FOR NEW ENGLAND AND THE NEW ENGLAND POWER POOL § 12.3, http://www.iso-ne.com/regulatory/part_agree/participants_agreement.pdf (last visited Sept. 15, 2007) [hereinafter PARTICIPANTS AGREEMENT].

86. *ISO New England, Inc.*, 109 F.E.R.C. ¶ 61,382 (2004); *see also* PARTICIPANTS AGREEMENT, *supra* note 85, § 12.5.

87. ISO NEW ENGLAND INC., F.E.R.C. ELECTRIC TARIFF NO. 3, SECTION IV.B (2004); PARTICIPANTS AGREEMENT, *supra* note 85, § 12.5.

88. PARTICIPANTS AGREEMENT, *supra* note 85, § 12.5.

89. This becomes even more important if, as we argue below, states can exercise little influence through the NEPOOL stakeholder process.

90. More recently, hybrid boards have been gaining traction. *See infra* text accompanying notes 99-110.

91. *See infra* Part III.B.

92. Klevorick, *supra* note 18, at 309.

the public interest in the stakeholder process, this accountability equation may be a faulty one.⁹³

For a stakeholder board, preserving autonomy from any one stakeholder group is of the utmost importance to maintain independence, even at the cost of inefficient decisions. Veto power cannot belong to a class of market participants. Additionally, two classes of market participants acting together should not be able to compel the rest of the board to make a particular decision.⁹⁴ The need for consensus may result in the least common denominator option winning out.⁹⁵ For a wholly non-stakeholder board, the issue is to make sure that the RTO does not isolate itself from market participants and other interested parties.⁹⁶ This problem has been brought to the forefront recently, since most of the RTOs have non-stakeholder boards and there have been objections concerning the efficacy of this model in practice.⁹⁷ The FERC takes the issue up at length in the “Responsiveness of RTOs and ISOs” section in the Wholesale Competition ANOPR.⁹⁸

A third alternative for board structure is a hybrid board—a combination of outsiders and stakeholder members.⁹⁹ The FERC includes a hybrid board as one potential means of establishing greater RTO “responsiveness to stakeholders”¹⁰⁰ in its recent ANOPR.¹⁰¹ Some applaud the notion of the “actual bill-payers” taking part in decisions.¹⁰² For example, the Transmission Access Policy Study

93. For example, according to NSTAR, “ISO-NE [which has an independent board] has generally been able to attract exemplary persons to sit on the Board. However, there is a key voice on the board that is missing; the voice of the consumer.” Comments of NSTAR Electric Co., *Wholesale Competition in Regions with Organized Markets*, Docket Nos. RM 07-19-000 & AD7-7-000, at 9 (F.E.R.C. Sept. 14, 2007).

94. Order No. 2000, *supra* note 14, at 857.

95. In fact, this is one of Commissioner Suede Kelly’s objections to hybrid boards, let alone purely stakeholder boards. *See also* Wholesale Competition ANOPR *supra* note 9, at 36,928.

96. *Id.*

97. Telephone Interview with Roy Thilly, President and Chief Executive Officer, Wisconsin Public Power, Inc. (Mar. 26, 2007) (notes on file with authors).

98. *See also* Wholesale Competition ANOPR *supra* note 9, at 36,294-36,297.

99. This type of board is not unique; it has been used in many settings. Consider, for example, the Board of Trustees at University of Vermont which “consists of 25 members: nine legislative; nine self-perpetuating; three gubernatorial; two students; and two ex-officio members, the governor of Vermont and the president of the university.” THE UNIVERSITY OF VERMONT, UNIVERSITY ADMINISTRATION AND GOVERNANCE, http://www.uvm.edu/about_uvm/?Page=administration.html (last visited Sept. 15, 2007).

100. The term “accountability,” which we predominately use and the term “responsiveness,” which the FERC in its Wholesale Competition ANOPR tends to use, as well as the terms “effectiveness,” “independence,” and “transparency,” can all be used to describe desired goals for RTOs. Without entering into the morass of competing definitions, priorities and emphases that these words attempt to express, we merely note that one useful bench-mark is to ask whether the resulting institutions—the RTOs—are likely to achieve the social goals of just and reasonable rates as well as sustained reliability, adequacy and resource parity of power decisions—for direct market participants as well as for those to whom market participants pass on the cost of the transactions.

101. Wholesale Competition ANOPR, *supra* note 9, at 36,295.

102. Such is the view of one public power CEO: “I have experience on a hybrid board at American Transmission Company and I think the system works very well. It is the utility owners who pay the bills that often ask the hard questions of management. I believe that RTO governance would benefit significantly by having a minority of Directors on the Board elected by the stakeholder group as a whole, so that some of the people who actually pay the bills, and are affected directly by RTO decisions, are part of the decision-making process.” Roy Thilly, President and CEO, Wisconsin Public Power Inc., Prepared Statement at the Federal

Group suggests a hybrid board wherein “independent directors should hold a majority of board seats (including on board committees) to prevent capture of the board by stakeholders. The stakeholder minority, however, should be substantial and balanced among stakeholder interests.”¹⁰³

One positive asset of a hybrid board advocated by some is the potential to help solve one of the main problems with the current structure: the excessive isolation and therefore lack of responsiveness of the independent RTO Board. Stakeholder warning bells may be raised when it appears that outside board members rely upon advice from RTO management and staff, not only for information, but as a replacement for independent counsel and consideration.¹⁰⁴ A hybrid board might afford some security in this system by allowing individuals and groups who have an economic stake in transmission to participate in board decisions, ask management questions, and raise issues that other board members may not see.

However attractive these features of a hybrid board might be, other critics have serious misgivings, asserting that such boards are not just impracticable but indeed impossible. Indeed, Commissioner Suedeen Kelly rejected the recommendation of hybrid boards in her concurrence/dissent of the Wholesale Competition ANOPR, asserting:

I believe that establishing a hybrid board would jeopardize the fundamental principle of independence upon which ISOs and RTOs are based . . . it is not clear to me how one would distinguish between “inappropriate” advocacy for one’s interests, and perfectly reasonable advocacy for one’s interests. Additionally, a hybrid board composed of independent and non-independent board members could needlessly complicate the board dynamic and make cooperative decision-making more difficult and time consuming . . . I do not believe it is workable for the board of an RTO or ISO given the many important and time-critical issues they deal with.¹⁰⁵

Furthermore, there is another fundamental flaw of hybrid boards, at least as currently described in the Wholesale Competition ANOPR, and that is one of basic definitions.¹⁰⁶ Before even coming to whether a hybrid board could function, the FERC must determine who this hybrid board would be.¹⁰⁷ The task of deciding which stakeholders would, and which would not, be on any RTO board is daunting. No functioning board could really encompass all the diverse interests of those affected by an RTO’s decisions (and any board large enough to offer seats to all affected parties would inevitably have to devolve power to a more limited internal executive committee). Further, at least one commenter recommending such boards suggests that stakeholder board members would be

Energy Regulatory Commission Conference on Competition in Wholesale Power Markets, at 5 (Feb. 27, 2007), <http://www.ferc.gov/EventCalendar/Files/20070301133025-Thilly,%20Wisconsin%20Public%20Power.pdf>.

103. Comments of the Transmission Access Policy Study Group, *Wholesale Competition in Regions with Organized Markets*, Docket Nos. RM 07-19-000 & AD7-7-000, at 34 (F.E.R.C. Sept. 14, 2007) [hereinafter TAPS].

104. RESTRUCTURING AT THE CROSSROADS, *supra* note 51; TAPS, *supra* note 103, at 36 (“Boards comprising only independent directors are more prone to capture by RTO management.”).

105. Wholesale Competition ANOPR, *supra* note 9, at 36,298.

106. See Wholesale Competition ANOPR, *supra* note 9.

107. TAPS, *supra* note 103, at 46 (suggesting that the following perspectives should be included: generator, transmission owner, end-use customers [industry or consumer advocate], transmission-dependent LSE, and other).

executives that come from “companies [that] have a financial stake in the RTO’s decisions and pay its bills.”¹⁰⁸ Who would represent the ratepayer’s interest in such a construct remains a serious concern.

Merely defining those with legitimate interests is a task that has been difficult for the FERC to resolve.¹⁰⁹ Given the care with which the FERC attempted to define some of these terms in Order No. 2000, the ambiguity in recent discussions is ample evidence of the difficulties that would arise in attempting to develop even-handed “neutral” principles for selecting representative board members.¹¹⁰ Yet the absence of unambiguous selection principles would, inevitably, lead to a process in which, by default, the participants who could devote greatest resources to influencing selection would wind up with the greatest representation on the resulting boards.

4. Board Selection and Termination

Thus far, RTO structures seem to have coalesced into independent boards instead of hybrid or stakeholder ones. There are two main types of independent board selection structures—self-perpetuating boards and stakeholder-selected boards. ISO-NE is an example of a self-perpetuating board. Directors are elected in staggered three member “classes” that each serve three year terms.¹¹¹ The Board’s Nominating and Governance Committee, a Board of Directors standing committee, is committed to work with NEPOOL and NECPUC in developing a slate for nomination.¹¹² The proposed directors for a given class are elected by a majority of directors currently in office serving as the “members” of the corporation.¹¹³ There are age and term limits (which may be waived).¹¹⁴

The slate of candidates is proposed by a Joint Nominating Committee made up of representatives of the ISO board members, six stakeholder representatives representing different sectors,¹¹⁵ and one representative of NECPUC.¹¹⁶ Once the Joint Nominating Committee develops a slate, the NEPOOL Participants

108. *Id.* at 36. These commenters argue further that “direct involvement of senior executives on a hybrid board will bring a different and broader perspective that should be valuable to independent board members and RTO management” and that executives “can more readily compromise to break deadlocks than can mid-level managers.” TAPS, *supra* note 103, at 40.

109. See, for example, the divergent uses of the terms “customer” (apparently wholesale), “customer” (apparently retail), “stakeholder,” “market participant,” and “other affected interests,” in paragraphs 31, 21, 141, 123, and 115 (respectively) of the ANOPR. Wholesale Competition ANOPR *supra* note 9, at 36,279, 36,280-81, 36,291-94.

110. See also Order No. 2000, *supra* note 14, at 842. TAPS makes suggestions regarding how selection of stakeholder board members could be selected. These suggestions include requirements that the stakeholder board members meet the same qualification requirements as the independent stakeholders, that they be of a sufficiently high level in their organization (e.g., CEO-level), and that their selection be by a supermajority of stakeholders. TAPS, *supra* note 103, at 44.

111. PARTICIPANTS AGREEMENT, *supra* note 85, § 9.2.3. The CEO of ISO-NE is the tenth board member.

112. Order No. 2000, *supra* note 14, at 815, 828, 842.

113. ISO NEW ENGLAND, INC., ARTICLES OF INCORPORATION § (7)(e) (2005). Directors of non-stock corporations are elected by the members of the corporation as there are no shareholders.

114. PARTICIPANTS AGREEMENT, *supra* note 85, § 9.2.3.

115. See *infra* Part III.B.

116. PARTICIPANTS AGREEMENT, *supra* note 85, § 13.1.2. The actual construction of the nominating committee is slightly more complicated.

Committee votes on the proposal, with a 70% aggregate Sector Voting Shares requirement for endorsement.¹¹⁷

If the NEPOOL Participants Committee does not endorse the slate, the Joint Nominating Committee proposes a new slate to NEPOOL (in which at least one nominee is different from the original slate).¹¹⁸ If NEPOOL does not endorse this slate either, the Joint Nominating Committee proposes one of the two slates to the Board.¹¹⁹ In this way, the stakeholders have significant influence on the slate proposals (both through the Joint Nominating Committee and through the slate endorsement process), but they need not approve a slate for it to go to the ISO-NE board.

If the ISO-NE Board does not approve a slate presented to it, then the nominating process begins again, and the Joint Nominating Committee must present a new slate at the next meeting (though the new slate need not have any changes).¹²⁰ If the Board does not approve a slate before its annual meeting, then it bypasses the process and can nominate and approve members on its own.¹²¹ Finally, director removal can occur via a two-thirds vote of current directors.¹²²

In contrast, some other RTOs provide that “stakeholders” elect board members, even though those board members must be independent. Thus, for example, in PJM, the “Members Committee” (made up of five sectors) elects the board members.¹²³ Theoretically, this structure imposes more accountability to certain stakeholders, but perhaps less accountability to affected ratepayers who may not have effective representation on the PJM Members Committee.¹²⁴ This power has real world consequences—the stakeholders voted out board members in MISO last year.¹²⁵

5. Board Member Independence

One concern about board member selection and independence is similar to an uneasy concern sometimes raised about regulators—many have either held jobs in the industries that are being regulated, or they have an interest in working in those industries after they leave government service. Thus, there are two types of bias: one based on a person’s background and experience and the other based on future employment prospects.¹²⁶ Such concerns can easily be translated into concerns about RTO management.

117. PARTICIPANTS AGREEMENT, *supra* note 85, § 13.2.1.

118. *Id.* § 13.2.3.

119. PARTICIPANTS AGREEMENT, *supra* note 85, § 13.2.2.

120. *Id.* § 13.2.3.

121. PARTICIPANTS AGREEMENT, *supra* note 85, § 13.2.4.

122. ISO NEW ENGLAND INC., ARTICLES OF INCORPORATION (7)(g) (2005). The President and CEO may be removed by a plain majority of the directors. *Id.*

123. PJM INTERCONNECTION, L.L.C., AMENDED AND RESTATED OPERATING AGREEMENT OF PJM INTERCONNECTION, L.L.C. § 7.1 (2007), <http://www.pjm.com/documents/downloads/agreements/oa.pdf>.

124. *See infra* Part III.B.

125. Audrey A. Zibelman, PJM Interconnection, LLC, Testimony before Federal Energy Regulatory Commission—Conference on Competition in Wholesale Power Markets, Docket No. AD07-7-000 (May 8, 2007).

126. Ernesto Dal Bó, *Regulatory Capture: A Review*, 22 OXFORD REV. ECON. POL’Y 203, 214 (2006).

In such a technical industry, application of expertise gained in all sectors is vital to any RTO's operations, but the interest of legitimacy must also be served. ISO-NE's structure begins to deal with these concerns. Directors and staff cannot have a financial interest in the market or in governance participants, involuntary acquisition of securities (e.g., inheritance), or identification of a new market participant.¹²⁷ This rule assures the independence of the RTO's decision-makers during their tenure, and is particularly meaningful because directors have day jobs which must be held outside of market or governance participants.¹²⁸ Similarly, in the PJM, a prospective Board Member cannot have worked for a Member, affiliate, or related party of a member within the five years preceding election.¹²⁹

However, these ameliorative measures do not resolve the questions of independence. It would seem impossible to find people who both have the expertise necessary to do their job as board members and managers and also have absolutely no connections in the industry in which they must have this expertise. By the same measure, it would be Pollyanna-esque to expect these professionals to be able to park their past experiences and allegiances at the door.

B. Stakeholder Participation in RTOs

Stakeholder processes in RTOs can offer a check on management and, in a sense, hold it accountable.¹³⁰ In ISO-NE, stakeholders can elect to participate in NEPOOL, the stakeholder group that advises the RTO. NEPOOL "provide[s] the sole Participant Processes for advisory voting on ISO matters and the selection of the ISO Board members, except for input from state regulatory authorities and as otherwise may be provided in the Tariff, [Transmission Operating Agreement], and the Market Participant Services Agreement."¹³¹

The NEPOOL participants elect to be members in one of six "sectors": generation, transmission, supplier, alternative resources, publicly owned entities, and end users.¹³² Participants vote for their own perceived interests on a sector-

127. Emphasizing flexibility between different RTO structures, the FERC did not set this out as an actual rule regarding financial independence of board members in Order No. 2000, though it did state that "the overarching standard [is] that its decisionmaking process must be independent of individual market participants and classes of market participants." Order No. 2000, *supra* note 14, at 857. Note also that, for example, in ISO-NE, there are exceptions for a limited transition period after they are initially employed.

128. This can create some difficulties by narrowing the pool of eligible board members. See Comments of ISO New England, Inc., *Wholesale Competition in Regions with Organized Markets*, Docket Nos. RM07-19-000 & AD07-7-000, at 41 (F.E.R.C. Sept. 14, 2007) (ISO-NE and NEPOOL requested authorization from the Commission in 2005 to allow Mr. James Pignatelli, the CEO of Tucson Electric Power Company, to serve on the ISO-NE Board given his experience in the public utility sector. Despite the distance between the New England region and Tucson Electric and the overwhelming regional support for Mr. Pignatelli, the Commission rejected the filed application, noting that the Commission disfavors interlocks between two or more public utilities, even where the public utilities are not affiliated).

129. PJM INTERCONNECTION, L.L.C., AMENDED AND RESTATED OPERATING AGREEMENT OF PJM INTERCONNECTION, L.L.C. § 7.2 (2007), <http://www.pjm.com/documents/downloads/agreements/oa.pdf>.

130. The FERC, seeking comments on "how well these processes are working and how their effectiveness might be improved," describes the purposes of these stakeholder processes: "[t]hey are intended to provide the views of various customer and stakeholder groups to the RTOs and ISOs. Some are also intended to help the RTOs and ISOs make decisions on sometimes contentious transmission and market matters." *Wholesale Competition ANOPR supra* note 9, at 36,296.

131. PARTICIPANTS AGREEMENT, *supra* note 85, § 2.2.

132. *Id.* § 7.3.2.

weighted basis, with sector voting shares (with one exception related to the Alternative Resources sector) divided equally¹³³ between the sectors.¹³⁴ This means that each sector gets a 16 2/3% vote in a NEPOOL decision.¹³⁵ A member's voting share is its sector's voting share divided by the number of voting members who cast affirmative or negative votes on the matter.¹³⁶ NEPOOL has many duties, including providing counsel to the RTO; they also have FERC filing abilities under certain circumstances.

NEPOOL acts on most matters through the NEPOOL Participants Committee, which is comprised of more than 210 entities (affiliates are not entitled to multiple votes).¹³⁷ The responsibilities of the Participants Committee include advising ISO-NE, making filings on behalf of NEPOOL, decisional authority with respect to the New England generation information database and certificate system, adopting and approving a budget, and voting on ISO-NE board members (see above). The Participants Committee oversees several subcommittees and three standing technical committees chaired by ISO-NE representatives: markets, reliability, and transmission.¹³⁸ Issue-focused working groups, task forces and sub-groups can be established by each of the principal committees and are active as needed.

Importantly, barring exigent circumstances, NEPOOL has the opportunity to consider and comment on changes that ISO-NE wishes to make to "Market Rules, Operating Procedures, Manuals, Reliability Standards, Information Policy and changes thereto, and on Installed Capacity Requirements and changes to General Tariff Provisions and Non-TO OATT Provisions."¹³⁹ The Participants Committee can support an ISO-NE proposal by a two-thirds vote (60% if the change involves a market rule).¹⁴⁰ However, this power remains limited.

If this supermajority does not support a change, ISO-NE can still file the change with the FERC.¹⁴¹ However, if the Participants Committee does not

133. According to NSTAR, this "sector voting structure can be skewed when representatives of one sector have the option to fill multiple sectors. For example . . . it is possible for a generation developer to become a member of the End User sector by simply having an office which uses electricity, or for a conventional generation owner with a minor business interest in renewable generation to become a member of the Alternate Resource sector. The presence of these entities in the sectors dilutes the voting power of the 'pure' sector members." Comments of NSTAR Electric Co., *Wholesale Competition in Regions with Organized Markets*, Docket Nos. RM 07-19-000 & AD7-7-000, at 11 (F.E.R.C. Sept. 14, 2007).

134. Note that the transmission owners also have their own separate committee, the PTO Administrative Committee, which meets at least quarterly:

(1) to consider recommendations to the ISO regarding actions, policies and rules of the ISO affecting the PTOs' Transmission Facilities; (2) to consider and vote upon proposed amendments to this Agreement; (3) to consult with the ISO as may be provided for under this Agreement; and (4) to consider any other matters relating to the administration of this Agreement by the PTOs.

ISO-NE, TRANSMISSION OWNERS AGREEMENT § 11.04 (a)(i) (2006), http://www.iso-ne.com/regulatory/toa/er06-1181_toa-composite_6-29-06.pdf.

135. PARTICIPANTS AGREEMENT, *supra* note 85, § 1.

136. *Id.*

137. NEW ENGLAND POWER POOL, LIST OF NEPOOL PARTICIPANTS (2007), http://www.iso-ne.com/committees/nepool_part/list_of_nepool_participants.pdf.

138. *Id.* § 8.1.

139. PARTICIPANTS AGREEMENT, *supra* note 85, § 8.1.3(d).

140. *Id.* § 11.1.2.

141. This is true in other RTOs as well—for example, MISO submitted its recent Ancillary Services Market proposal to the FERC after the Stakeholders' Advisory Committee voted "19½ against and 3½

support an ISO-NE market rule, but supports a different proposal by 60%, then that version must also be filed with the FERC, along with an ISO-NE explanation why it did not adopt NEPOOL's version and why the ISO-NE version is superior.¹⁴²

This right to advise the RTO and comment on its decisions does not legally operate as a means of holding the organization accountable. However, the reality is that it tends to operate as a check against bad decisions—the RTO staff obviously would not want to bring many issues to the stakeholders only to have their proposals rejected. While ISO-NE has filed changes in the absence of a Participants Committee recommendation, we are not aware of any time when it has taken a formal action contrary to an affirmative position explicitly supported by the requisite majority of stakeholders.¹⁴³

In ISO-NE, the Board and NEPOOL do coordinate their functions and activities. The ISO-NE CEO attends Participant Committee meetings, and Board Members participate at the request of the NEPOOL Committee.¹⁴⁴ They coordinate dates of meetings so issues raised and discussions of the Participants Committee can be reported to the Board.¹⁴⁵ In addition, the Board must meet with participants at least twice a year.¹⁴⁶ All of this means that the stakeholders identified through the stakeholder process have several formal avenues of communication with the ISO management and board. Importantly, this mechanism does not allow for the stakeholders to initiate action, only to react to RTO proposals.

C. Exit/Termination

An individual stakeholder's ability to either join or exit an RTO—to “vote with its feet”—bears on accountability. Relatively easy exit from an RTO can help make the organization accountable to market participants, though, if abused, it could also hold each RTO's independence hostage. If important participants (for example, transmission owners) disagree with each RTO's decision-making and feel that the RTO is no longer in their best interest, the voluntary nature of these organizations permits them to exit, at least in certain situations. This reality creates a conflict between RTO independence and its desire to retain participants and geographic spread.

There are several variables involved with exiting—and these are governed by the agreements made at the establishment of the RTO. For example, in ISO-NE, the FERC may allow exit under different circumstances, depending on whether exit is at the end of or during the agreement's term.¹⁴⁷ A transmission

abstentions.” Lloyd B. Webb, Procurement Manager, Eastman Chemical Co., and Chairman, Electricity Consumers Resource Council (ELCON), Oral Remarks at Federal Energy Regulatory Commission Conference on Competition in Wholesale Power Markets, Docket No. AD07-7-000 (May 4, 2007).

142. PARTICIPANTS AGREEMENT, *supra* note 85, § 11.1.5.

143. *Future of Markets*, *supra* note 43, at 47. A majority, but less than 59% of the Participants Committee supported ISO-NE's LICAP proposal. In PJM, 2/3 of the stakeholders voted against an economic plan for transmission. *Id.*

144. PARTICIPANTS AGREEMENT, *supra* note 85, § 10.2.1.

145. *Id.* § 10.2.2.

146. PARTICIPANTS AGREEMENT, *supra* note 85, § 10.2.6.

147. ISO-NE, TRANSMISSION OWNERS AGREEMENT § 10 (2006), http://www.iso-ne.com/regulatory/toa/er06-1181_toa-composite_6-29-06.pdf.

owner exiting at the end of the term must fulfill certain requirements, including transferring operational authority to some entity other than the owner and a FERC determination that the withdrawal is just and reasonable.¹⁴⁸

This need for FERC approval may guard against abuse of this ability to exit. For example, in MISO, two Kentucky utilities were granted the ability to withdraw by the FERC.¹⁴⁹ Conducting a just and reasonable analysis, the utilities were allowed to exit, transitioning control over their transmission facilities to third parties, such as Tennessee Valley Authority. In addition, they paid \$33.2 million to withdraw.¹⁵⁰

In this case, termination may have acted as a wake up call to the RTO's management. Losing members shrinks the size of the RTO and could lessen its prestige and ability to operate effectively. Management's self-interest dictates that it pay attention to the needs of members, lest they leave. With the large penalties for exit, the fact that exiting members do not regain custody of their transmission and the need for FERC approval potentially guard against abuse and make this tool useful, even if rare. Termination can throw a significant wrench into any RTO ventures. However, the voluntary nature of RTO membership means that an RTO can allow the needs of transmission owners threatening to exit to outweigh the public's interest.

D. Market Monitoring

Market monitoring¹⁵¹ is a significant part of each RTO's overall accountability system.¹⁵² The FERC has determined that competitive markets will provide just and reasonable rates¹⁵³ pursuant to the public's interest, and Market Monitors help guard that interest and keep the RTO accountable to the public by assuring that the market is, in fact, competitive.¹⁵⁴ The market

148. *Id.* § 11.04; *Guidance on Regional Transmission Organization and Independent System Operator Filing Requirements under the Federal Power Act*, 104 F.E.R.C. ¶ 61,248, at P 3 (2003), cited in *Maine Pub. Util. Comm'n v. FERC*, 454 F.3d 278, 280 (D.C. Cir. 2006).

149. See *Louisville Gas and Elec. Co.*, 114 F.E.R.C. ¶ 61,282 (2006).

150. *Final fee calculation shows LG&E, KU paying \$33.2 million to get out of MISO*, INSIDE FERC, at *6, Oct. 23, 2006, available at 2006 WL 19263772.

151. We stress here that market monitoring is an integral part in the development of accountability systems for RTOs, deserving the attention of both management and directors. We also recognize that a complete discussion of Market Monitoring, especially in light of the recent ANOPR, deserves its own article. Here, we highlight some major issues in market monitoring but are not able to give the topic the full consideration it deserves in a separate paper.

152. One need only observe that fully thirty-eight of the one hundred and seventy paragraphs of the FERC's Wholesale Competition in Regions with Organized Electric Markets ANOPR were dedicated to "Market Monitoring Policies" to understand how integrally related market monitors are to the governance and accountability of RTOs. Wholesale Competition ANOPR, *supra* note 9, at 36,276.

153. Federal Power Act § 206, 16 U.S.C. § 824(e) (2000).

154. In the FERC's 2005 Policy Statement on Market Monitoring Units, the FERC set out four duties of Market Monitors. All of these duties, performed independently of the RTO, build accountability of the overall RTO structure. These duties are:

- 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.

monitor's ability to do his or her job without interference from the RTO or its management is fundamental to any RTO's governance structure.

Perhaps the most dramatic outcome of a flawed RTO system is that some firms are able to exercise market power over the price of electricity. Because it is difficult to supervise markets and because firms can exercise market power to artificially affect prices, monitoring these new markets is a vital part of any governance and accountability structure. Though a market can pass a "horizontal screen" that measures market concentration, participants can still exercise market power which is extremely difficult to uncover.¹⁵⁵ Market malfeasance is subjective, not objective, and therefore can also be difficult to define.¹⁵⁶

RTOs employ market monitors (MMUs) to oversee the market. According to FERC Commissioner Kelly, Market Monitors have several responsibilities:

They protect. They detect and respond to questionable actions by market participants. They mitigate. They take action designed to change market behavior that appears to be problematic and that needs to be halted immediately. They provide advice. Both real-time advice and strategic advice. They are neutral actors who recommend actions and policy changes based on immediate observations and/or based on market research.¹⁵⁷

These functions come from a delegation of responsibilities to the RTOs themselves.¹⁵⁸ First, the FERC has delegated the authority to "correct all prices

- 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 Rule violation, and immediately notify appropriate Commission staff for possible investigation.

Policy Statement on Market Monitoring Units, *Market Monitoring Units in Regional Transmission Organizations and Independent System Operators*, Docket No. PL05-1-000, at 1-2 (F.E.R.C. May 27, 2005) (internal citation omitted).

155. Seth Blumsack & Lester Lave, *Mitigating Pivotal Suppliers in Deregulated Electricity Markets*, <http://www.andrew.cmu.edu/user/sblumsac/usaee.pdf> (last visited Sept. 15, 2007); ROBERT J. MICHAELS, *ELECTRICITY MARKET MONITORING AND THE ECONOMICS OF REGULATION* (2007), <http://ssrn.com/abstract=964308>.

Near the peak, a generator's bid that is well above cost may be accepted and set the market-clearing price because almost all the others are operating. A generator in a "load pocket" may control a tiny fraction of RTO capacity but have substantial unilateral power. Generators may tacitly collude as they make inferences about one another's bidding. Transmission constraints may allow subtle exercises of market power—the owner of a high cost plant may operate it to congest transmission that will raise market prices that its other plants will receive. Near-term demand responses may be insufficient to mitigate generator market power.

Id. at 4.

156. Technical Conference, In Re *Review of Market Monitoring Policies*, Docket No. AD07-8-000 (F.E.R.C. Apr. 5, 2007) (referring to comments during the first session).

157. Suedeem Kelly, Commissioner, FERC, Opening Remarks at Technical Conference on Policies Regarding Market Monitoring (Apr. 5, 2007), <http://ferc.gov/press-room/statements-speeches/kelly/2007/04-05-07-kelly.pdf>.

158. As a matter of constitutional law, a federal agency cannot delegate to a private body the authority to make decisions about the substantive provisions of federal law or regulatory obligations. See *U.S. Telecom Ass'n v. FCC*, 359 F.3d 554 (D.C. Cir. 2004) (demonstrating a recent example of the long-standing principle set out in *Schechter Poultry Corp. v. U.S.*, 295 U.S. 495 (1935)). We are not suggesting that the FERC's reliance, to date, upon RTOs to carry out essential functions violates that constitutional prohibition. To the

that do not reflect operation of the ISO market rules.”¹⁵⁹ Second, some RTOs have the broader authority to “correct market design implementation flaws.”¹⁶⁰

The problem with these authorities is that they may inherently limit the interests of some of the RTO’s most active and involved stakeholders. Because of this, it continues to be unclear which responsibilities the RTOs can meaningfully take on and which must be carefully overseen (or taken over) by regulators. The MMU is smack in the middle of this uncertain space, determining whether the tariff is being followed and whether market power is being employed. These are responsibilities that are allocated to the RTOs, but at the same time, the MMU’s assessments may also diverge from an RTO’s views.

An example from the PJM area illustrates such a divergence. Joseph Bowring, PJM’s Market Monitor alleged that PJM management repeatedly asked him to modify or hide his conclusions from PJM stakeholders and the FERC.¹⁶¹ He further alleged, that PJM exerted editorial control over the Monitoring Unit, PJM pressured MMU staff to transfer divisions and did not hire replacement staff in a timely manner, and threatened removal of databases and computer programs from the MMU.¹⁶² The FERC did not conclude that all these allegations were proven, but did find that while “PJM has not committed tariff violations . . . the significant tension between PJM management and the Market Monitor could compromise the MMU’s ability to perform its tariff-defined functions and that, as a result, tariff modifications may be necessary to reform that relationship.”¹⁶³ The FERC instituted a settlement process to determine the relationship between PJM and its market monitor and made “a preliminary finding that the Market Monitor should report to the Board of Managers or to an independent committee of the Board, rather than to both the Board and PJM management.”¹⁶⁴

There seems to be a relatively strong consensus that MMUs need to be independent of RTO management.¹⁶⁵ In many regions, this independence appears to be in effect. For example, ISO-NE has a two-tiered MMU structure,

degree that the RTO’s functions and effectiveness create the factual basis for a finding that markets create just and reasonable rates, the FERC’s reliance upon those practices constitutes fact finding, rather than delegation. However, we do note that there is clearly some point at which the FERC’s reliance upon RTOs to make discretionary decisions would constitute excessive delegation. *See also* Suedeen Kelly, et al., *The Subdelegation Doctrine and the Application of Reference Prices in Mitigating Market Power*, 26 ENERGY L.J. 297 (2005).

159. Vince, *supra* note 57, at 119.

160. *Id.* “[T]his sort of authority was viewed as a temporary measure to assist in the initial implementation of the markets.” Vince, *supra* note 57, at 199.

161. *Organization of PJM States v. PJM Interconnection, L.L.C.*, 119 F.E.R.C. ¶ 61,165 (2007). (The FERC has instituted an investigation into Dr. Bowring’s allegations.) *See also* Technical Conference, In re *Review of Market Monitoring Policies*, Docket No. AD07-8-000 (F.E.R.C. Apr. 5, 2007) (statement of David Patton); Jeff Gelles, *How Much Power Does Grid’s Monitor Have?: A Departure at the Company That Operates the Region’s Electrical Network Renews Questions Over Its Oversight*, PHILADELPHIA INQUIRER, July 28, 2007, available at http://www.philly.com/philly/business/20070728_How_much_power_does_grids_monitor_have_.html.

162. *Id.*

163. *Allegheny Elec. Coop. v. PJM Interconnection, L.L.C.*, 120 F.E.R.C. ¶ 61,254 (2007).

164. *Id.*

165. For example, the FERC’s recent ANOPR states that in FERC conferences regarding market monitoring, “virtually every commenter agreed with the need for independence.” Wholesale Competition ANOPR, *supra* note 9, at 36,290.

with both internal and external market monitors. Importantly, both the internal and external market monitoring units are governed by a committee of ISO-NE board members (not by the ISO's internal management).¹⁶⁶

The job of ISO-NE's internal MMU is to oversee the "[d]ay-to-day, real-time review of market behavior."¹⁶⁷ It also consults with the Independent (and external) Market Monitoring Unit, provides support and refers concerns to the Independent Unit and/or ISO Board, makes recommendations regarding changes to "improve competitiveness and efficiency," and produces weekly, quarterly, and annual reports.¹⁶⁸ The external independent unit is selected by the RTO Board, not by management, and if it finds a problem with the markets, the MMU must inform the FERC, the Board, the state public utility commissions, and the governance participants.¹⁶⁹

There are several lessons to be drawn regarding market monitoring. First, to do their jobs, MMUs must have extensive access to the RTO, RTO decision-making, and most importantly, RTO data. However, outside of ISO-NE, there have been meaningful allegations that the work of some market monitors was impaired by the RTO itself. For example, as described above, in April 2007, PJM's internal Market Monitor publicly questioned the MMU's ability to do its job, alleging that PJM management forced it to modify the State of the Market Report, precluded communications with the membership committee when it disagreed with the MMU's analysis, and delayed report releases because it disputed the MMU's conclusions.¹⁷⁰ Without judging the merits of the specific allegations, we can note the potential for such concerns to be significant.

Influence can be difficult to track. Who employs the MMU and how that contract is governed can protect MMUs from undue influence. After all, an external market monitor on a contract can be replaced, influenced by the implicit or explicit threat of replacement, or simply overloaded by the volume of data from one or multiple ISOs.¹⁷¹ Thus, as either employees or contractors of the RTOs, the MMU's independence must be carefully guarded. In MISO, the external MMU has a two year contract, but the FERC must approve any contract termination or failure to renew.¹⁷² The FERC's oversight, particularly when operated at arm's length, may not be enough to protect the MMU from the RTO's interests. Being an employee (unprotected by specific tariff obligations)

166. The ISO New England Board has a standing committee, the Markets Committee, that is "responsible for overseeing issues relating to the New England markets including, without limitation, oversight of the Company's [market] assessments and market monitoring, and reporting and market-power mitigation functions and oversight of substantive market analyses." ISO NEW ENGLAND INC., CHARTER OF THE MARKETS COMMITTEE OF THE BOARD OF DIRECTORS (2005), http://www.iso-ne.com/aboutiso/corp_gov/charters/markets_comm_chtr.doc.

167. PARTICIPANTS AGREEMENT, *supra* note 85, § 9.4.4 (b).

168. *Id.* § 9.4.4(e).

169. PARTICIPANTS AGREEMENT, *supra* note 85, § 9.4.3(a); Order No. 2000, *supra* note 14; 18 C.F.R. § 35.34(k)(6)(iii) (2007) (stating that "[r]eports on opportunities for efficiency improvement, market power abuses and market design flaws must be filed with the Commission and affected regulatory authorities.")

170. Technical Conference, In re *Review of Market Monitoring Policies*, Docket No. AD07-8-000 (F.E.R.C. Apr. 5, 2007) (prepared statement of Joseph E. Bowring).

171. Technical Conference, In re *Review of Market Monitoring Policies*, Docket No. AD07-8-000 (F.E.R.C. Apr. 5, 2007) (oral statement of Commissioner Fred Butler).

172. Technical Conference, In re *Review of Market Monitoring Policies*, Docket No. AD07-8-000 (F.E.R.C. Apr. 5, 2007) (oral statement of David Patton).

of the RTO may create inherent differences of opinion since part of the MMU's job is monitoring the RTO and being critical of it.

Selection of MMUs is a related issue in MMU independence. The RTOs themselves select the Market Monitors. As stated above, RTO interests are at stake in the MMU decision-making. Professor Michaels argues that MMU reports do not present complete pictures of the market landscape; reports are written by "nonrandom economists."¹⁷³ Consider again that one person or group can serve as the monitor for several RTOs simultaneously and evidence that minority views have been withheld from the public's (or the FERC's) view.¹⁷⁴ This outcome may be in the RTO's best interests (but not the public interest). Furthermore, one individual or group can perform as the external market monitor for several RTOs, thus limiting the number of alternatives that RTOs are able to explore.

The market monitoring issue in some ways exemplifies the overall RTO governance question. The current structure requires that although monitors should be independent of RTO decision-making, RTOs are still accountable for bad market monitor work. According to the FERC, market monitors are not its agents in figuring out what market power issues exist. However, some experts involved with the issue (including PJM's market monitor) have questioned whether these organizations should be accountable to some entity other than the RTO.¹⁷⁵ For example, why are market monitors accountable to RTOs if the FERC is ultimately responsible for making sure that customers receive just and reasonable rates and assuring that the electricity system is delivering such rates?¹⁷⁶ One related problem in this current structure is that there are limits on communications between the FERC and MMUs, particularly in the direction of the FERC to MMUs.¹⁷⁷

A connected issue is the relationship of state governments to the market monitors. In the current system, states are nearly powerless to monitor the markets. It can be very difficult for states to get the data that they need to do market monitoring. For example, knowledge of the actual bids made by sellers in wholesale markets is as vital to policing of those markets as is the public recording of bids made for stocks and securities in policing securities markets. However, ISO-NE rules have allowed such information to be kept confidential for up to six months¹⁷⁸ in contrast to confidentiality periods as short as one day in UK/Wales and Australian wholesale electricity markets.¹⁷⁹

173. Robert J. Michaels, *Watching the Watchers*, PUBLIC UTILITIES FORTNIGHTLY, July 13, 2003, at 36. "Three independent system operators (ISOs) and their MMIs reached quite different decisions on the economically efficient practice of 'virtual bidding.' Politics trumped economics, for reasons probably inherent in the organizations themselves." *Id.*

174. Michaels, *supra* note 173.

175. Technical Conference, In re *Review of Market Monitoring Policies*, Docket No. AD07-8-000 (F.E.R.C. Apr. 5, 2007) (prepared statement of Joseph E. Bowring).

176. Public Util. Dist. No. 1 of Snohomish County v. FERC, 471 F.3d 1053 (9th Cir. 2006).

177. Technical Conference, In re *Review of Market Monitoring Policies*, Docket No. AD07-8-000 (F.E.R.C. Apr. 5, 2007) (oral statement of Joseph Kelliher); Electric Power Supply Ass'n v. FERC, 391 F.3d 1255 (D.C. Cir. 2004).

178. In ISO-NE there is currently a proposal, filed by NEPOOL with ISO-NE, to reduce the lag for which Demand Bid and Supply Offer data are available from six months to three months. Comments of ISO New England, Inc., *Wholesale Competition in Regions with Organized Markets*, Docket Nos. RM07-19-000 & AD07-7-000 (F.E.R.C. Sept. 14, 2007). This policy excludes information regarding individual companies, an

The rationale for trying to keep bids anonymous is that competitors will gain an advantage, and be better able to game the market, if the names of bidders are not obscured. Many people have noted that any market participant with a working knowledge of the regional market and generation units can identify individual bidders with a small degree of additional effort. In general it is non-participants, including the public, who are unable to “decipher the code”, not market competitors. Consequently, the bid anonymity does little to enhance the competitiveness of the market, and merely makes the markets less transparent to non-market participants.¹⁸⁰

This ongoing issue has been addressed over and over again, but the states continue to claim that access to data is still being withheld.¹⁸¹

In a FERC docket concluding in 2004, the PJM states and PJM itself agreed to a disclosure structure in which states would sign non-disclosure agreements and PJM would approve the disclosure.¹⁸² There have been ongoing complaints about this system. For example, in a report to Virginia’s governor, the Virginia State Corporation Commission stated:

[t]he integration of Virginia’s electric utilities into PJM provides the SCC with a unique challenge in obtaining information from PJM and Virginia utilities required to monitor wholesale markets. Over the past year, the SCC and its staff sought to obtain data and information necessary to carry out the market monitoring that was envisioned by the General Assembly when the Act was first passed in 1999. To date, our staff’s efforts to work with PJM have met with mixed results. Difficulties in obtaining vital data and information leaves the Virginia State Corporation Commission unable to warrant independently that PJM’s competitive wholesale electricity markets are effectively competitive.¹⁸³

Finally, even if the state commission can retrieve the data it needs, it still must come up with funding to monitor a market over which it has little

exclusion objected to by the Massachusetts Attorney General. Comments of the Massachusetts Attorney General, *Wholesale Competition in Regions with Organized Electric Markets*, Docket Nos. RM07-19-000 & AD07-7-000, at 5 (Sept. 14, 2007).

179. SYNAPSE ENERGY ECONOMICS, INC., BEST PRACTICES IN MARKET MONITORING: A SURVEY OF CURRENT ISO ACTIVITIES AND RECOMMENDATIONS FOR EFFECTIVE MARKET MONITORING AND MITIGATION IN WHOLESALE ELECTRICITY MARKETS (2001), <http://www.synapse-energy.com/Downloads/SynapseReport.2001-11.PJM.Best-Practices-in-Market-Monitoring.01-60.pdf>.

180. *Id.* at 27.

181. The FERC has established a proposal to begin to address some of these concerns in its recent ANOPR:

The Commission proposes that state commissions may make requests for additional information from the MMUs. The Commission understands that information such as general analyses of the market and aggregated price data may assist state commissions in performing their regulatory functions, and believes reasonable requests along those lines may be appropriate . . . The Commission believes that the foregoing proposal allowing states to request tailored information should be for information regarding general market trends and performance, not information designed to aid state enforcement or related actions against individual companies. States have their own enforcement agencies which are more properly employed for such tasks.

Wholesale Competition ANOPR, *supra* note 9, at 36,293. “However, if during the ordinary course of its activities an MMU were to discover evidence of wrongdoing that was within a state commission’s jurisdiction, it is expected that the MMU would report such information to the state commission.” *Id.* n.102.

182. *Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices*, 107 F.E.R.C. ¶ 61,108, at P 19 (2004).

183. STATE CORP. COMM’N, COMMONWEALTH OF VA., STATUS REPORT: THE DEVELOPMENT OF A COMPETITIVE RETAIL MARKET FOR ELECTRIC GENERATION WITHIN THE COMMONWEALTH OF VIRGINIA iv-v (2006), http://www.scc.virginia.gov/caseinfo/reports/2006_intro.pdf.

regulatory authority. Market monitor reports are available, but the market monitors are in no way accountable to individual states.

E. Section 205 Filing Rights

The question of “Who gets Federal Power Act section 205 filing rights?” was a major stumbling block for the establishment of several RTOs.¹⁸⁴ The reasons for this are clear: these rights allow the holder to make rate change filings directly to the Commission.¹⁸⁵ The RTO, by internal negotiations, cannot define who gets filing rights. It can propose solutions to the filing rights question and file a tariff, but the FERC has independent responsibility to look to the Federal Power Act to determine rights, as does the judiciary in reviewing FERC decisions.

After wrangling by stakeholders and the emerging RTOs, the FERC has allowed two entities to hold § 205 rights regarding RTO actions. First, RTOs maintain § 205 rights “that apply to the rates, terms and conditions of transmission services over the facilities operated by the RTO.”¹⁸⁶ These rights include:

- (1) filings regarding transmission customer payments to RTOs to recover costs paid to owners;
- (2) filings regarding their own costs;
- (3) filings to “propose any other changes in the rates, terms, and conditions of service to the transmission customers.”¹⁸⁷

Second, transmission owners retain § 205 filing rights for issues regarding RTO payments to owners for anything related to use of their facilities.¹⁸⁸ According to the FERC, states (via public utility commissions or state groups such as Regional State Committees [RSCs])¹⁸⁹ do not have § 205 rights (at least with regard to ISO-NE).¹⁹⁰ States and RSCs can still intervene in any FERC docket that has been opened by those who hold § 205 rights.¹⁹¹ They can also

184. Telephone Interview with Paul Peterson, Senior Associate, Synapse Energy Economics (Mar. 15, 2007) (notes on file with author). Section 205 is shorthand for Section 205 of the Federal Power Act of 1933, 16 U.S.C. § 824d (2000).

185. While anyone may challenge the reasonableness of a utility rate under section 206, holders of section 205 filing rights may file for rate changes without showing that the current rate is unreasonable. Under section 205, the burden of proof is merely “to show that the increased rate or charge is just and reasonable.” Federal Power Act of 1933, § 205(e), 16 U.S.C. § 824d(e) (2000). Section 206, however, requires a showing “that any rate, charge, classification, rule, regulation, practice, or contract is unjust, unreasonable, unduly discriminatory, or preferential.” Federal Power Act of 1933, § 206(b), 16 U.S.C. § 824e(b) (2000).

186. Order No. 2000, *supra* note 14, at 858.

187. *Id.*

188. Order No. 2000, *supra* note 14, at 858.

189. *See infra* Part IV.C.

190. *ISO New England, Inc. v. New England Power Pool*, 106 F.E.R.C. ¶ 61,280, at P 79 (2004) (FERC Order Granting RTO status subject to Fulfillment of Requirements and establishing hearing and settlement judge procedures). “Finally, for the reasons noted above, we will reject NECPUC’s request that the Regional State Committee be given concurrent filing rights along with the Transmission Owners over rate design changes. The FPA grants Section 205 filing rights to public utilities only, and the Regional State Committee will not be a public utility.” *Id.*

191. *Mississippi Power Co.*, 36 F.P.C. 133, 134 (1966) (stating that “[t]he [public utility] may at any time file rate changes pursuant to § 205(d) of the Federal Power Act unless precluded from doing so by contractual commitments. In addition, any person, including the [public utility], may at any time raise by complaint the

seek a hearing under § 206, although the standard for consideration of such Section 206 petitions may be more stringent than for Section 205 filings (at least in theory, if not in practice).

IV. CHALLENGES TO RTO ACCOUNTABILITY

The debate about to whom RTOs should be accountable has persisted since their inception. The simple and most obvious answer is that RTOs should be accountable to the FERC and its perception of the public interest; but how this works in practice is another question entirely.¹⁹² Because the FERC has not explicitly conditioned the creation of market-based rates on the creation of RTOs, the RTOs are in effect voluntarily established by private parties.¹⁹³ This requires cooperation of several private interests, as stated above. But once the RTO is established, who can decide whether or not an RTO is acting for the public interest?

A. *The RTO Accountability Problem*

1. Many Entities Claim Accountability

The first part of the problem is that many entities can (and do) claim that the RTO is accountable to them. While much has been said about RTO independence, particularly from market participants, it still is accountable (both formally and informally) in several different areas to several different entities.

First, and most broadly, RTOs should be accountable to the public interest. Each citizen who uses and pays for energy from each RTO's distribution region has a stake in the outcomes of the market system. The FERC is allowing wholesale markets because when they are truly competitive these markets will, according to the FERC, provide "just and reasonable" rates.¹⁹⁴ In the broadest sense, the RTO is accountable to each and every citizen for ensuring that they receive just and reasonable rates (at least in the wholesale market).¹⁹⁵

Second, RTOs should be, and legally are, accountable to the FERC.¹⁹⁶ As stated above, the FERC approves each RTO's organization and origination documents and decides ongoing questions and issues. This accountability question has been addressed by Chairman Kelliher: "RTOs are not self-regulating organizations; they cannot set rules and enforce rules unilaterally . . . we set and enforce the rules, so we're ultimately responsible."¹⁹⁷ The FERC is

issue of lawfulness of the rate level and request a hearing thereon before the Commission in another proceeding.").

192. Order No. 2000, *supra* note 14, at 811.

193. There are significant questions about whether FERC has the authority to require transmission owners to form RTOs. *Atlantic City Elec. Co. v. FERC*, 295 F.3d 1 (D.C. Cir. 2002). That issue differs from a policy of stating that market-based rates can be assumed to be just and reasonable only if the underlying market is managed by an adequately independent RTO.

194. Order No. 2000, *supra* note 14, at 840.

195. Note here that we are not arguing that RTOs are directly accountable to states. However, below, we argue that the states are important representatives of the public interest as expressed here.

196. Conference Transcript, In re *Review of Market Monitoring Policies*, Docket No. AD07-8-000, at 219 (F.E.R.C. Apr. 16, 2007).

197. *Id.* at 90.

responsible for enforcing the “just and reasonable” wholesale rates mentioned above and, as such, oversees the RTOs.¹⁹⁸

Third, RTOs matter to market participants. Depending on the type of decision and the RTO in question, different participants can play an advisory role or they can directly impact the RTO’s actions.¹⁹⁹ This is especially true because RTOs are voluntary organizations and certain stakeholders have the ability to exit while others do not.²⁰⁰ In addition, in at least one RTO, the stakeholders can hold the RTO’s board accountable because they directly elect that board.²⁰¹ It is important to remember that these participants have different needs—and different influence levels—even though they are all stakeholders.²⁰²

Fourth, as a practical matter, RTO actions have vital significance for the states. The operation of an RTO in a state affects all of the citizens of that state and cumulatively plays a significant role in the state’s economy. Additionally, short of the transmission corridors for which the FERC has backstop authority, the states must approve transmission lines. Many states must approve new generation, and states also regulate reserve margins. RTOs fall within the “gray area between state and federal oversight” and as such, they are (or should be) accountable to the states.²⁰³ All of these matters affect the success of RTOs.

The diversity of interests that have a stake in the RTO’s decision-making makes operation of the RTO a balancing act between stakeholders who “are not equally important.”²⁰⁴ The diversity of groups the RTO is accountable to in some ways reflects the many “lenses” through which RTOs may be viewed.²⁰⁵

198. *Public Util. Dist. No. 1 of Snohomish County. v. FERC*, 471 F.3d 1053 (9th Cir. 2006).

199. Some argue that RTOs should be held accountable to the market participants who have the most to lose if the markets are not efficient. For example, Sam Randazzo, an attorney for industrial end-users in Ohio, argues that control over the RTO should be vested in those who hold the residual risk and have the opportunity for largest residual gain from the organization’s efficiency. Sam Randazzo, General Counsel, Industrial Energy Users-Ohio, Speech before the Harvard Energy Policy Group: Spotlight on the RTO Board: Governance (Apr. 3, 2002), <http://www.ksg.harvard.edu/hepg/Papers/Randazzo%20RTO%20Gov%204-02%20Atlanta.pdf>.

He argues that the current transmission system requires transmission-dependent customers to bear a “significant residual risk” and that independent merchant generators also hold some risk. *Id.* at 12. Thus, according to Randazzo, the “accountable to whom” question is answered by “transmission dependent customers and independent merchant generators.” Randazzo, *supra* note 199, at 12.

200. Memorandum from Roy Thilly, President and Chief Executive Officer of Wisconsin Public Power, Inc. to Mariah Sotelino (Sept. 25, 2007) (stating that the “voluntary structure adopted has ended up leaving those entities [who can exit, including transmission owners] with disproportionate influence”).

201. For example, this occurred in MISO last year. See Order No. 2000, *supra*, note 14.

202. Consider, for example, the FERC testimony of Lloyd Webb, Procurement Manager of Eastman Chemical Company:

All stakeholder processes are skewed in favor of supply-side interests. While the interests of supply-side participants are diverse on many supply-related issues, it is not so diverse on issues of importance to demand-side interests, and we often see supply-side interests quickly converted to unanimity on these issues. Thus, supply-side interests can often stop any initiative with strong demand side support, but demand side interests cannot stop any initiative with strong supply-side support.

Technical Conference, *Conference on Competition in Wholesale Power Markets*, Docket No. AD07-7-000, at 211 (F.E.R.C. May 8, 2007).

203. *Id.* at 192; see also *infra* Part IV.B.4.

204. NANCY VALLEJO & PIERRE HAUSELMANN, INT’L INST. FOR SUSTAINABLE DEV., GOVERNANCE AND MULTI-STAKEHOLDER PROCESSES 3 (2004), http://www.iisd.org/pdf/2004/sci_governance.pdf.

205. See *supra* Part II.B.

All of these strings pulling RTOs in different directions make holding them accountable to those that need them most—the public—even more difficult.

2. Non-Profit Nature of RTOs

A second problem in terms of RTO accountability is their non-profit nature. As stated above, all of the RTOs are, functionally or legally, currently non-profits. A non-profit is not “financially responsible for its actions since it has no equity at risk and must have the ability to pass along all of its costs to market participants in order to make credible commitments to pay those who provide it with services.”²⁰⁶ This is similar to the “moral hazard” argument that “where the party bearing risk [e.g., end users] is not the party managing risk [the RTO], there is an increased danger that the risk of financial loss will be greater.”²⁰⁷ The non-profit structure, therefore, requires that the ISO’s Board must “establish clear performance goals, to monitor managerial performance in achieving these goals, and to reward managers for meeting or beating the goals and to penalize them when performance falls short.”²⁰⁸ However, setting and measuring goals is difficult because RTOs have so many different responsibilities and interests at stake.²⁰⁹

The FERC’s regulation is essential to assuring that RTOs meet the public interest (with the help of stakeholder and state filing authorities, depending on the circumstances). But it is difficult for even the FERC to hold the RTOs accountable for their decisions. The FERC can approve or disapprove proposals, it can strongly suggest certain future actions, but it cannot (in lieu of illegal actions) withdraw managers or board members.²¹⁰ Those responsibilities fall to the boards and the stakeholders of the various regions (depending on the RTO).

First, their non-profit status “makes cost review more difficult.”²¹¹ Like a government-sponsored enterprise, “[s]anctioning the [RTO] for failure to fulfill its public policy purpose would then make fulfillment of its public policy purpose that much more difficult[.]”²¹² In other words, taking away funding from RTOs may not be the way to keep the lights on at an affordable price. RTOs are expensive to run and expensive to oversee.

Moreover, the FERC generally allows all RTOs to recover their expenditures. Non-profit RTOs or those like PJM which own no assets “do not absorb losses and instead pass through all costs that they incur.”²¹³ Thus, if an

206. PAUL JOSKOW, MASS. INST. OF TECH., COMMENTS IN RESPONSE TO FERC RULEMAKING ON REGIONAL TRANSMISSION ORGANIZATIONS 20 (1999), http://econ-www.mit.edu/faculty/download_pdf.php?id=535.

207. KOPPELL, *supra* note 52, at 136.

208. PAUL JOSKOW, MASS. INST. OF TECH., COMMENTS IN RESPONSE TO FERC RULEMAKING ON REGIONAL TRANSMISSION ORGANIZATIONS 20 (1999), http://econ-www.mit.edu/faculty/download_pdf.php?id=535.

209. *See infra* Part IV.B.2.

210. California Indep. Sys. Operator Corp. v. FERC, 372 F.3d 395 (D.C. Cir. 2004).

211. *See* Financial Reporting and Cost Accounting, Oversight and Recovery Practices for Regional Transmission Organizations and Independent System Operators, 69 Fed. Reg. 58,112 (2004).

212. KOPPELL, *supra* note 52, at 44.

213. *See, e.g.*, Financial Reporting and Cost Accounting, Oversight and Recovery Practices for Regional Transmission Organizations and Independent System Operators, 69 Fed. Reg. 58,112 (2004) (*e.g.*, NYISO has a separate charge for unbudgeted expenses; Midwest ISO’s Schedule 10 charge, while capped at \$0.15/MWh,

RTO acts imprudently, the FERC can reduce its rates but the loss would fall on the ratepayers, not the RTO.²¹⁴ However, in a recent example, the FERC rejected a MISO proposal for passing through costs of Reliability Standard violations to customers, instead announcing a technical conference to consider the problem of distributing reliability responsibilities.²¹⁵ In essence, any material and persistent penalty can be sustained only by a reduction in operations because the transmission owners will not have recovered their rates.

B. The Public Interest Problem

One element to keep in mind when considering the challenges to RTO accountability is that, as the FERC affirms, RTOs must perform a multitude of wide-ranging tasks. Having a variety of goals can be a complicating feature for those interested in good governance.²¹⁶ When RTOs are asked to balance between several different interests and outcomes, it makes designing a framework that holds each of these interests in check very difficult. For example, research on the design of regulatory bodies suggests that when an agency has multiple objectives, interest groups can use the different objectives to “influence the trade-off between the objectives.”²¹⁷ Meanwhile, reliance on general goals, such as “the public interest,” can result in similar problems.²¹⁸

Moreover, the public’s interest in RTO decision-making is extremely difficult to particularize. Stakeholders’ interests diverge dramatically. First, industrial, residential, and commercial customers have different needs and interests in the wholesale market. Second, there is geographic diversity between customers in different states. The needs of customers in a rural state with significant generation capacity are different from those in urban centers. Third, there is diversity in temporal interests (e.g., inter-generational equity issues).

allows for the deferral, with interest, of any costs which would cause the rate to exceed the cap during one period to be recovered during a later period when actual costs for that period are less than the capped rate).

214. Telephone Interview with Harvey Reiter, Partner, Stinson Morrison Hecker, LLP (Feb. 9, 2007). (notes on file with author).

215. Order Rejecting Tariff Changes Without Prejudice and Establishing Technical Conference, 119 F.E.R.C. ¶ 61,222, at P 5 (2007).

216. Some suggest that RTOs have or should have a singular, measurable goal of “just and reasonable rates be the lowest possible rates.” See, e.g., Comments of the Transmission Access Policy Study Group, *Wholesale Competition in Regions with Organized Markets*, Docket Nos. RM 07-19-000 & AD7-7-000 (F.E.R.C. Sept. 14, 2007). To a large extent, we agree, formulating the goal of RTOs as serving the public interest in maintaining just and reasonable rates. However, we add that attention must be given to balancing the short-term “lowest possible reasonable rate” with the intergenerational and geographic disparities between ratepayers. This is where such a singular RTO goal can become more complicated and harder to measure. See also Comments of the Massachusetts Attorney General, *Wholesale Competition in Regions with Organized Markets*, Docket Nos. RM 07-19-000 & AD7-7-000, at 8 (F.E.R.C. Sept. 14, 2007) (“[I]f the requirement to consider least-cost alternatives were made explicit in ISO-NE’s obligations, or if at the very least the executive compensation incentives to plan for system reliability were balanced with incentives to reduce the overall energy and transmission costs to end users, the existing ISO-NE and stakeholder institutions and processes will be more likely to achieve just and reasonable rates. Although there may be differences of opinion as to the meaning of “least cost,” based on regional interests or short- versus long-term concerns, the Massachusetts Attorney General submits that such issues could be resolved by consensus through regional stakeholder processes.”).

217. Dieter Helm, *Regulatory Reform, Capture, and the Regulatory Burden*, 22 OXFORD REV. ECON. POL’Y 169, 181 (2006).

218. *Id.* at 182.

Some consumer interests militate toward low prices immediately, while others would like lower prices and public goods (such as air quality) in the long run. The combination of these three tensions means that any single interest group—like one of the wise men touching the elephant—may refuse to recognize the legitimacy of what other interests see as essential.

To preserve the public interest in RTO decision making, individual interests must be aggregated in some way to make combined interests effective. However, organizing such a large and diverse group creates a collective-action problem.²¹⁹ One might expect such aggregation to occur through state-appointed and state-elected representatives. After all, they have the responsibility for representing the public interest in energy decisions. However, this has not been the case across the board. Regulatory officials cannot bind themselves to decisions which they do not control; furthermore, as discussed below, future related adjudications in state regulatory bodies can hamper participation.

1. Capture

Capture is “the process by which vested interests bias the incentives of regulators and governments to act in their interests rather than the broader public interest.”²²⁰ “In general, large, heterogeneous groups with relatively small per capita stakes and which are otherwise unlikely to organize will be disadvantaged relative to small, homogeneous groups with high per capita stakes that are already organized.”²²¹ Analogizing to the regulatory capture literature, stakeholder groups, or incumbent management, can become a means for dividing up rents between organized groups, while less organized groups are left out in the cold.²²²

In the regulatory context, some have argued that capture can result in “favourable regulation by vote-seeking politicians.”²²³ However, RTOs are sheltered from the federal political process: they are regional organizations, impacting only a portion of the federal voting public; they are regulated by the

219. Robert Michaels, who has been a skeptic of the current RTO systems and an advocate for for-profit transcos, summarizes these problems:

The theory of political participation predicts substantial activity by preexisting organized interests whose members have few conflicts among themselves, large amounts at stake, and low costs of influencing the process, whether out-of-pocket or foregone market opportunities. Those without interests that are unorganized, whose members compete with one another, and whose costs cannot be recovered in the regulatory process have generally been a smaller presence in ISO formations. . . . Small consumers who have low individual stakes and little organization are least likely to represent themselves, save for advocacy groups whose dues-paying membership includes relatively few of them.

Robert J. Michaels, *The Governance of Transmission Operators*, 20 ENERGY L.J. 233, 246 (1999). Michaels does not consider, in the quoted text above, the ability of consumer advocates and attorneys general to represent (with whatever difficulties) the aggregated interests of consumers. Prof. Michaels states that one barrier to participation has been that “[f]ew if any ISO formations have proceeded under rules which allow cost recovery by participants who can claim financial hardship.” *Id.* at 246 n.47.

220. Dieter Helm, *Regulatory Reform, Capture, and the Regulatory Burden*, 22 OXFORD REV. OF ECON. POL’Y 169, 174 (2006).

221. RICHARD SCHMALENSEE & ROBERT WILLIG, *HANDBOOK OF INDUSTRIAL ORGANIZATION VOL. II* 1265 (Elsevier Science Pub Co. 1989).

222. *Id.*

223. Ernesto Dal Bó, *Regulatory Capture: A Review*, 22 OXFORD REV. OF ECON. POL’Y 203, 206 (2006).

FERC, whose authority is established by congressional actions; and their decisions are complex and difficult to understand—neither Congress nor the FERC has found the resources necessary to delve into that level of detail. These are all elements that make this vote-seeking less likely, though possible, if enough questions are raised about their efficacy.²²⁴

Some argue that price and market-based systems are less likely to be influenced by capture.²²⁵ This is because firm-specific lobbying is less successful when the regulators “do not set prices for individual firms.”²²⁶ However, RTOs do set market rules that benefit one group of participants over another—for example, a rule can benefit generators over customers or vice versa. In this case, the efforts of the generators to establish a rule that is beneficial to them is akin to that of an individual firm in the command-and-control setting. The RTO decision-making process is one that inherently creates winners and losers. Finally, as we discussed earlier, the non-profit nature of RTOs makes regulatory leverage less effective than with for-profit businesses.

2. Public Representation in the Stakeholder Process

The complicated, technical, and expensive structure of the stakeholder process results in serious challenges for public representation. There are several interrelated difficulties associated with the current structure for ensuring that the consumer interest is represented and has the opportunity to hold RTOs accountable, not just when there are major choices being made, but in the day-to-day decisions the RTO makes.²²⁷

First, applying our example of ISO-NE, it is important to state that the stakeholder process in ISO-NE does not inherently disfavor the public interest. The structure requires that either 60% or 66 2/3% of the participants agree in order to take particular actions (depending on the decision being made).²²⁸ Each of the six sectors get 16 2/3% of the vote (assuming the Alternative Resources sector is completely filled out), so to reach 60% a mixture of several sectors is necessary—two sectors can nearly kill any proposal, and three can definitely inhibit one proposal.²²⁹

However, this may not be true in all stakeholder processes. There are some stakeholders who claim that they should have been consulted when an RTO made certain decisions, and who allege that they have not been allowed to participate. For example, a coalition of stakeholders claimed that the California

224. See *infra* Part II.E.

225. Dieter Helm, *Regulatory Reform, Capture, and the Regulatory Burden*, 22 OXFORD REV. ECON. POL'Y 169, 183 (2006) (citing the “combination of command-and-control and revolving doors” as aggravating the revolving door problem).

226. *Id.*

227. When there are simplified, highly visible structure choices, such as whether to have a single, nationwide Standard Market Design, or whether perceived future capacity needs require LICAP (locational installed capacity), then the states sometimes can play a significant role. However, regarding other decisions, the ones that cumulatively may make a larger impact on the public, the states are likely to be significantly less successful. Helm, *supra* note 225, at 184. See, e.g., William H. Smith, *Formation and Nurture of a Regional State Committee*, 28 ENERGY L.J. 185, 187 (2007) (noting that “[i]n several cases, critical decisions had been made before states could prioritize the dockets they should intervene in.”).

228. PARTICIPANTS AGREEMENT, *supra* note 85, § 11.1.2.

229. *Id.* § 1.1.

ISO (CAISO) did not consider stakeholder views regarding a marginal loss rule. These stakeholders claimed that the CAISO refused to discuss the issue with them.²³⁰ In another example, Electricity Consumers Resource Council (ELCON) (originally a supporter of restructuring) argues that “[a]ctive resistance to demand response is pervasive within the governance structures of ISOs and RTOs . . . with a coalition of suppliers who would lose money if loads were dispatched off, rather than generation dispatch up.”²³¹ It is difficult enough for the public interest to be represented in the stakeholder process when there is a sense that the structure is fair, but when the structure itself does not provide legitimacy to the undertaking, diminished representation of the public interest can be catastrophic. Despite the protections included in the stakeholder process, concerns about representation of the public interest are strong. Participation in membership organizations can be prohibitively costly. As alluded to above, these “monitoring costs” are extremely high.²³² The RTOs and market participants play in a highly technical world of acronyms, complex engineering, and economics. Participation in the daily grind of RTO decision-making and FERC oversight requires not only technical understanding but a great deal of time.²³³ In comparison with large organizations that will be dramatically impacted by an RTO’s decisions, individual energy users have extremely high costs of participation in stakeholder processes compared with the potential benefits.²³⁴

Thus, large companies that have a great deal at stake in the market can overwhelm the process because they can invest so much more in the stakeholder processes. Smaller organizations, regulatory representatives, and public interest groups have less money to participate, so it is harder for them to meaningfully do so. Even if representatives of the public interest (both governmental and non-governmental) have a designated seat at the table (for example, as members of the “end user” stakeholder group), if there are very few actual human beings representing the public interest in the room and participating in negotiations, they are less likely to be heard.²³⁵

230. Request for Rehearing of the Coalition Contesting the Use of Marginal Losses in MRTU, *California Indep. Sys. Operator Corp.*, Docket No. ER06-615-000 (F.E.R.C. Oct. 23, 2006). In this case, according to the pleadings, the FERC did not respond to the parties’ complaints about participation.

231. Supplemental Comments of the Electricity Consumers Resource Council (ELCON), *Conference on Competition in Wholesale Power Markets*, Docket No. AD07-7-000, at 13 (F.E.R.C. Mar. 12, 2007), <http://www.elcon.org/Documents/FERCFilings/3-13Supplemental%20Comments%20AD07-7-000.pdf>.

232. Michael Levine & Jennifer Forrence, *Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis*, 6 J.L. ECON. & ORG. (SPECIAL ISSUE) 167 (1990); See also AMERICAN PUB. POWER ASS’N, ON THE GROUND: PUBLIC POWER UTILITY EXPERIENCES IN WHOLESALE ELECTRICITY MARKETS 6, 12 (2007), <http://www.appanet.org/files/PDFs/OnTheGround.pdf>.

233. This is evidenced by the fact that two sectors (End User and Public Power) were unrepresented at a recent NEPOOL Reliability Committee meeting. Comments of NSTAR Electric Co., *Wholesale Competition in Regions with Organized Markets*, Docket Nos. RM 07-19-000 & AD7-7-000, at 11 (F.E.R.C. Sept. 14, 2007).

234. In addition, the diffusion of interests in the stakeholder process potentially allows incumbent management (a more cohesive group and one with the most intense interest in the outcome) to dominate the process.

235. Telephone Interview with Paul Peterson, Senior Associate, Synapse Energy Economics (Apr. 12, 2007) (notes on file with authors).

A related concern is that a minority of stakeholders can slow down progress by employing “process.” This not only can keep the RTO from moving forward (in the hope that it will find middle ground and avoid a battle at the FERC level), but it also increases costs for other stakeholders. If there is discord among the participants and the RTO decides to go forward to the FERC anyway, the FERC can suggest that the RTO go back and adjust the proposal to find greater support.²³⁶ This affords stakeholders more power in the process, but also draws it out temporally and waters down innovation. In addition, the culture of the electric industry, in which generation and transmission players “maintain insider status” does not promote the public interest.²³⁷ Stakeholders without this status “depend on a real, functioning market and are the most likely victims of market failures.”²³⁸

Another criticism is that these time-consuming negotiations are attended by middle managers. This means, according to some participants, that the representatives are less flexible and less innovative than the top brass might be. They are given marching orders and may hesitate to deviate from them. Compromises that might be beneficial to many parties are left on the table by people who do not have the authority to suggest them, much less commit to their approval.²³⁹

Finally, regarding representatives of state interests such as Public Service Boards and Public Utility Commissions, there are difficult ethical complications (sometimes rising to ethical issues) associated with active membership in the stakeholder groups. These commissions often have to make rulings on intrastate issues regarding the same entities that are fellow stakeholders at the RTO, creating difficult interactions and ethical considerations. Participation in detailed negotiations on these matters with some—but not all—of the parties who may later appear before the state commissions can make it challenging in both appearance and substance to treat all parties equally in future state-contested case proceedings. For example, imagine yourself as a litigant opposing the siting of a power generating facility. Imagine that the commissioner hearing the siting dispute has negotiated, in detail, the provisions of an RTO tariff designed to encourage such facilities. Imagine further that the party opposing you in this litigation (i.e., the generator) was a party to those negotiations. Will you have full faith in the ability of the commissioner to hear your arguments with an open mind?

236. Repeatedly, where parties seek FERC resolution of an issue, FERC issues an Order partially resolving the matter, and relies on the parties for completion and to “fill in the details.” The effect, of course, is to encourage parties with deep resources or an interest in the status quo to apply a strategy of “what’s mine is mine, what’s yours is negotiable.” For example, consider the NESCOE, a proposed Regional State Committee discussed below in section III.C.3.

237. Charles H. Koch, Jr., *Collaborative Governance in the Restructured Electricity Industry*, 40 WAKE FOREST L. REV. 589, 602 (2005).

238. *Id.* Interestingly, Michaels seems to agree with Koch’s assertion, stating that “ISOs are supported by those who have been best at playing the politics of traditional regulation, and opposed by those who have generally been less successful.” Robert J. Michaels, *The Governance of Transmission Operators*, 20 ENERGY L.J. 233, 260 (1999).

239. Telephone Interview with Roy Thilly, President and Chief Executive Officer of Wisconsin Public Power, Inc. (Mar. 26, 2007) (notes on file with author).

These criticisms highlight our underlying conclusion—stakeholder processes fail to fully represent the needs of the public interest. Outspent, outnumbered, and procedurally encumbered, representatives of the public interest cannot fairly compete in the stakeholder process even when the process itself is deemed equitable.

3. The Value of State Regulators

State regulators have many attributes that would offer helpful knowledge bases to RTO regulation.²⁴⁰ First, they have local knowledge that is vital to the planning for demand and the siting of future energy capacity projects. Second, many states have a broad mandate that encompasses the long-term non-market implications of RTO decision-making.²⁴¹ For example, many state commissions must take environmental impacts into account as part of their general authority and responsibilities, and even more take into account issues like efficiency and conservation through resource planning processes, emphasizing the long-term implications of RTO decision-making.²⁴² In addition, state regulators are closer to the state and regionally-based problems with which RTOs must deal. Their expertise is in dealing with the retail end of the electricity structure, and that means advocating for end users, in contrast with the FERC's experience with the wholesale markets. In some ways, because of their proximity to the end users, it may be true that these regulators will more easily be held accountable for their decisions.²⁴³ Finally, while the legitimacy of RTOs is under strain, state-based involvement in these markets could increase the RTOs' responsiveness to public concerns.²⁴⁴

At the same time, the states, as yet, have not played a day-to-day role in RTO decision-making. Since these organizations were established, state regulatory bodies have struggled to determine what their role is in this new system regarding the markets, reliability determinations, and future planning.

240. As the Vermont Public Service Board and the Vermont Department of Public Service observed about six years ago, "We do believe that it would be advantageous to set up a formal institutional structure for making such joint decisions [in regard to siting]" Wood Letter, *supra* note 13, at 9.

241. See *supra*, note 5 (regarding state and federal mandates to consider the public interest).

242. Michael Dworkin et al., *Revisiting the Environmental Duties of Public Utilities Commissions*, 7 VT. J. ENVTL. L. 6 (2006); Michael Dworkin et al., *The Environmental Duties of Public Utility Commissions*, 18 PACE ENVTL. L. REV. 325 (2001).

243. This accountability issue is complicated and has been investigated thoroughly regarding public commissions. This is because they are often separated from the political process by executive-level appointment instead of election. However, in many ways, they are still closer to the issues raised by RTOs than the FERC.

244. Consider, for example, the testimony of James Brew, representative for the Steel Manufacturers in front of the FERC regarding RTO governance: "The RTOs, just as they did in demand response, have a slant to pay the generators first and one of the ways in which I think we've gotten off track in developing the wholesale markets is that the state's role to the RTO has become largely advisory, yet they have to do the work on transmission pricing." In re *Conference on Competition in Wholesale Power Markets Before the Federal Energy Regulatory Commission*, Docket No. AD07-7-000, at 145 (F.E.R.C. Feb. 27, 2007) (statement of James Brew, Representative, Steel Manufacturers).

4. State Participation in Other Processes

There are several means outside the stakeholder process by which the public interest can be represented.²⁴⁵ Again, using New England as an example, currently the most important informal relationship is between the New England Conference of Public Utilities Commissioners (NECPUC) and ISO-NE.²⁴⁶

NECPUC has participated as a third party since the RTO's inception and in many issues that have been decided since then. Formally, one of the approximately twelve members of the Joint Nominating Committee for the ISO-NE board members is a representative of NECPUC.²⁴⁷ Informally, the ISO-NE board and staff meet with NECPUC several times a year, but do not have any formal requirement to do so; nor do they have any formal requirement to adhere to any NECPUC requests. In the big decisions, it appears that the FERC takes NECPUC's recommendations extremely seriously.²⁴⁸ However, NECPUC does not participate in the RTO's decision-making on a day-to-day basis.

NECPUC, which is outside of most stakeholder processes, does not have a formal role in many material decisions. Thus, NECPUC must rely on the informal relations described above. These informal relationships are vital, and the communications between decision-makers is important, but an informal communication process, if handled haphazardly, can result in RTO management having an incomplete understanding of the issues from the state's perspective, and in recurring appeals to the FERC to implement the Commission's stated interest in cooperation and intraregional concurrence. Some of these problems are being addressed through Regional State Committees, more formal groups that have been, and are being, established across the country.²⁴⁹

C. The Regional Problem and State Involvement

Structurally, one of the most difficult issues pertaining to many RTOs is their regional scope—usually bigger than a state and smaller than a nation. The RTO, via its governance process, as set out above, makes decisions at a regional level. There is no elected or appointed government at the regional level to

245. It is important to remember that informal communications happen between all parties, and that many participants in RTO decision-making believe that transmission owners and generators, through informal meals and conferences, are best able to make sure that the RTOs are aware of their needs and desires. This sense, whether or not it is true, also enhances the legitimacy problems that RTOs are currently facing.

246. This is likely to change slightly when the Regional State Committee (NESCOE) is established. See NEPOOL, PARTICIPANTS COMMITTEE MEETING AGENDA (2006), http://www.iso-ne.com/committees/comm_wkgrps/prtcpnts_comm/prtcpnts/mtrls/2006/sep82006/supplemental_notice_sept8.pdf.

247. PARTICIPANTS AGREEMENT, *supra* note 85, § 13.1.2. The actual construction of the nominating committee is slightly more complicated.

248. For example, on very high profile decisions, such as the creation of four RTOs for most of the United States, the FERC withdrew its proposals in response to state opposition/state concerns. See, e.g., John S. Moot, *Economic Theories of Regulation and Electricity Restructuring*, 25 ENERGY L.J. 273, 314 (2004) (regarding Standard Market Design, "State opposition was not particularly surprising, given the natural bureaucracy competition for power, but it was nearly fatal to SMD due to state influence in Congress and the states' potential veto power over the transfer of operational control to an RTO").

249. See *infra* Part IV.B.1.

regulate RTO decisions.²⁵⁰ The RTO is regulated at the federal level via FERC oversight. The impacts of these federal and regional decisions are felt by consumers locally, and depending on the decision, regionally. The outcome is that the regulatory process for RTOs does not align with their impacts.²⁵¹

Part of the reason for this may be because the FERC's original intent was a few regional RTOs that would be much more national in scope than what has actually occurred.²⁵² In reality, several individual states have their own RTOs, such as New York (NYISO), Texas (ERCOT), and California (CAISO). Regional RTOs include consumers in as few as six and as many as fourteen states, and a Canadian province. Thus, the regulatory process and the public interest are not parallel constructs. The FERC, meanwhile, is headquartered in Washington, D.C., and oversees six RTOs and the rest of the country, which operates in several bilateral markets. While it is the FERC's job to make sure that the public interest is represented in each RTO's actions (remember those just and reasonable rates), this is a difficult job with hundreds of moving parts in any one RTO, much less the nation as a whole. The FERC is just not suited to hear locally-oriented issues or complaints about regional decisions; its size, skill-set, institutional knowledge, and jurisdictional roots leave the FERC with limited awareness of the impacts its actions have on end users.²⁵³

One means of regionalizing state oversight is the creation of Regional State Committees (RSCs). The FERC promoted the formation of RSCs through its 2002 Standard Market Design Notice of Proposed Rulemaking.²⁵⁴ The FERC highlighted several purposes of such committees, particularly involvement in transmission and resource adequacy.²⁵⁵ The FERC has since closed the Standard Market Design (SMD) docket, but RSCs have been developed in several regions, including MISO (the Organization of MISO States), PJM (the Organization of PJM States),²⁵⁶ the Southwest Power Pool (SPP Regional State Committee), and

250. California stands as one exception to this generalization—the Governor appoints Board of Governors members. FERC, ISSUE #1 - GOVERNANCE/VOTING STRUCTURE (2006), <https://www.ferc.gov/industries/electric/indus-act/rto/handbook/CAISO/1-governance.doc>.

251. Recognizing this, in 2002 the Vermont Public Service Board recommended an advisory committee to the RTO Board made up of state regulatory commissions:

We support the development of an advisory arrangement between the RTO board and the state regulatory commissions. We also believe that it is important to have a strong and healthy advisory relationship between state regulatory authorities and existing or future ISOs or RTOs. We think that state regulators' participation on the ISO-NE's existing advisory committee should be strengthened to the degree consistent with the regulators' other obligations.

Wood Letter, *supra* note 13, at 15.

252. The FERC originally envisioned four mega-RTOs spanning the continental United States.

253. It is certainly true that the FERC does work at the local level regarding hydroelectric re-licensing issues. However, there are some very significant differences between hydroelectric re-licensing and state and local RTO issues. Perhaps most importantly, regarding hydroelectric, the FERC is given very specific elements that it must consider in making decisions. RTO decisions are much more amorphous and are based on less clearly laid out congressional mandates. In addition, the historic head-count of FERC employees assigned to hydro-electric reviews is far higher on a kWh or dollar basis than for RTO assessment.

254. Vince, *supra* note 57, at 135.

255. Notice of Proposed Rulemaking, *Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design*, [2002 Proposed Regs.] F.E.R.C. STATS. & REGS. ¶ 32,563 (2002), 67 Fed. Reg. 55,551 (2002) [hereinafter SMD NOPR].

256. PJM, which originally stood for Pennsylvania, New Jersey, and Maryland, now also includes parts of Delaware, Illinois, Indiana, Kentucky, Michigan, North Carolina, Ohio, Tennessee, Virginia, West Virginia,

ISO-NE (the New England States Committee on Electricity [NESCOE], still in development).²⁵⁷ These organizations are meant to provide the RTO, “market participants[,] and the Commission with a consensus view from states in the area,” and could address “regional solutions to issues that may fall under federal, state, or shared jurisdiction.”²⁵⁸ These organizations can play vastly different roles in different regions and different governance structures.

For example, the Organization of MISO States (OMS) plays several roles. It supports the three state representatives on MISO’s twenty-three member stakeholder committee (called the Advisory Committee). These representatives are tasked with trying to represent the interests of all of the OMS states and to relay information back and forth between the Advisory Committee and OMS.

New England is an example of how difficult it can be to establish an RSC that has real involvement in the RTO decision-making process and the limits in the powers that stakeholders are willing to cede to the states.²⁵⁹ In June of 2004, the governors of New England petitioned the FERC to establish an RSC, then, a year later, the FERC responded with an order deferring action, and requesting that the petitioners and other parties (with whom they had already failed to reach agreement) return to further negotiations.²⁶⁰ Finally, in the fall of 2006, a proposal was made to, and approved by, the NEPOOL Participants Committee with 81.59% of the committee voting in favor.²⁶¹ The next step for the NESCOE will be a joint petition (by the New England States and ISO-NE) to the FERC to actually establish the funding mechanism for the organization.²⁶² Yet that next step offers a chance to revisit the previous half decade of delay while resolution is deferred.

The proposal that is currently on the table creates a not-for-profit organization which represents six states through representatives appointed by

and the District of Columbia. PJM INTERCONNECTIONS, LLC, OVERVIEW <http://www.pjm.com/about/overview.html> (last visited Aug. 26, 2007).

257. Gregory Basheda, *Regional State Committees Can Help Provide a Regional Perspective to Planning Siting Decisions, Reducing the Need for Federal Preemption*, 19 *Electricity J.* 43 (2006), available at LEXIS.

258. Vince, *supra* note 57, at 135 (quoting SMD NOPR, *supra* note 255, at PP 551, 554).

259. It is important to note the difference between RSCs and regional associations of regulatory utility commissioners. Within the National Association of Regulatory Utility Commissioners (NARUC), the public service commissions of the various states have created a set of informal regional associations for the sharing of information and for more efficient representation of their interests at the FERC, the FCC, and other decision-making bodies. These organizations do not have formal regulatory powers but they do have significant influence on some relatively high-profile decisions. However, they are not set up to offer either day-by-day, detail-by-detail participation in, or oversight of, either RTOs or wholesale power markets. In addition, it is important to recognize that the regional state commissions, such as the New England Conference of Public Utility Commissioners (NECPUC), represent independent regulatory commissions which are distinct from the legislative or gubernatorial officers of each state, such as the New England Governors’ Association (NEGA).

260. *The Governors of: Conn., Me., Mass., N.H., R.I., Vt.*, 112 F.E.R.C. ¶ 61,049 (2005).

261. NEPOOL, PARTICIPANTS COMMITTEE MEETING AGENDA ITEM #1 (2006), http://www.iso-ne.com/committees/comm_wkgrps/prtcpts_comm/prtcpts/mtrls/2006/oct132006/supp_notice_oct_13_2006.pdf. Interestingly, the voting breakdown was as follows: Generation Sector – 17.03%; Transmission Sector – 17.03%; Supplier Sector – 17.03%; Alternative Resources Sector – 14.84%; Publicly Owned Entity Sector – 0.90%; and End User Sector – 14.76%. *Id.*

262. See *infra* notes 258-260 and associated text (regarding the funding mechanism associated with RSCs).

each governor.²⁶³ The goal of the organization is “to represent the interests of the citizens of the New England region by advancing policies that will provide electricity at the lowest possible price over the long term, consistent with maintaining reliable service and environmental quality.”²⁶⁴ The NESCOE would work in two policy arenas: (1) resource adequacy, and (2) system planning and expansion. These areas include tariff changes and market rules, siting issues (working with both NECPUC and the Power Planning Committee), an emphasis on renewable energy, and the states’ position on the annual Installed Capacity Requirement (ICR) (which is important, because ICR is outside of NECPUC’s jurisdiction). Regarding ICR, the NESCOE will have a representative at NEPOOL meetings who will vote on ICR so that the representative can present the NESCOE’s position.²⁶⁵

Importantly, the NESCOE is to become an “Individual Participant” in NEPOOL,²⁶⁶ but will not have a NEPOOL vote.²⁶⁷ Accordingly, the “NESCOE [will] engage in regular and active participation in the established NEPOOL and PAC stakeholder consultation process.”²⁶⁸ This means that while the NESCOE will be able to participate in NEPOOL as an observer, it will not be able to vote in NEPOOL decisions.²⁶⁹ The NESCOE proposal includes avenues for making proposals to both NEPOOL and ISO-NE. In addition, the NESCOE reserved the right to make filings pursuant to § 206 when ISO-NE does not resolve a matter “satisfactorily.”²⁷⁰

The NESCOE’s budget calls for no more than \$1.4 million in years one and two, and \$2.2 million in years three through five.²⁷¹ This limitation appears to be the result of an effort to negotiate acceptance of the NESCOE concept from the NEPOOL participants. The effect, of course, is to limit the resources of the NESCOE to far less than the level of resources committed to RTO matters by many market participants. ISO-NE, together with the states, is requesting a tariff mechanism that will cover the NESCOE’s budget with monies from the Regional Network Load.²⁷² Each state gets one vote in the NESCOE’s decision-making process, and policy determinations require both a numerical majority (e.g., 4 or more), and a “majority weighted to reflect relative electric load of each state within the region’s overall load.”²⁷³

The NESCOE proposal has had to overcome years of political wrangling both between states and between the organizations of the states and the ISO-NE

263. NEPOOL, *supra* note 246. Note the difference between an RSC that includes members of the state regulatory commissions, and an RSC on which states are represented by appointees of the governors.

264. *Id.*

265. NEPOOL, *supra* note 246.

266. PARTICIPANTS AGREEMENT, *supra* note 85, § 6.3.1.

267. AGENDA ITEM #1, *supra* note 261.

268. NEPOOL, *supra* note 246.

269. It is unclear how this is better than the current situation in which states may be voting participants in the “end users” group but three of six states choose not to participate.

270. *Id.*

271. NEPOOL, *supra* note 246.

272. *Id.* The NESCOE’s budget appears to be relatively separate and distinct from ISO-NE. NEPOOL, *supra* note 246 (stating that “ISO-NE will support the collection of costs of the NESCOE, in general, but will not take any position on the specific budget or costs of operation proposed by the NESCOE.”).

273. *Id.*

stakeholders. Keeping that in mind, there are several problems with the NESCOE proposal as it stands from the perspective of the public interest.²⁷⁴

While the proposal provides the NESCOE with the ability to make proposals to ISO-NE and to NEPOOL, it does not provide the states with any special status regarding these organizations, nor does it provide the states with special filing status with regard to the FERC.²⁷⁵ This puts the NESCOE at a distinct disadvantage in representing the public interest since (barring exigent circumstance) NEPOOL has the right to review any ISO-NE § 205 filing and also has a much more concrete relationship with both the RTO and the FERC.

It is understandable that funding for the NESCOE should be ramped up slowly while its actions get underway; however, the organization must have enough money to fulfill the vital needs that we have outlined above. Indeed, at rates typically charged by professional, legal, or accounting firms, simply attending all of the meetings called for by NEPOOL, the FERC, and the RTO, could fully exhaust the NESCOE budget without allowing for enough analysis and preparation to effectively present its own concerns. At least one person voiced concern that because of its limited power and jurisdiction, it may not be worth it for states to fully engage.²⁷⁶ The influence yielded may not outweigh the cost of participating.

Thus far, RSC funding has been through the RTO itself.²⁷⁷ For example, PJM collects costs of the Organization of PJM States as they are a cost of the PJM's operations.²⁷⁸ Thus, the grounds for funding an RSC are based upon allowing the RTO to charge its customers for the costs of the RSC.²⁷⁹ There are several implications of this funding mechanism. If the budget for RSCs is limited to the funds necessary to cover aiding the RTO in its coordination with the states, the amounts may well be small. If the funds are set at the level necessary to ensure the degree of "public participation" to bring public interest considerations into a meaningful role in ultimate decision-making, then the budget may have to be significantly greater than amounts in current proposals. To the extent that the FERC wishes to rely upon organizations such as the NESCOE to ensure that the public interest is considered in RTO decision-making, it will need to recognize that the greater scope requires greater capabilities. The NESCOE is certainly a move toward ensuring representation of the public interest, but it is not a strategic cure for the problem.

274. The upcoming discussion assumes that the current proposal will continue to move forward and will be presented to the FERC for consideration.

275. Contrast this proposal with the concept of regional regulation, *infra* Part V.A.1.

276. Telephone Interview with Paul Peterson, Senior Associate, Synapse Energy Economics (Apr. 12, 2007) (notes on file with author).

277. RSCs, themselves not utilities for purposes of the Federal Power Act, have not been funded separately from RTOs.

278. "The costs PJM seeks to recover are legitimate business expenses of an RTO." *PJM Interconnection, L.L.C.*, 113 F.E.R.C. ¶ 61,292 (2005).

279. However, as with other ancillary services, RSCs are and should be funded through tariffs of the relevant RTO to the extent that they are necessary to ensure "just and reasonable rates." Federal Power Act § 206, 16 U.S.C. § 824e (2000).

V. EASING THE PUBLIC INTEREST ACCOUNTABILITY PROBLEM

Our discussion of potential solutions are divided up into two categories. First are strategic solutions that would require large structural changes. Second, we present several tactical recommendations, changes that could occur within the current system.

One issue which we have not directly addressed in this paper overlays all of these recommendations—the costs that some of these changes may require. As stated above, we purposefully did not enter into a discussion about whether the benefits of RTOs outweigh the costs, leaving that issue to other commentators and economists.²⁸⁰ However, we highlight here that most of the suggestions below will be costly and will require adding another layer of process to solve a serious problem. These costs may increase the already high cost of RTO administration, but as it stands now, changes are necessary to increase consideration of the public's interest in RTO decisions and actions.

A. Strategic Improvements

1. Regional Regulation

One possible solution to this dilemma lies in regional regulation.²⁸¹ Whether horizontal (among states) or vertical (between states and the federal government), regional regulation may be an effective means to fill the vacuum that has been highlighted above. This is especially true because it might alleviate some of the federal-state tensions that have been in existence ever since the famous *Attleboro* decision and are arguably exacerbated via the growth of the FERC's jurisdiction and influence over electricity policy in the past decade.²⁸² Some problems, such as the cost accountability difficulties involving non-profits, may not be rectifiable by replacing FERC jurisdiction with a regional governance structure, but this structure may be more responsive to the public interest representation difficulties.²⁸³

Reviewing the complex legal issues regarding compacts and regional regulation is outside the scope of this paper. This is particularly true given our goal, stated in the introduction, of considering not whether RTOs are a positive introduction to the regulatory system, but instead, how to ensure that the public interest is considered in the RTO process as fully as possible. Thus, for the purposes of this paper, we merely highlight the possibility that compacts or other

280. See, e.g., Seth Blumsack, *Measuring the Benefits and Costs of Regional Electric Grid Integration*, 28 ENERGY L.J. 147 (2007).

281. See, Felix Frankfurter & James M. Landis, *The Compact Clause of the Constitution—A Study in Interstate Adjustments*, 34 YALE L.J. 685, 687-688 (1925). Several articles and conferences were published regarding energy regulation in the early and mid 1990s. See, e.g., DOUGLAS N. JONES ET AL., NAT'L REGULATORY RESEARCH INST., THE OHIO STATE UNIV., REGIONAL REGULATION OF PUBLIC UTILITIES: OPPORTUNITIES AND OBSTACLES (1992) <http://www.nrri.ohio-state.edu/dspace/handle/2068/220>; Christi Davis & Douglas M. Branson, *Interstate Compacts in Commerce and Industry: A Proposal for "Common Markets Among States"*, 23 VT. L. REV. 133 (1998); Frank P. Darr, *A Critical Analysis of Joint Board Policy at the Federal Energy Regulatory Commission*, 30 SAN DIEGO L. REV. 485 (1993).

282. Public Util. Comm'n of R.I. v. Attleboro Steam & Elec., 273 U.S. 83 (1927).

283. Telephone Interview with Nancy Brockway, NBrockway & Assoc., April 6, 2007 (notes on file with author).

forms of re-organization of the FERC's jurisdiction over these organizations would be beneficial to the public interest.²⁸⁴

2. The FERC's Responsibility

As the ANOPR recognized, many parties perceived a need for the FERC to step up its oversight of RTOs.²⁸⁵ Certainly, some perceived that the FERC was putting more emphasis into expanding the scale of RTOs than into the development of good market rules and in doing so was deferring to transmission owners and other stakeholders. Notably, the FERC has never credibly threatened to make the availability of pooled markets conditional on effective operations of RTOs.²⁸⁶

Delegating power to a non-profit private organization without establishing clear measures of success creates an incentive structure that is difficult to overcome.²⁸⁷ Until now, the FERC has relied heavily on the carrot approach to regulation, hoping to incentivize good behavior and RTO establishment. Here, we emphasize three points: first, increasing the FERC's oversight and willingness to exert restraint on RTO management, even if that means creating dissent among stakeholders; second, increasing the FERC's presence in the regions; and third, emphasizing that the continuance of wholesale markets requires a certainty that RTOs will be governed in ways that take action to ensure the long-term public interest.²⁸⁸

First, as stated above, there have been several recent reports critiquing the FERC's reluctance to involve itself in the details of RTO oversight. This reluctance may be overcome—the FERC's recent ANOPR on wholesale

284. Darr, *supra* note 281 (regarding the FERC's ability to enter into compacts and its aversion to such arrangements); cf. Charles B. Curtis, *Maintaining a Proper Balance Between Federal and State Authority—Is There a Place for Regional Regulation?*, 5 ELEC. J. 28 (1992).

285. Wholesale Competition ANOPR *supra* note 9, at 36,279-36,281. See also *In re Remediating Undue Discrimination Thru Open Access*, RM01-12-000 (F.E.R.C. May 20, 2003) (during which several state regulators requested that the FERC increase its oversight).

286. *Atlantic City Elec. Co. v. FERC*, 295 F.3d 1, 12 (D.C. Cir. 2002) (holding that the FERC could not force RTOs or ISOs to make interconnection arrangements). See also, Vince, *supra* note 57. The D.C. Circuit did not state that the FERC could not condition pooled markets upon the prior development of effective RTOs. Notably, the Ninth Circuit recently emphasized that the FERC's duty to ensure just and reasonable rates could not be fulfilled merely by relying on the existence of wholesale markets, absent a determination that those markets were adequately healthy to ensure that the resulting wholesale rates were just and reasonable. See, *Public Util. Dist. No. 1 of Snohomish County Wash. v. FERC*, 471 F.3d 1053 (9th Cir. 2006).

287. KOPPELL, *supra* note 52, at 66.

288. It is possible that problems related to the RTOs' governance structure are merely hypothetical problems and that no real harm to the public interest has arisen from them. Indeed, the RTOs assert that they have decreased the costs of power within the territories they serve, if one adjusts for increases in extrinsic fuel costs. However, there is clearly some risk that a set of rules developed under the active influence of those who sell and transmit power, with less involvement by those who ultimately bear its costs, may favor those who can devote the greatest resources for developing and administering those rules. The simple fact that wholesale markets, at their margins, have become so heavily dependent on a single fuel source—natural gas—suggests that RTOs have favored low-diversity resource strategies, rather than the development of diverse portfolios. As forward capacity markets seek to limit risks by encouraging balanced portfolios, it will be particularly important to ensure that those who govern RTOs consider interests that go beyond short-run predicted price considerations. The chances of lower long-term costs, with equal or better reliability levels, will be greatly increased if the governance of RTOs considers both resource parity and long-term portfolio management. Both seem more likely if the RTOs are open to considering views that go beyond those of direct participants in short term market transactions.

competition in regions with organized electric markets appears to be a move toward expanded involvement.²⁸⁹ The FERC has authorized RTOs to take on important duties with a form and level of oversight that many find unsatisfactory; it has relied on the effectiveness of RTOs' operations to justify creation, continuance, and expansion of wholesale markets. Both the legal limitations on the FERC's power and the FERC's failure to make effective RTO governance a necessary precondition to market rates have made the problems of protection of the public interest difficult to solve.²⁹⁰

Meanwhile, the Ninth Circuit recently chastised the FERC for failing to oversee long-term contracts that were executed in California during the energy crisis there. The court found that the FERC had adopted the deferential *Mobile-Sierra* review of the market-based long term contracts without first determining that the "contracts at issue were initially entered into in fully functioning markets."²⁹¹ In effect, the Ninth Circuit required greater FERC oversight to protect the public interest in maintaining "just and reasonable" rates.²⁹² More recently, the Illinois Attorney General filed a complaint based on the Ninth Circuit's determination.²⁹³

In the short term, to maintain the legitimacy of these organizations, the FERC must provide real and structured oversight, and show a willingness to withdraw market authorization if necessitated by the actions or inactions of stakeholders and/or RTOs. Until now, the FERC's deferential relationship with the RTOs made it seem almost impossible that it would revoke market participant or RTO status.²⁹⁴ However, this is perhaps the most meaningful accountability measure that the FERC has.²⁹⁵ The trouble is, of course, that similar to Professor Koppell's analysis of Fannie Mae and Freddie Mac, two government sponsored enterprises, the federal government must choose between weak authority to require certain actions and draconian responses to misdeeds.²⁹⁶

Second, the FERC should establish a real regional presence if it is going to maintain jurisdiction over RTO decisions. The FERC could be restructured to have regional divisions in a manner similar to the regional divisions used by the United States Environmental Protection Agency, Health and Human Services, or

289. Wholesale Competition ANOPR, *supra* note 9, at 36,280 (stating, "The Commission has a duty to improve the operation of wholesale power markets to support competition.").

290. These legal limitations are made clear in *California Independent System Operator Corp. v. FERC*, in which the D.C. Circuit Court ruled that the FERC did not have the "authority to replace the selection method or membership of the governing board of an ISO," but instead could, if the California ISO did not comply with the FERC's requirements, "declare that CAISO is not an ISO." *California Indep. Sys. Operator Corp. v. FERC*, 372 F.3d 395, 398, 404 (D.C. Cir. 2004). The FERC could, however, "declare that CAISO is not an ISO" if the California ISO did not comply with FERC requirements. *Id.* at 404.

291. *Public Util. Dist. No. 1 of Snohomish County Wash. v. FERC*, 471 F.3d 1053, 1087 (9th Cir. 2006).

292. *Id.*

293. The case recently was dismissed with prejudice after the parties settled. *The People of the State of Illinois v. Exelon Generation Co.*, 121 F.E.R.C. 61,015 (2007).

294. See *California ISO Corp. v. FERC*, 372 F.3d 395 (D.C. Cir. 2004) (stating that rather than reconstitute the Board of Directors, which the FERC had no power to do, the agency could withdraw ISO status to remedy a lack of independence).

295. See *supra* text accompanying notes 198-206.

296. KOPPELL, *supra* note 52, at 48.

the Federal Reserve Bank.²⁹⁷ Over time, such regional offices might well develop the knowledge and institutional competence regarding the regional and state-based issues.²⁹⁸ Their presence could include monitoring capabilities, designated employees, and oversight capacity. However, public acceptance of their legitimacy would also require an institutionalized and effective path for consideration of the public interest in addition to price-specific or price-limited considerations.

Third, as argued above, one of the main purposes of incorporating state oversight into the RTO structure is because of the states' interest not just in the market today, but in the long term impacts of each RTO's market and planning decisions. To the degree that the FERC decisions reflect the non-price factors inherent in many states' definitions of the public interest, the rationale and pressure for state (or public interest) involvement in the decision-making process will be greatly alleviated.

B. Tactical Enhancements

1. Increased Representation of the Public Interest via State Action

The development of RSCs is certainly a step in the right direction towards ensuring representation of the public interest in RTO decision-making. However, as outlined above, these committees do not have the power or the resources to successfully advocate on behalf of their citizens. More resources, a broader jurisdiction, and parity with other stakeholders are necessary to improve the effectiveness of these organizations, which have an unenviable job—representing the diverse interests across states and users in an incredibly complicated, expensive, and fundamental process.

Another means to the end of providing a voice for the public interest in the RTO decision making process is to establish a regional public advocate program within the stakeholder process. As described above, there are several systematic reasons that state-based public interest representatives do not have the capacity to fully represent their state's interests in the RTOs' stakeholder processes. Advocates whose sole job is to represent the interests of the public on the regional scale would not juggle both in-state and regional responsibilities. In addition, economies of scale could be found for groups of public advocates. This is particularly true when one considers the high cost and high technological know-how necessary to fully participate in RTO decision-making processes. In fact, currently, only three of the six states are involved in the stakeholder process in ISO-NE. While public advocates working together on a regional basis has certainly occurred on an *ad hoc* level, these groups have not necessarily been structurally linked and a common funding pool has not been established.²⁹⁹

This public advocate's office would have to answer to some cumulative state-based authority, although it is unclear who this might be. One option might

297. While the FERC does have regional offices, they are mostly associated with hydropower projects. FERC, <http://ferc.gov/contact-us/contact-us.asp> (last visited Sept. 15, 2007). The FERC's RTO oversight is divided up into three regions—Eastern, Central, and Western. *Id.*

298. Small numbers of FERC staff are embedded in a few RTOs.

299. See, e.g., Motion to Intervene and Protest of the Att'y Gen. of the Commonwealth of Mass., *New England, Inc.*, 117 F.E.R.C. ¶ 61, 310 (2006) (Docket No. ER07-116-000).

be whoever, in each of the member states, has the responsibility to represent the public interest. The trouble would be fear of paralyzing the ability of the regional public advocate to perform her job because of tensions between the needs of the different states. Of course, these problems are similar to the issues with establishing the NESCOE.

Another issue remaining to be resolved regarding a regional public advocate is how it would participate in the regional processes. Participation merely as a member (or accumulation of members) in the end user's segment of the NEPOOL participants may not achieve the stated goal of ensuring that the public interest is adequately considered. Perhaps a stand-alone stakeholder group (within NEPOOL) or a process that parallels NEPOOL's for informing ISO-NE's Board and Management of issues of the public interest on day-to-day decisions would be particularly helpful.

2. Management and Board-Based Accountability

Of course, even with these formal procedures for increasing state-based involvement in day-to-day decisions, the problems associated with having non-governmental, non-profit organizations manage energy markets continue to be incredibly demanding. The most important issue is how to keep the management and board accountable to the public interest (outside of the suggestions outlined above).³⁰⁰ One issue that the FERC has been continuing to address (but has not yet been fully able to do so) is increasing the availability of data, both about bids and markets and about the business decisions that the RTOs make.³⁰¹ These forms of transparency allow various organizations, especially states, to participate in the RTO process.

One possible suggestion is including "360 degree" feedback for boards and management.³⁰² This requires feedback from stakeholders, supervisors, peers, and subordinates. It would allow management and the board to receive feedback on their performance and would be a potentially transparent way to increase communications between stakeholders, employees, and the people who are making each RTO's decisions.

A related alternative would be to have an external auditor provide each RTO with a report card.³⁰³ As Former FERC Commissioner Brownell has suggested,

300. According to FERC Chairman Kelliher, in passing the RTO Accounting and Financial Reporting Final Rule, "Greater transparency may encourage greater cost accountability by RTOs, but there probably is a limit to what can be accomplished through transparency alone. The Commission has a legal duty to assure RTO costs are just and reasonable" Joseph T. Kelliher, Chairman, FERC, Statement on RTO Accounting and Financial Reporting Final Rule (Dec. 15, 2005) (Docket No. RM04-12-000); Order No. 668, *Accounting and Financial reporting for public Utilities Including RTOs*, F.E.R.C. STATS. & REGS. ¶ 31,199 (2005), 70 Fed. Reg. 77,626 (2005).

301. Wholesale Competition ANOPR, *supra* note 9, at 36,293. "The Commission proposes that offer and bid data, without identification of the market participants, be posted on the RTO's or ISO's Web site, where it will be available to the Commission, to interested state commissions, and to stakeholders. The Commission proposes a lag of three months for posting this data[.]" *Id.*

302. Telephone Interview with Commissioner Nora Brownell, Consultant, BC Consulting (Mar. 9, 2007) (notes on file with author).

303. ISO-NE produces its own scorecard with the goals of "operational excellence" as well as "reliability and market operations." Comments of ISO New England, Inc., *Wholesale Competition in Regions with Organized Electric Markets*, Docket Nos. RM07-19-000 & AD07-7-000, at 40 (F.E.R.C. Sept. 14, 2007). The

[T]he idea of an [RTO] report card whereby a judge would set a criteria—limited, I might add—you don’t need to do the regulatory let’s have a metric system that includes 400 measurements. Eight to ten measurements by which an [RTO] and, therefore, by association its boards and its management are evaluated each year.³⁰⁴

Importantly, these report cards would be made public, potentially creating outside pressures to ensure positive performance. The notion of measuring and comparing the different RTOs offers a chance for comparative competition, i.e., “yardstick competition,” a phrase with roots and precedents in the power industry.³⁰⁵ The report cards should be scored by success in furthering the public interest.³⁰⁶ To do this, an independent scoring body should be recruited by the FERC and charged with developing, through transparent procedures, a multi-party assessment of the successes of the RTO in furthering the public interest within its region and throughout the United States. In particular, scoring should recognize such elements as reliability (measured by transmission and generation-related outage), rate or price trends (both with adjustments for commodity price changes, and without such adjustments, given the importance of encouraging fuel diversity in resource portfolios), price volatility, and emission trends (for carbon, mercury, and priority pollutants).³⁰⁷

report cards that we suggest would be consistent across the RTOs, would reach out to those affected by market practices and not just those involved in them, and would consider a broad range of topics, as discussed below.

304. In *re Remediating Undue Discrimination Thru Open Access*, RM 01-12-000 (F.E.R.C. May 20, 2003) (statement of Nora Brownell, former FERC Commissioner).

305. Yardstick competition is where the performance of several entities is compared. Harvey L. Reiter & Christopher Cook, *Rate Design, Yardstick Competition, and Franchise Competition: An Integrated Approach to Improving the Efficiency of 21st Century Electric Distribution*, 12 ELEC. J. No. 7, Aug. 1999, at 94, 96, available at LEXIS. For example, concerning distribution, where “more than one distributor can provide electric distribution services in a state, or in several neighboring states, [Yardstick Competition] allows the regulator to compare the performances of the utilities it regulates to one another as well as to other utilities when it sets rates.” *Id.*

306. For example, NECPUC suggests the following potential metrics for measuring RTO success:

- Compare cost of debt and weighted cost of capital among ISOs/RTOs. The consumer needs to be assured that financial controls are strong and fiscal management is alert to containing expenses.
- Track violations of NERC standards and NPCC criteria within each control area. Since ISOs/RTOs are required to enforce infractions, it is important to trend the frequency and severity of problems. This is an important measure for assessing the effectiveness of an ISO/RTO’s focus on reliability.
- Cost of energy, capacity and transmission should be compared and contrasted among and inside each ISO/RTO. Despite regional variances in base numbers, comparing rates of escalation can be useful in spotting adverse trends.
- Develop appropriate internal operating ratios for functionally similar ISOs/RTOs (e.g., Full-Time Employees (“FTEs”)/million customers, Officers/FTEs, and Percentage of Information Technology projects completed on-budget/on-time) to provide a glimpse into organizational efficiency and thereby provide a comparative basis for budgetary requests.

Comments of The New England Conference of Public Utilities Commissioners et al., *Wholesale Competition in Regions with Organized Electric Markets*, Docket Nos. RM07-19-000 & AD07-7-000, at 24 (F.E.R.C. Sept. 14, 2007).

307. Current complaints with the compensation and measurement systems assert that they are unreasonably focused on reliability without due attention to cost control and other issues that impact ratepayers. Comments of the Massachusetts Attorney General, *Wholesale Competition in Regions with Organized Electric Markets*, Docket Nos. Docket Nos. RM07-19-000 & AD07-7-000, at 6 (F.E.R.C. Sept. 14, 2007).

Another set of suggestions relate to the transparency of RTO decision-making. As the FERC recently suggested, in its ANOPR, one solution to promote more stakeholder “customer responsiveness” would be to create an advisory board to an RTO’s board of directors made up of representatives of the stakeholders. While this idea is appealing, in that it will promote understanding of stakeholder views to the board members, it will promote the public’s interest only if a significant portion of its constituent parts have the incentive to do so.

One formula that was employed in ISO-NE, until the committee was disbanded in 2003,³⁰⁸ was an advisory board “cross-section of consumer, business, and regulatory interests,” that was “charged to consult with, and provide advice to, the Board.”³⁰⁹ Such an advisory board could encourage the Board of Directors to communicate with, and understand how the public’s interest might be impacted by the RTO’s decisions. In recent comments to the FERC, NECPUC stated that it did not desire the reestablishment of an advisory committee and that “[m]ore effective use of the current organizations—ISO-NE, its Board, the [NEPOOL Participants Committee], state regulators, etc.—is much preferred.”³¹⁰

Richard Cowart, Director of the Regulatory Assistance Project and former Chair of the Vermont Public Service Board, has been a member of two such committees. These included the (since-disbanded) general advisory committee for ISO-NE, described immediately above, and the (ongoing) Environmental Advisory Council for the New York ISO. He suggests several traits for a successful RTO advisory committee. These include: (1) direct access to RTO governing boards, without information being filtered through management (noting that NYISO board members routinely attended two to three environmental advisory committee meetings per year); (2) selection of members on the basis of technical expertise in specific areas, rather than as representatives of stake-holders; (3) meaningful staff assistance from within the RTO, including the ability to convert “conversational” comments into specific text with substance and continuing influence (noting, too, the discipline that arises when the drafting process brings an advisory committee to agreement on specific language and recommendations); (4) regular meetings with well-formed agendas focusing on substantive issues in a timely manner (that is, soliciting advice in circumstances where the advice is both relevant and timely); (5) an opportunity for the comments of Advisory Committee members to be seen by others, including regulators, beyond the RTO; and (6) an expectation that RTO Boards and managers will publicly address specific recommendations of such

308. Apparently, because the NESCOE (still not created) was expected to be established shortly. Interview with Richard Sedano, Former Commissioner of the Vermont Public Service Board (June 7, 2007) (notes on file with author).

309. Letter from William W. Berry, Chairman of the Board of ISO New England, to Richard Sedano, Commissioner of the Vermont Public Service Board (Jan. 11, 2000) (on file with author).

310. Comments of The New England Conference of Public Utilities Commissioners et al., *Wholesale Competition in Regions with Organized Electric Markets*, Docket Nos. RM07-19-000 & AD07-7-000, at 22 (F.E.R.C. Sept. 14, 2007). The Consumer Advocates in PJM requested a board advisory committee that would be similar to the MISO committee already established. Comments of the Joint Consumer Advocates, *Wholesale Competition in Regions with Organized Electric Markets*, Docket Nos. RM07-19-000 & AD07-7-000, at 24 (F.E.R.C. Sept. 14, 2007).

committees.³¹¹ Clearly, the design and use of advisory committees will require care. Yet, at some administrative cost, they offer an opportunity to gain increased consideration of external views, without undermining the independence of the RTO boards themselves.

One somewhat related suggestion to an advisory committee is that Board meetings be conducted under an “Open Meeting Policy” which allows for stakeholder participants in board meetings, although this suggestion could result in demanding an incredible amount of board member time and energy.³¹² Another concern about this suggestion is that it would foster a meeting that was more focused on performance instead of allowing frank, closed-door discussion.³¹³

Another element promoting accountability is a performance-based remuneration system for management and board members. Some element of the pay or bonus scale can be based upon the outcome of the standards as stated above, using a transparent standards-based system. Some RTOs already have tied their remuneration to some performance standards, but detractors argue that the standards measuring performance put undue emphasis on certain issues while missing others.³¹⁴ Because of this difficulty in execution, incentive programs can be extraordinarily difficult to implement.³¹⁵ For example, an incentive program for the legal staff may reward resolution of cases, or settlements, even though settling all cases creates inefficiency—bad outcomes and incentive for more litigation. On the other hand, incentivizing the number of cases won creates pressure to pursue costly litigation past the point of reason.

Another significant way to hold management accountable for the impact of the markets on the public interest is to make sure that an independent market monitor is overseeing the markets and has full abilities to inform the FERC and the public about the validity of the market and its structure. A market monitor that can be relied upon for these services will go far in holding the decision-

311. Interview with Richard Cowart (Aug. 15, 2007) (notes on file with author).

312. Technical Conference, *Conference on Competition in Wholesale Power Markets*, Docket No. AD07-7-000 (F.E.R.C. May 8, 2007), <http://www.ferc.gov/EventCalendar/Files/20070523130728-transcript%2023685.pdf> (statement by the Hon. Mark Christie, President, Organization of PJM States, Inc.).

313. Comments of ISO New England, Inc., *Wholesale Competition in Regions with Organized Electric Markets*, Docket Nos. RM07-19-000 & AD07-7-000, at 36 (Sept. 14, 2007) (“Open meetings will result in staged productions in which information will be limited to avoid disclosure of confidential information.”).

314. For example, according to a coalition of New England states, ISO-NE provides in excess of a 50% increase in salary based on incentive payments for senior staff. Motion to Intervene and Protest of New England Advocates, *ISO New England, Inc.*, Docket No. ER07-116-000, at 8 (F.E.R.C. Nov. 21, 2006) [hereinafter New England Advocates]. There are two bonus programs, the Annual Performance Incentive for all employees, and the Long-Term Incentive Plan (LTIP) for certain members of senior staff. According to ISO-NE, the LTIP is “based on the achievement of annual performance goals that are developed prior to commencement of each year.” *Id.* at Attachment A at 3 (quoting ISO New England, Report of Compensation and Human Resources Committee). Overall LTIP achievement was 97.8% in 2005. New England Advocates at 4. This group has criticized the system, arguing that incentives worth 50% of base salary without a justification for such an increase are inappropriate. *Id.* at 7.

315. In CAISO, for example, there is a multi-step process of aligning executive performance and a multi-year business plan that is developed in conjunction with stakeholders. Testimony of Yakout Mansour, President and CEO of California Independent System Operator Corp. Technical Conference, *Conference on Competition in Wholesale Power Markets*, Docket No. AD07-7-000, at 196-197 (F.E.R.C. May 8, 2007), <http://www.ferc.gov/EventCalendar/Files/20070523130728-transcript%2023685.pdf> (statement by Yakout Mansour, President and CEO, California Independent System Operator Corp.).

makers responsible for their actions. For this to be possible, the market monitor (whether internal or external) must be completely independent from the RTO and must be able to freely communicate with non-RTO entities such as the FERC.³¹⁶ However, market monitors are not directly held accountable to any one entity, particularly if they do not work for the FERC and are “independent” from RTOs. While they may add another layer of accountability, how they are held responsible for their actions and decisions and to what extent they actually represent the public interest can be uncertain.

VI. CONCLUSION

Wholesale electric power and transmission transactions will be consistent with the standards of the Federal Power Act only if those transactions lead to rates, terms, and conditions of service that are just and reasonable. In areas with organized wholesale markets, the FERC relies on RTOs to design, monitor, and implement the rules for those transactions and (increasingly) to deliver plans and incentives that will ensure future electric power reliability. Thus, the independence and effectiveness of RTOs are necessary prerequisites to any determinations that transmission systems will operate in nondiscriminatory ways and that market-based pricing can be relied upon to produce just and reasonable rates. This raises difficult issues because there are tensions between ensuring that RTOs are, at the same time, responsive to the legitimate concerns of those who participate in power markets and are considerate of the larger public interests—such as long-term reliability, environmental impacts, and non-participant economic interests—indirectly affected by wholesale power and transmission transactions.

Not surprisingly, RTOs have been the subject of controversy in the development of energy markets and the FERC has devoted recurrent efforts to address these issues, with increasing emphasis upon the governance questions that underlie all other RTO decisions. In part the controversies about RTOs are not really about RTOs themselves, but arise from a larger issue that we do not address here; i.e., whether organized wholesale power markets themselves bring positive outcomes for end-users. But, even within the world of those that accept the desirability (or inevitability) of organized wholesale markets, the creation and administration of RTOs raises difficult governance issues.

One major issue is that RTOs have focused on the specific financial issues most relevant to those that sell and transmit power in wholesale markets, with less attention to the larger public issues that are indirectly, but vitally, affected by RTO decisions. Thus, we have proposed some measures to enhance the transparency of RTO governance and other measures (including greater state governmental involvement) to increase the diversity of views presented for consideration by RTO boards and managements in their governance actions.

Another issue involves the responsiveness of RTOs overall, including responsiveness to the legitimate needs of market participants. Thus, we have summarized and commented upon the FERC’s recent proposals in this area, as well as suggesting some additional measures.

316. Technical Conference, In re *Review of Market Monitoring Policies*, AD07-8-000, at 76-79 (F.E.R.C. Apr. 5, 2007) (testimony of Hung-Po Chao, Market Monitor for ISO New England).

Most importantly, however, we stress that the ultimate responsibility for the responsiveness and effectiveness of RTOs lies with the FERC. Thus, we recommend that the FERC make explicit its willingness to revoke its authorization of market-based pricing in areas and at times when the independence, responsiveness, and effectiveness of RTOs cannot be guaranteed. Only then will there be adequate incentive for those that sell and transmit power in organized markets to help implement the governance standards necessary to ensure the public interest.

Now, as the FERC, and the nation that it serves, seeks to improve the governance of RTOs, it is more than ever time to recognize that a duty to perform multiple functions requires an ability to consider the concerns of multiple constituencies. As the elephant of the RTO is approached by the elders, each coming from one of many separate backgrounds, a clear FERC statement is needed: market-based rates can be treated as 'just and reasonable' only if the governance of RTOs is designed to consider the interests of market participants and, also, the interests of the public—those vitally, if less-directly, affected by RTO practices now and in the near future.³¹⁷

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