Chapter IX
Transmission Improvements Group
Market Monitoring Report
(Draft 5 – July 22, 2005)

1. Executive Summary

Because of the West Coast energy crisis of 2000-2001, Because of the West Coast energy crisis of 2000-2001, there is a heightened awareness for the need for an independent market monitorIn addition, there is a general perception that certain aspects of the markets for wholesale power and transmission services in the region could be improved. As a result, TIG recommends the creation by contract of an Independent Market Monitor (IMM) for the Northwest. The independence of the IMM would be established by various contractual safeguards, including the formation of an open Market Monitoring Committee (MMC); the reservation of a portion of the annual budget for investigations initiated by the IMM and for responses to complaints filed by market participants; the retention of an independent auditor to review certain tasks of the IMM; and adequate funding for monitoring over a five-year period. It is important to have monitoring in place before another crisis hits the region, and a monitor may in fact help avert or alleviate another financial crisis. Reports (regular and special) of the IMM should help alleviate concerns about the potential for future manipulation by putting an oversight mechanism into place to serve as an "early warning system" regarding pending problems. The existence of an IMM who can receive and process complaints about the behavior of specific market participants should also increase the confidence in existing market structures.

TIG proposes a contractual framework for the initiation, funding, governance, and evolution of independent market monitoring activities in the Pacific Northwest. The framework would include five types of agreements: (a) a multilateral Market Monitoring Agreement (MMA) to establish and fund monitoring activities; (b) a Professional Services Agreement (PSA) with an IMM (most likely an existing consulting firm); (c) a PSA with an independent auditor who would examine certain activities of the MMA under the PSA; (d) Non-Disclosure Agreements (NDAs) governing the protection of confidential or commercially sensitive information received by the IMM during its course of work; and (e) agreements between state agencies and the IMM governing their relationship. Decision-making would be ultimately the responsibility of the region's transmission owners, although they would be advised and receive recommendations from a broadly representative Market Monitoring Committee (MMC). The MMC would also have certain authorities regarding investigations and expenditures within the scope of a market monitoring plan approved by the transmission owners and an annual budget.

The remainder of this report describes the contractual framework for monitoring, including governance and decision-making; provides estimated costs of monitoring and a mechanism for allocating such costs to transmission owners in the region; explains the roles and responsibilities of market participants and state agencies; describes linkages between the Market Monitoring Charter and the other TIG

charters; sets out a schedule for implementation; reviews legal issues; and provides additional information, including contract outlines, in appendices. Appendix IX-C shows the implementation (work flow) of the proposal; Appendix IX-D itemizes the responsibilities of various parties; Appendices IX-J and IX-K provide links to relevant materials from the Midwest, where market monitoring has most recently been implemented. Appendix IX-L lists potential providers of monitoring services. The other appendices are described later in this Chapter.

2. Functions to be Performed within the Charter's Four Corners

The original TIG Market Monitoring Charter is attached as Appendix IX-A. This Charter formed the basis for the more detailed report here, including the draft contracts for implementation of monitoring. The first report of the IMM, prepared during 2006, would be a State of the Market (SOM) report for the year 2005. Following that, the IMM would issue interim reports if major problems in market structure or performance are found, and it would issue annual SOM reports.[1] In its first SOM report, the IMM would address issues such as who owns generation; who owns transmission; what determines market prices (spot, day-ahead, and forward); barriers to entry into energy and transmission markets; the frequency and length of transmission curtailments; and how events outside the Northwest influence market performance inside the Northwest. The IMM may also be requested by the MMC to conduct special investigations on market structure, conduct of market participants, and market performance. In addition, the IMM may initiate special investigations on its own or in response to complaints from market participants. The Scope of Work of the IMM is expected to evolve over time to meet the needs of the Northwest. See Appendix IX-E for a fuller description of the IMM's Initial Scope of Work for 2006.

3. Organizational/Contractual Form(s) Required to Implement Function

A. Background

No institutions, entities, or agreements regarding market monitoring exist in the Northwest. Portland General Electric (PGE) was required to develop a market monitoring plan as part of the proposed sale of PGE by Enron to the Texas Pacific Group, but that plan is now moot given the decision of the Oregon PUC and subsequent decisions by Texas Pacific. Thus, market monitoring in the Northwest starts with a "clean sheet of paper."

In other parts of the United States, market monitoring takes two forms. The dominant form is associated with ISOs and RTOs, which have internal monitoring departments and, in some cases, external market monitors. Another form of monitoring, found much less frequently, is associated with individual jurisdictional utilities, which are required by FERC to set up agreements with outside market monitors as a condition

[1] The scope of work after 2006 has not yet been determined, but would depend on what is discovered in the initial SOM report.

of approval of some request by the utilities at FERC (e.g., acquisition of generation resources by vertically-integrated utilities that are not part of RTOs or ISOs). Neither of these forms of monitoring is relevant or cost-effective for the Northwest. The proposal for monitoring here assumes that monitoring can be established without (or in advance of) any ISO- or RTO-like entity. This proposal also encompasses multiple FERC-jurisdictional and non-FERC-jurisdictional Transmission Owners, and so should be more cost-effective than the option of each FERC-jurisdictional Transmission Owner setting up its own monitor.

B. Summary of the Overall Structure

Market monitoring in the region would be accomplished pursuant to a set of contractual relationships established by market participants, independent contractors, and regulatory agencies.

- First, the Participating Transmission Owners (PTOs) would execute a multilateral contract (the MMA) that would obligate them to hire and pay the costs of an IMM. See Appendix IX-B for a sample contract, including a general market monitoring plan.
- Second, the IMM would be an independent contractor providing professional services under contract (either multilateral or bilateral) to the PTOs. See Appendix IX-G for a sample services agreement.
- Third, certain activities of the IMM would be audited by an independent firm retained for this purpose. The auditor's work would also be governed by a PSA (multilateral or bilateral) with the PTOs.
- Fourth, the exchange of data between market participants and the IMM and the submission of unredacted reports to regulatory agencies would be governed by Non-Disclosure Agreements (NDAs) to protect confidential or commercially sensitive information. See Appendix IX-I for a sample NDA.
- Fifth, the states would be expected to execute individualized agreements with the IMM governing the relationship between the IMM and state agencies.

The multilateral contract among PTOs would also establish an MMC through which stakeholders that are not PTOs (as well as PTOs themselves) can provide input and make decisions and recommendations regarding the scope of work and performance of the IMM. No modification of any existing entity or contract would be required to implement this proposal. The following subsections describe the responsibilities of market participants that would be specified in the MMA and other agreements.

C. Primary Obligations and Rights of Transmission Owners that Execute the Multilateral Contract

The Transmission Owners executing the multilateral contract would be obliged to hire an IMM. The first IMM would be selected by a vote of the Transmission Owners based on a recommendation from the MMC. A contracting agent (either a

Transmission Owner or an affiliated corporation, if a captive corporation is formed) would execute the contract with the IMM on behalf of the Transmission Owners. The multilateral contract would set the initial scope of work for the IMM.

The Transmission Owners would be obligated to fund the activities of the IMM. The multilateral contract would establish both a floor and a ceiling for funding: a minimum annual amount and a maximum amount over the life of the contract.[2] The term of the contract would be five years with opportunities for extension. Although a Transmission Owner may withdraw from the MMA, that Transmission Owner would retain its obligation to fund the IMM during the contract term.

Each Transmission Owner would be obligated to provide data requested by the IMM that is reasonably necessary or desirable to perform its work. The Transmission Owners would be obligated to negotiate in good faith to develop a common amendment to their OATTs that would require Transmission Customers to cooperate with and provide information to the IMM, subject to Non-Disclosure (confidentiality) Agreements. It is expected that each Transmission Owner would execute a bilateral confidentiality agreement with the IMM, as would each Transmission Customer once a new common OATT provision is approved. Development of templates of the confidentiality agreements would be part of the process of developing amendments to the OATTs.

If the MMC fails either to form initially or to perform its duties as defined in the MMA, the PTOs would take over the responsibilities assigned to the MMC and continue to carry out the obligation to fund and oversee market monitoring under the MMA. The purposes of this fallback mechanism are to ensure that market monitoring is performed even if the MMC fails for some reason, and to provide an incentive for the MMC to not fail, because of potential concerns about leaving the PTOs entirely in charge of monitoring.

D. Primary Rights and Obligations of MMC Participants

All interested stakeholders may participate in the MMC. MMC Participants would have to agree to follow a code of conduct that would govern their participation. The primary responsibilities of the MMC would be to develop a market monitoring plan and budget for the IMM, within the annual budget established by the Transmission Owners; to perform an annual review of the performance of the IMM; to recommend to the Transmission Owners that they retain or terminate the IMM; and to recommend a new IMM if they recommend termination of the then-current IMM..

The MMC would vote on matters properly before the Committee in accordance with procedures set out in the Transmission Owners' multilateral contract. Each MMC Participant must qualify for one of four classes. There would be three voting classes: Transmission Owners; load-serving entities and end-use loads; and generators. Each of these three classes would have voting rights. A fourth class, representatives of

[2] The current contract maximum being considered is $10 million over five years.

states in which the Transmission Owners operate transmission, would be non-voting. Each MMC Participant may cast one vote. Actions would be taken by the MMC on specified matters if a simple majority of two out of the three voting classes vote in favor of the action.

The MMC would vote on the following matters, among other things:

Decisions

a) Elect an Executive Committee to carry out ministerial duties (or decide not to)
b) Develop market monitoring plan
c) Develop annual scope of work for IMM
d) Develop RFP for monitoring services
e) Develop RFP for auditing services
f) Evaluate proposals from vendors for monitoring and auditing services
g) Authorize expenditures within annual budgets established by the Transmission Owners under the MMA
h) Conduct performance review of vendors
i) Make requests to the IMM to conduct investigations.

Recommendations to Transmission Owners

a) Recommend specific vendors to be hired by Transmission Owners (monitoring and auditing)
b) Recommend annual budgets after 2006; recommend within-year budget amendments if necessary
c) Recommend action by Transmission Owners based on performance reviews of IMM (e.g., termination)
d) Review invoices submitted by IMM (probably by subcommittee) and make recommendations regarding payment
e) Recommend amendments to this Section 7 of the MMA.

Decisions of the MMC could be remanded by the Transmission Owners to the MMC if the decision would cause the IMM to undertake activities outside the market monitoring plan, or if the decision would cause a new undue burden on the Transmission Owners. Remands would have to be accompanied by written explanations and a counterproposal or proposals.

E. The Independent Market Monitor

The IMM would be an independent contractor and would perform its functions as described in the Scope of Work without the direct oversight of either the Transmission Owners or the MMC. The IMM would provide reports or information to the MMC and the Transmission Owners at the same time it communicates those reports and information directly to the appropriate regulatory agency or enforcement authority and to the public at large. The IMM would provide reports to the MMC, but those reports would contain aggregate information and be redacted, as required by the IMM's confidentiality agreements. Reports to regulatory agencies may also be

redacted depending on the nature of individual state laws and the NDAs executed by state agencies with the IMM. The IMM would have no enforcement authority.

Initially, the IMM would be responsible for monitoring and analyzing activities in the transmission markets in the geographical area in which the Transmission Owners' transmission systems are located. This would require the IMM to monitor and analyze data from the wholesale power and transmission markets in the Northwest. The IMM would also look at activities in, and data from adjacent (e.g., Canada and California) and economically related (e.g., natural gas) markets that affect the power and transmission markets defined to be within the geographical scope of the IMM's activities.

The IMM would produce an annual SOM Report and perform investigations both in response to complaints and on its own initiative. The IMM would have discretion to determine whether a complaint merits an investigation and the scope of that investigation. The IMM would provide a report for each investigation.

The independence of the entity(ies) performing monitoring services under the MMA would be ensured by the following:

a) The entity would be hired based on a recommendation of the entire MMC.
b) The entity would be audited by an independent auditor; the scope of the auditor's work would adjust over time to track the work of the IMM.
c) The MMC would conduct a performance review of the IMM.
d) The MMC would not be permitted to filter or limit the data or information acquired by the IMM.
e) The MMC would not edit or limit the reports issued by the IMM.
f) The MMA would establish an annual budget floor for each year of the MMA (the existence of a floor does not mean that actual expenditures must be greater than or equal to the floor, but that the signatories would guarantee that each year a certain amount of funds would be available).
g) Part of each annual budget would be set aside for investigations of complaints and for investigations initiated by the IMM (e.g., 20 percent).
h) If the IMM disagrees with the budget submitted by the MMC to the Transmission Owners, the IMM may submit its own budget recommendation to the Transmission Owners each year.
i) The IMM would be required to adhere to a strict conflict of interest policy, including a prohibition on any business with any entity that is monitored under the terms of this Agreement.

F. Alternatives Considered

The Market Monitoring Charter Group considered the option of incorporating the work of the IMM under the umbrella of an existing organization, such as the Northwest Power Pool (NWPP). The Group determined that market monitoring could be a "stand-alone" activity, created and governed by a new multilateral agreement. This approach avoids any complexities associated with modifying the

agreements that form the Northwest Power Pool. Thus, no role for the NWPP or any other existing entity is considered necessary.

The Charter Group has also considered two options to ensure that the IMM has access to the data and information required to perform its responsibilities: bilateral agreements between the IMM and individual market participants regarding the obligation to cooperate with and provide information to the IMM, and a generic provision in transmission tariffs and contracts that would have the same effect. The Charter Group reached the conclusion that the tariff amendment approach would be more comprehensive and easier to administer, but recommends that the IMM's opinion on this subject be obtained in early 2006.

G. Term Sheets/Contract Outlines

Appendix IX-B to this Report is the outline of the MMA. The outline is considered to be complete at this point, but is reasonably expected to change during negotiations of the details. The outline contains principles for each section and subsection of the MMA.

Other contracts would be required, in addition to the MMA, including:

- PSA between the IMM and the agent of the Transmission Owners (or between the IMM and individual PTOs); see Appendix IX-G;
- PSA between the independent auditor and the Transmission Owners (multilateral or bilateral);
- NDAs between the Transmission Owners and the IMM and between individual market participants and the IMM; see Appendix IX-I; and
- Agreements between the states and the IMM (see Section 9 of this Chapter for more details).

H. Necessary Tariff Changes

In order for the IMM to perform its functions, it is expected that the IMM will have to have access to some data and information from individual market participants. There is currently no mechanism in place that would ensure that the IMM would have access to the required data. The first task of the IMM will be to determine the best means to obtain the required data for work beyond the initial SOM report. One possibility is that PTOs would develop modifications to their OATTs that would specify the responsibilities of Transmission Customers to cooperate with the IMM, beginning in 2007. If the IMM recommends such modifications, the PTOs would work during 2006 to develop and submit tariff modifications to FERC. (Possible tariff modifications are discussed below in section 7.B. and in Appendix IX-H.)

I. Governance, Decision-Making, and Dispute Resolution

The governance of market monitoring would be established by agreement, not by creating a new institution or entity. This approach is expected to be both effective

and cost-effective because all interested market participants would have the opportunity to participate in the MMC and because the monitoring services themselves would be obtained under PSAs with consulting firms (vendors) that have experience in this area. If a vendor failed to perform adequately, it could be replaced, thus assuring that attention would continuously be paid to both quality and cost.

Decision-making is also established by the MMA. The MMA would specify the roles of the PTOs and other market participants. The contract among the Transmission Owners would govern the multilateral relationship among the Owners. The MMA would establish an MMC to make certain decisions and recommendations to the Transmission Owners. Disputes among the Transmission Owners or between the Transmission Owners and the MMC would be settled by ADR as specified in the MMA. Disputes between Transmission Customers and the IMM would be settled pursuant to the dispute resolution provisions of the OATTs.

J. Role of the States

The states would have *ex officio* positions on the MMC and would have access to confidential or commercially sensitive information under the terms of the NDAs with the IMM. The states would have the right to conduct formal or informal investigations based on the reports of the IMM. The states would also have the right to meet directly with the IMM. (See Section 9 of this Chapter for more details.)

4. Linkages to Other Charters

- **Common OASIS.** The IMM would need to establish "data conduits" (systems for the transfer of data) with the Transmission Owners directly, which would require the IMM to get data from the Common OASIS and individual Transmission Owners.
- **Planning/Expansion.** The IMM may reach conclusions that are important to the work of the Planning/Expansion Charter Group and should communicate directly with whatever committees or entities are created to accomplish planning and expansion of the transmission system. For example, the IMM may identify where additional transmission capacity might relieve congestion and improve market performance.
- **Reliability/Security.** If consolidation of control areas occurs, that would reduce the number of data conduits required between Transmission Owners and the IMM.
- **Flow-Based Services.** The IMM must also understand the calculation of ATC, so that any inefficiencies in the use of the transmission system can be identified and addressed. In addition, the provision of flow-based transmission services would depend in part on agreements between regional Transmission Providers and regional Generation Owners (including those with contract rights to generation) to redispatch generation to relieve congestion, which means that the compensation paid to such generators would be a matter of concern to all market participants.

The IMM would be in the best position to judge whether the mechanisms for compensation are reasonable and not based on the exercise of market power.

5. Cost-Benefit Analysis

A full-blown cost-benefit analysis of establishing and operating an IMM is beyond the resources of this TIG effort. However, there are some concepts and measures that provide a useful assessment of the market efficiencies likely to be gained by having an IMM in place.

For the purposes of this analysis, it is assumed that the costs are measured by the costs incurred by the Transmission Owners to fund the IMM. Those costs are expected to be in the range of $500,000 to $750,000 in the first year (2006), ramping up to between $1 million and $2 million per year in subsequent years (2007-10), subject to an overall contract cap of $10 million. These costs would, in a manner to be determined, be passed along to users of the transmission system and thus ultimately to consumers. In addition, the Transmission Owners would incur some incremental costs associated with establishing "data conduits" (market monitoring systems) with the IMM. Those data-related costs should be minimal initially given that the data the IMM would want exists already. Similarly, Transmission Customers could also incur some additional costs depending on what information would be required by the IMM and how that data is provided. Again, those costs should be minimal because the data should already exist and the only question is establishing the methods for the IMM to query the appropriate databases.

On the benefits side, it is assumed that the net benefit is measured by the change in costs of service paid by consumers compared to those that they would have faced without the IMM. There are two general sources of benefits. One is the potential for costs lower than would occur in the absence of the IMM. This means that ratepayers would pay less for the same level of service. The other source is the reduction in cost risk (variance) faced by consumers. The latter views the IMM as a form of insurance. Average costs could actually increase (slightly) but be considered worth it to protect against large cost increases such as happened during the 2000-2001 West Coast market crisis.

It probably would be impossible to observe whether consumer costs were higher or lower as a result of the existence of the IMM, except for the money actually paid for the IMM. But a goal of having the IMM is to encourage competitive behavior and discourage anti-competitive behavior. There is anecdotal evidence that in markets with effective IMMs, bids tend to be closer to prices that reflect marginal costs. In a market consisting of 100 percent bilateral trades, no one can know whether trading would be made more efficient or not, simply due to the existence of a market monitor.

In addition, if the IMM reveals sub-optimal uses of the system, steps could be taken to improve such uses, although the IMM would not impose mitigation or any change on market participants. Available capacity effectively may be increased. This is an

example of the efficiencies that greater transparency could bring to the market. The SOM report that the IMM would produce would be the initial source of improving market transparency.

Transparency also may ease entry to the market as the IMM identifies barriers to entry and they are alleviated. If additional regional pricing points, such as Mid-C, emerge, they would also support more visible spot market pricing. While the IMM would not necessarily be the reason for additional pricing points, its existence could provide impetus to the region to establish those points as it gains more confidence and trust in power and transmission markets.

On balance, TIG believes that direct costs to consumers would potentially be lower with an IMM, even accounting for the funding costs, but TIG is unable to estimate the magnitude or even the probability of that potential.

The risk reduction benefit is equally difficult to estimate. When wholesale spot market prices exceed short-run marginal costs, the market is by definition non-competitive. There are a number of ways for market participants to effect non-competitive pricing. The most common is to withhold generation from the market. Other than bilateral contractual requirements, there is nothing to compel a generator to offer its power into the market. Despite that, TIG believes that the existence of an IMM would help shine a bright light on generators that choose not to produce during periods of high or rising prices or of tight supplies. That "front page" test not only would provide early warnings of potential anti-competitive behavior, it likely would discourage the behavior at the outset.

Another way to try to manipulate the market is to hoard transmission. Again, anecdotal evidence suggests that hoarding occurs, although it is becoming more difficult and increasingly expensive to do. The IMM would have a key role in identifying those opportunities in tariffs, business practices, rate schedules, and the operation of transmission markets to improve the use of existing transmission capacity. If the IMM can bring consistency and efficiency to the transmission markets it is monitoring, the possibilities of hoarding would be reduced.

There are two ways to evaluate the potential benefits of the IMM. One is to look at the costs of market meltdowns such as California's a few years ago. Estimates of the costs of that "event" range in the billions of dollars. Ratepayers ultimately pay almost all of those costs. While the IMM might not be able to prevent such market abuses completely, it should be able to identify them and initiate corrective action earlier than would otherwise occur. With potential costs to consumers of millions of dollars a day, the benefits of early correction are obvious.

The other way to evaluate the potential benefits is to put the costs into context. The energy sector of the Pacific Northwest is an $8 billion-a-year industry (approximately). Assuming an annual cost of $1 million for monitoring, this means that consumers would be paying, on average, about one cent for every hundred

dollars worth of their electric power bills. This clearly is relatively cheap insurance. Any reduction in the cost of delivered energy or the variance of such costs that can be attributed to the IMM would have an enormous cost-benefit ratio.

In summary, despite the inability to calculate an estimate of the IMM's net benefits, TIG believes that the potential for reducing costs, and especially the risks of highly variable costs, is significant. These potential benefits almost certainly exceed the relative low cost of achieving them.

6. Costs and Flow of Funds

The estimated cost of monitoring is expected to be in the range of $500,000 to $750,000 in 2006, increasing thereafter to $1 million to $2 million per year, and subject to a five-year cap of $10 million. These costs would be allocated to, and recovered by PTOs, probably through charges for the use of their systems. The costs of monitoring would thus be borne by end-users through their payments for the transmission system.

Once funds are collected by Transmission Owners, they would be turned over to an agent designated by the signatories to the MMA, who would pay invoices submitted by the IMM. The MMC or its Executive Committee would review the invoices of the IMM and advise the signatories to the MMA as appropriate.

The maximum annual budget for 2006 would be set in the MMA. Actual costs below the 2006 maximum would be determined through solicitation of bids from, and negotiations with, potential suppliers of IMM services. Subsequent budgets for 2007-2010 would be developed by the MMC and submitted to the participating Transmission Owners as recommendations.

7. Schedule for Implementation

A. Phased Approach

In 2006, the work of the IMM would be divided into two phases. In Phase I, the IMM would prepare a general retrospective report on the structure and performance of Northwest transmission and energy markets in 2005, based to the greatest extent possible on publicly available information. Phase I is expected to be completed by no later than June 2006, assuming that the IMM is retained by January 1, 2006. In Phase II, the IMM: (1) would address a limited number of empirical questions associated with the performance and efficiency of transmission and energy markets in the Northwest in 2005; (2) may investigate specific events during 2005 and issue reports on findings; (3) would assess and develop market monitoring systems for monitoring after 2006; and (4) would develop recommendations for monitoring activities in 2007-11. During the first part of Phase II (i.e., the third quarter of 2006), the MMC would develop a recommended budget for monitoring activities in 2007 and present the budget to the signatories of the MMA for their approval. Phase II would be

completed no later than the end of 2006. Procedures would be in place by the end of 2006 to enable the IMM to request information from Transmission Customers, including NDAs, which would expand the potential scope of work of the IMM. Annual SOM reports, specific reports based on investigations, and the accumulation of knowledge generally would determine the scope of work of the IMM after 2006.

B. Schedule (Year/Quarter)

Completion of Contractual Structure

2005/III Obtain regional acceptance (including consultation with the Congressional delegation) of the proposal for market monitoring

2005/IV Negotiate MMA, including initial scope of work for 2006; execute MMA; establish MMC; develop market monitoring plan; issue RFP for market monitoring services (see Appendix IX-F for examples); evaluate responses; interview vendors; select vendor for initial monitoring services

2006 – Phase I

2006/I Set out schedule for MMC during 2006; begin work on SOM for 2005 (IMM); get opinion from IMM regarding need for amendments to OATTs

2006/II Complete SOM for 2005 (IMM); if recommended by the IMM, begin process of developing amendments to regional OATTs

2006 – Phase II

2006/III If required, submit proposed common amendments to regional OATTs to FERC (TOs); identify and begin establishment of "market monitoring systems" (i.e., systems for data transfer); continue regular meetings between IMM and MMC as needed; develop budget recommendations for 2007; develop and issue RFP for auditing services

2006/IV Develop procedures for management of complaints and investigations in 2007 and following; develop NDAs and agreements between states and IMM; receive approval from FERC for amendments to OATTs; select independent auditor for review of specific activities of the IMM during 2007 and following (and 2006 if confidential data is used by the IMM in the preparation of the SOM for 2005)

Post-2006 Monitoring Activities

2007/I Implement new OATT provisions requiring cooperation with the IMM; set up procedures to manage complaints and requests for investigations; execute NDAs as necessary

C. Required Regulatory Approvals

If recommended by the IMM, FERC approval of amendments to regional OATTs requiring cooperation with the IMM, including NDA templates, would be required. State-jurisdictional Transmission Owners would file for state regulatory approvals as necessary, including accounting orders or other mechanisms facilitating recovery of

the costs of monitoring from Transmission Customers, including end-users. No other regulatory approvals are expected to be required.

8. Legal Issues and Their Potential Resolution

A. FERC Jurisdiction over the IMM

One goal of TIG is to develop proposals for improving the Northwest transmission system that do not expand FERC's jurisdiction over non-FERC-jurisdictional entities and do not create new FERC-jurisdictional entities. Based on conversations with attorneys and FERC staff, the Market Monitoring Charter Group assumes that monitoring itself is not a FERC-jurisdictional activity as long as the monitor is independent of the Transmission Owners and the work is not performed by an entity, or overseen by a group, that has responsibility for performing other functions for the transmission system that might compromise that independence. The approach proposed here (i.e., an independent contractor focused solely on monitoring) is consistent with those assumptions.

The IMM contemplated by the TIG proposal would be an independent contractor under contract to the PTOs and overseen by the MMC (and ultimately the PTOs). The MMC would establish the scope of work of the IMM and provide an annual review of its performance with the help of an independent auditor. The IMM would have discretion regarding undertaking investigations; would report directly to FERC, other regulators, and other state and federal enforcement agencies; and would make its reports available to the public at large (perhaps in redacted form or with aggregated data). The IMM and the MMC would not be part of a larger organization that would perform other functions affecting regional power or transmission markets.

B. Liability

The TIG participants perceive a need to protect the PTOs from liability for malfeasance (errors and omissions) by the market monitor. Ultimately, the IMM is expected to receive, analyze, and report on confidential information received from the PTOs and ultimately from the Transmission Customers and other market participants. Furthermore, publication of the fact of an ongoing investigation could harm the entity being investigated even if no wrongdoing is found when the investigation is concluded. As the entities responsible for hiring and funding the IMM, the PTOs could become liable for acts of the IMM.

One means of restricting the liability to which the PTOs are exposed would be to make the IMM an independent contractor. Because the PTOs would not direct or oversee the work of the IMM, the PTOs should not then be held responsible for the IMM's actions.

The PTOs would require that the IMM maintain insurance for errors and omissions and other potential malfeasance. It is likely that the contract between the PTOs and

the IMM would also contain releases of liability and possibly indemnification provisions.

C. Confidentiality

The PTOs, and eventually Transmission Customers, would be required to turn over confidential information to the IMM. Two concerns have been raised: that the confidential information not be made public outside of an investigation report sent to regulators and that the IMM not be used simply as a free "discovery engine", perhaps by potential or actual competitors.

The IMM would have an obligation to keep information confidential and be obligated to take reasonable and customary precautions to protect the information. If it receives a request for information from a government agency with the authority to compel disclosure, the IMM would immediately notify the party that originally provided the information to the IMM so that party could contest the disclosure if it chose to do so. Parties are expected to execute bilateral contracts (NDAs) with the monitor to enforce these protections.

D. Common OATT Provision

In order to provide the IMM with the information needed to monitor the markets adequately, and if recommended by the IMM, the PTOs would agree to work towards a common OATT provision that would require Transmission Customers to cooperate with the IMM and provide information reasonably requested by it.

That OATT provision has yet to be developed but may contain the types of rights and obligations shown in Appendix IX-H. Transmission Customers would agree to provide information directly to the IMM (but not to the Transmission Owners).

Transmission Customers would be expected to execute bilateral contracts (NDAs) with the IMM to protect the confidentiality of their information.

9. Roles of the States

Representatives of the state utility regulatory agencies and the state Attorneys General ("State Agencies") would participate on the MMC. Each State Agency would be free to determine the nature and extent of its participation consistent with the agency's authorities and responsibilities.

State Agencies would execute an agreement with the IMM including at least the following provisions:

a) Agreement by the IMM to provide the State Agency with copies of the regular reports produced by the IMM as well as the results of any special investigations undertaken by the IMM;[3]

b) Agreement by the IMM to inform the State Agency of any special investigation it undertakes of a utility or other market participant located in that state;

c) Agreement by the IMM to be accessible to the State Agency for discussion and analysis of market data affecting the state and to undertake special investigations if requested by the State Agency;

d) Agreement by the State Agency to protect confidential information to the degree permitted by law; [4]

e) Agreement by the State Agency to identify a point of contact to work as necessary with the IMM;

f) Agreement between the State Agency and the IMM on the conditions under which the IMM may serve as an expert witness in support of the analysis it provides in regular reports or special investigations as they may be pertinent to a state proceeding.[5]

10. Roles of Enforcement Agencies

As noted above, the IMM would have no enforcement authorities on its own. That is, the IMM will perform an investigative and reporting function, but will not have the right to require or prohibit any action by any market participant, including PTOs, except regarding the provision of data and information. However, the IMM will submit reports as appropriate (depending on its findings, and in unredacted form) to state regulatory agencies, federal regulatory agencies, state attorneys general, the Federal Trade Commission, the Securities and Exchange Commission, and the federal Department of Justice. These reports will be submitted to such agencies if, in the sole discretion of the IMM, behaviors or structures are found by the IMM that have the potential to violate laws or regulations that are enforced by such agencies.

11. Discussion of "Seams" Issues

The Northwest IMM would be required to consult with market monitors established in other parts (sub-regions) of the WECC and with any "umbrella" monitoring entity or vendor established for the WECC as a whole. This would include the California ISO's market monitor, the ISO's Market Oversight Division, and any market monitor

[3] Such reports may be unredacted if subject to a NDA.

[4] Each State Agency would need to fashion a commitment to protect the confidentiality of data to the degree permitted under law. Even if a State Agency is unable to execute a non-disclosure agreement, it would retain all subpoena authorities under existing laws.

[5] Monitors have appeared before FERC as expert witnesses in various proceedings.

that may be established in the Southwest region of the Western Interconnection. In addition, if the Seams Steering Group-Western Interconnection (SSGWI) establishes a pilot market monitor for the Western Interconnection, as it currently intends, the IMM would consult and coordinate with that monitor. These consultations should reveal issues of market structure and performance at the "seams" between sub-regions of the WECC. The IMM would be expected to report on those seams issues and to make recommendations for improving the efficiency of inter-regional power and transmission markets. The IMM would be required to report publicly on such issues. Finally, the IMM would report to FERC on "seams" issues.

12. Follow-on Work and Possible Plan

The work of the IMM and the functions of the MMC would evolve over time as more knowledge and understanding of the operation of Northwest energy and transmission markets are developed. The MMA should be flexible enough for annual budgets and scopes of work to be written within the overall plan for market monitoring. It is expected that issues will arise regarding the acquisition of data, relevant and necessary analyses, and recommendations for changes in market (or tariff) structure or the conduct of market participants, but those cannot be anticipated at this time.

Ultimately, the IMM is expected to analyze the structure and performance of Northwest wholesale energy and transmission markets and the conduct of individual market participants. The IMM would be largely concerned with discovering how close Northwest markets come to producing competitive outcomes. It is possible that the IMM would ultimately address such questions as the following:

- What effect, if any, do pancaked transmission rates have on generation efficiency?
- To what extent are hedging instruments adequate for market participants to manage risks?
- Are "correct" price signals being sent for long run entry or exit?

Finally, it is possible that FERC will develop requirements for market monitors in non-RTO regions. If FERC does issue rules in this area, the PTOs and MMC will have to reconsider the market monitoring plan, the annual scope of work, and the contracts that establish monitoring in the Northwest.

13. Discussion of Other Ideas or Recommendations Specific to the Charter Group

Although potential linkages to the work of other TIG Charter Groups have been discussed above, the proposal here for market monitoring can move ahead independently of the other Charter Groups. Negotiation of the MMA can be completed this year, and a vendor selected by the end of 2005. Even if no other changes are put into place, the work of monitoring can move ahead.

14. Appendices

A. Market Monitoring Charter
B. Outline of and principles for MMA
C. Chart showing implementation
D. List of responsibilities of market participants and IMM
E. Scope of work of IMM during 2006
F. Illustrative RFPs for monitoring and auditing services
G. Draft PSA for retention of IMM(s) (outline/principles)
H. Illustrative modifications to OATTs
I. Illustrative templates for NDAs
J. List of URLs for recent relevant SOM reports
K. Retention agreements between (a) Southwest Power Pool and Boston Pacific and (b) Midwest ISO and Potomac Economics (as examples of PSAs)
L. List of potential vendors for monitoring services.