

PROJECT NO. 31111

RULEMAKING TO ADDRESS AN	§	PUBLIC UTILITY COMMISSION
INDEPENDENT MARKET MONITOR	§	
FOR THE WHOLESALE ELECTRIC	§	OF TEXAS
MARKET IN ERCOT	§	

**ORDER ADOPTING NEW §25.365
AS APPROVED AT THE APRIL 13, 2006 OPEN MEETING**

The Public Utility Commission of Texas (commission) adopts new §25.365, relating to an Independent Market Monitor for the Wholesale Electric Market in the Electric Reliability Council of Texas (ERCOT) with changes to the proposed text as published in the November 11, 2005 issue of the *Texas Register* (30 TexReg 7338).

The new rule will enable the commission to enforce wholesale market rules to assure the efficient and reliable operation of electricity markets and the reliable delivery of electricity at reasonable prices during the transition to a fully competitive electric power industry in Texas. The Texas Legislature has determined that the independent organization shall contract with an entity selected by the commission to act as the commission's wholesale market monitor to detect and prevent market manipulation strategies and recommend measures to enhance the efficiency of the wholesale market. The Legislature has directed that the commission by rule define (1) the market monitor's responsibilities, including reporting obligations and limitations; (2) the standards for funding the market monitor, including staffing requirements; (3) qualifications for personnel of the market monitor; and (4) ethical standards for the market monitor and the personnel of the market monitor. The new rule defines those standards. The new rule provides many public benefits, including the protection of customers and market entities from high prices that could result from market rule violations and market manipulations, and the protection of the

developing wholesale market from potential market power abuses. Each of these benefits is important to meeting the legislative directive to protect the public interest by establishing a wholesale independent market monitor to support the role of the commission in enforcing market and commission rules.

The rule is adopted as part of the commission's efforts to establish an independent wholesale electric market monitor for the market in the ERCOT region, under Chapter 39 of the Public Utility Regulatory Act (PURA), Texas Utilities Code Annotated §§11.001-64.158 (Vernon 1998 & Supp. 2006). PURA Chapter 39 delegated many important functions to the commission in order to "protect the public interest during the transition to and in the establishment of a fully competitive electric power industry." Among those functions were the enforcement of market rules and the prevention of market manipulations. In order to protect the public interest and to assure that the market functions efficiently, the commission adopts this rule governing the independent wholesale electric market monitor for the ERCOT market. This rule is a competition rule subject to judicial review as specified in PURA §39.001(e). This new section is adopted under Project Number 31111.

A public hearing on the proposed section was held at the commission's offices, located in the William B. Travis Building, 1701 North Congress Avenue, Austin, Texas 78701, on Monday, January 9, 2006 at 9:30 a.m. Representatives from the Electric Reliability Council of Texas (ERCOT); Reliant Resources, Inc. (Reliant); Constellation Energy Commodities Group, Coral Power, LLC, Exelon Generation Co., LLC; FPL Energy, LLC, Suez Energy Marketing NA; and Texas Genco, LLC (collectively, Joint Commenters); TXU Generation Company LP and TXU

Portfolio Management Company LP (collectively, TXU), Brazos Electric Power Cooperative (Brazos), American National Power, Inc. (ANP), GDS Associates, the Office of Public Utility Counsel (OPUC), and CenterPoint Energy Houston Electric, LLC (CenterPoint) attended the hearing and provided comments. To the extent that these comments differ from the submitted written comments, such comments are summarized herein. Following the hearing, Joint Commenters filed a concise summary of its positions discussed at the hearing supplementing the comments and reply comments it had previously filed in the project.

The commission received comments on the proposed new section from TXU, Joint Commenters, Reliant, Brazos, the City of San Antonio acting by and through the City Public Service Board of Trustees (CPS Energy), ERCOT, and East Texas Electric Cooperatives (ETEC). Reply comments were received from Joint Commenters and the Office of Public Utility Counsel (OPUC).

Summary of Comments

General Comments

Tex-La Electric Cooperative of Texas, Inc., Deep East Texas Electric Cooperative, Inc., Houston County Electric Cooperative, Inc., Cherokee County Electric Cooperative Association, and East Texas Electric Cooperative, Inc., collectively, here the East Texas Cooperatives (ETCs) expressed support for the rule, which they stated gives broad authority to the independent market monitor (IMM), and agreed that the rule is necessary to protect the public interest. The ETCs believed that the IMM should have oversight capability and investigative powers in order to accomplish its purpose. The ETCs supported a rule that gives the IMM the tools to accomplish

those goals and opposed any changes to the rule that would unreasonably limit the IMM's ability to accomplish its purpose.

Joint Commenters recommended that the commission adopt procedures for the IMM similar to those for the market monitoring unit (MMU) for the PJM Interconnection (PJM), with modifications to avoid placing the IMM in an enforcement-type role prohibited by PURA.

In reply comments, OPC supported all the elements of the proposed rule. OPC believed that the rules governing the ERCOT IMM should not duplicate those found in PJM because of jurisdictional differences and distinct market characteristics.

Role of the IMM

TXU contended that the primary functions of the IMM are: (1) analyzing the conduct of particular market participants and the status of the wholesale market in general; (2) analyzing ERCOT's operations to ensure that it operates the market in an efficient and non-discriminatory manner pursuant to the ERCOT Protocols and Operating Guides; (3) determining whether its analyses support the need for a specific market intervention or require no action at all; and (4) reporting to the commission the results of the analyses supporting specific market intervention, including making recommendations regarding possible enforcement actions against a market participant or ERCOT and changes to commission rules or ERCOT Protocols or Operating Guides.

The commission generally agrees with TXU regarding the functions of the IMM and believes the rule adequately delineates the roles and functions of the IMM. The commission notes that the statute does not have any specific provision requiring the IMM to recommend that enforcement action be undertaken, other than the IMM's duty to report violations, potential violations, or potential market manipulations. While the IMM's findings and analysis will necessarily be part of the evaluation as to whether enforcement action is warranted, the ultimate decision to initiate an enforcement proceeding and recommend the imposition of penalties resides with the executive director of the commission, and the assessment of penalties can only be done through an order of the commission, not the IMM, pursuant to PURA §15.023. The rule that is being adopted is, for the most part, consistent with TXU's comments but includes greater detail concerning the IMM's duties, which is consistent with the commission's authority to define the IMM's responsibilities, under PURA §39.1515.

IMM Independence and Separation of Functions Between the IMM and Commission Staff

TXU asserted that, to maintain objectivity and establish its independence, it is necessary that the IMM's role be clearly distinguished from the enforcement and policy-making role of the commission, including the commission's Wholesale Market Oversight Section. TXU asserted that the IMM is not an agent for the commission or the commission staff and should be viewed as an independent entity. TXU also asserted that the positions and interests of the IMM are not necessarily aligned with those of the commission staff.

Reliant stated that the commission should clarify that, although there is a management relationship between the two organizations, it expects the IMM to provide independent analysis and recommendations to it and its staff.

The commission agrees that the IMM should establish its independence from the market participants and ERCOT. However, while it is unquestionable that the IMM has a unique role and should conduct independent analysis and reach its own findings, and certainly is in all ways required to be independent from the parties that it monitors, the commission cannot declare that the IMM is wholly independent from the commission itself, in light of the requirements in PURA regarding the commission's oversight of and interaction with the IMM. For example, the commission is required to select the IMM, ensure that the IMM has adequate resources, establish ethical standards for the IMM, and supervise and oversee the IMM, and the commission staff is to be able to communicate freely with the IMM. The commission agrees that the IMM should provide analysis and recommendations that are independent and based solely on its expertise to the commission. The commission believes the rule as proposed adequately separates the enforcement and policymaking roles of the commission from the market monitoring and analysis functions of the IMM.

While the IMM is required to recommend changes to commission rules or the ERCOT protocols as part of its annual report, the decision to make those changes resides with the commission. Likewise, while the IMM is required to report violations, potential violations, or potential market manipulations to the commission under subsection (l)(1), the decision to recommend enforcement action and the imposition of penalties or other remedial action

resides with the executive director of the commission, and the actual imposition of penalties or remedial action can only be done through commission order. For this reason, while the rule does provide that the IMM will provide testimony as part of the commission's staff case in an enforcement proceeding under subsection (d)(9), the rule does not inappropriately confer enforcement authority on the IMM, and no change to the rule is necessary.

The commission agrees with Reliant's comment that the analysis and recommendations of the IMM should be independent and based solely on the IMM's independent findings and expertise, and has further clarified the rule in this regard.

TXU stated that market participants and ERCOT should be notified if their behavior is being reported to the commission. For example, TXU referred to the market monitor for PJM, who issues a "demand letter" concurrently to the market participant and the respective public utility commission or board addressing actions the market monitor believes violate the rules and standards governing PJM; and to the New England Power Pool's Independent Market Advisor, who provides notice and an opportunity for the market participant to respond when questionable conduct is identified.

The commission disagrees with TXU that the IMM should be required to notify market participants when their behavior is being reported to the commission. The commission agrees that in order to perform its function effectively, the IMM should be permitted to engage in dialog with a market participant regarding the market participant's activities to

determine whether a potential rule violation or potential market manipulation has occurred, and that, as part of those discussions, the IMM may indicate that a potential violation or market manipulation may have occurred. The commission amends subsection (e) of the rule accordingly. However, the commission does not believe that it should require the IMM to notify market participants in all instances when behavior is reported to the commission. Should the commission staff determine that a reported violation or potential violation warrants additional investigation or enforcement action, §25.503(l) of this title already provides for an opportunity for a market participant to meet with the commission staff prior to conclusion of the staff's investigation. Therefore, the commission believes adequate notice provisions are already provided for by rule.

Additionally, the commission notes that the “demand letter” currently issued by the PJM MMU, as described in TXU's example, goes beyond simply informing a PJM market participant that it is being reported. The commission views the PJM “demand letter” as an enforcement tool, as the PJM MMU has the authority to demand in that letter that a market participant cease an activity or modify a behavior, and to penalize a market participant that is not responsive. In contrast, PURA specifically prohibits the commission from delegating enforcement authority to the IMM. The commission therefore declines to add this requirement in the rule.

Confidentiality of Competitively Sensitive Information

TXU stated that §25.362(e) of this title and section 1.3 of the ERCOT Protocols set out very specific requirements for how ERCOT should address competitively sensitive and confidential

information, and that those same requirements should be incorporated by specific reference in the IMM rule to expressly apply them to the IMM. TXU added that the current language of the rule is not sufficient to adequately protect confidential information because §25.362(e) and section 1.3 of the ERCOT Protocols apply only to the ISO. In fact, TXU added, the proposed rule language has little effect at all, since there are no detailed confidentiality procedures in PURA, the Substantive Rules, or the ERCOT Protocols that would apply to the IMM unless they are directly incorporated in this rule.

In reply comments, Joint Commenters agreed with TXU's comments on competitively sensitive information.

The commission agrees that the rule needs to contain provisions that adequately protect confidential or competitively sensitive information, and has modified the subsection (j)(1) of the proposed rule to clarify that the standards and procedures for handling confidential information that are contained in PURA, the ERCOT Protocols, commission rules, and other applicable law are incorporated by reference.

TXU stated that the market participant should be notified when its confidential information has been given to the commission so that it can take the necessary steps to make sure the information remains protected. In particular, information possessed by the commission is subject to Texas Public Information Act requests, and TXU believes that market participants should be informed when their information becomes subject to possible requests under the Act. In case of a formal request for confidential information, TXU would require the IMM director to address its request

in writing to a market participant's designated representative. This would provide the market participant sufficient background to respond quickly and accurately to the request, and would ensure that a formal request for confidential information from the IMM is duly recognized and addressed by the market participant.

The protection requested by TXU is already provided by §552.305 of the Tex. Gov't Code (the Texas Public Information Act). Under §552.305, a market participant whose confidential or proprietary information becomes the subject of a public information request has the right to be informed of the request within a reasonable time and the right to submit briefs to the attorney general before a decision is rendered. It is not clear from the comments how additional notice prior to the commission's receipt of information that a market participant considers confidential will provide any additional protection to the market participant. Moreover, considering the volume of potentially confidential information that will be exchanged between the IMM and the commission, sending and keeping track of such notices will pose an unnecessary administrative burden on the IMM. The commission concludes that the TPIA provides adequate protection from requests for public information and that a change in the proposed language is not necessary. The commission also concludes that requiring that the IMM make written formal requests for information that a market participant considers to be confidential is not necessary. The IMM will have to develop more detailed procedures for carrying out its responsibilities under this new rule, and this is a detail that can be addressed in such procedures. This rule protects the market participants' key interest: the protection of confidential information.

Proposed changes to individual subsections.

Joint Commenters suggested that the rule should clarify that it applies to market participants, to the IMM, and to ERCOT.

The commission is making a clarification in subsection (a) that this section also applies to the interactions between the IMM and market participants, in response to this comment.

Proposed subsection (b): Definitions

Joint Commenters requested that the proposed rule's definition of market participant in subsection (b)(3) include anyone who could benefit significantly from an outcome of a matter under the IMM authority, whether the entity participates in the wholesale market or not, and proposed to define "market participant" as: "any natural person, partnership, municipal corporation, cooperative corporation, association, government subdivision, or public or private organization that engages in any activity that is in whole or in part the subject of the ERCOT protocols, regardless of whether such entity has executed an agreement with ERCOT."

The commission finds that the definition in the proposed rule will benefit from adding Joint Commenters' language to clarify that all potential interested parties are captured by the definition. The commission therefore incorporates the proposed change as an additional definition but does not delete the previously proposed definition based on wholesale-market participation.

In proposed subsection (b)(3), (now (b)(2)), Brazos Electric suggested that the definition of “market” is essentially unlimited in scope. Brazos Electric proposed that the commission consider clarifying the definition by indicating that a market is related to the exchange of goods or services as related to the wholesale market within the ERCOT region.

In reply comments, the Office of Public Utility Council (OPC) disagreed with Brazos Electric and opposed the narrowing of the definition of the term “market.” According to OPC, such narrowing is unnecessary because whenever the term “market” is used in the proposed rule, it is followed by a qualifier that makes it clear that the IMM’s responsibility is geared toward a narrowly defined market.

The commission agrees with Brazos that the definition of the term “market” is broad but also agrees with OPC that a narrowing of the definition is not necessary for the purpose of this rulemaking and no additional clarification is needed. As OPC points out, the context clearly indicates that the scope of the IMM’s monitoring responsibilities is ERCOT markets.

The commission has also deleted the definition “protocols” in subsection (b)(4) as the term “ERCOT protocols” is already defined in §25.5 of this title. Other conforming changes have also been made to use the term “ERCOT protocols” consistently in this section.

Proposed subsection (c)(2): Objectives of market monitoring

Proposed subsection (c)(2) sets out one of the objectives of the IMM: to “recommend measures to enhance market efficiency.” ERCOT proposed to add “without compromising reliability” at the end of the subsection to clarify that the IMM recommendations are consistent with applicable standards and policies for grid reliability.

This paragraph implements PURA §39.1515(a) and (h), which require the IMM to recommend measures to enhance the efficiency of the wholesale market, and to provide recommendations to the commission and ERCOT on changes to the market design to correct flaws. The commission believes the IMM should have broad latitude in making these recommendations, because the commission and ERCOT are ultimately responsible for conducting an evaluation and deciding whether or not the IMM’s recommended changes should be made. The commission agrees with ERCOT that it is necessary to evaluate the reliability impacts of the recommended changes, but believes that the processes that the commission and ERCOT will use to evaluate the IMM’s recommendations will adequately consider those impacts, and therefore declines to make the change recommended by ERCOT.

Proposed subsection (d): Responsibilities of the IMM

ERCOT stated that proposed subsection (d)(4), which requires the IMM to “evaluate market participants’ and ERCOT’s compliance with the protocols and the effectiveness of ERCOT’s system operations,” could be interpreted as an extremely broad and open-ended mandate.

ERCOT proposed amending this subsection to limit the scope of this requirement to the objectives of the IMM, as defined in subsection (c).

The commission disagrees with ERCOT that the requirement to monitor ERCOT's compliance with the protocols is too broad, but agrees that the description of the IMM's responsibility to evaluate the effectiveness of ERCOT's system operations may be modified by adding specific examples to provide more clarity. The commission therefore modifies the rule to specifically indicate that IMM responsibilities include assessing the effectiveness of ERCOT's management of the energy, ancillary service capacity, and congestion rights markets operated by ERCOT, and to evaluate the effectiveness of congestion management by ERCOT. These examples are set out in a new subsection (d)(5).

ERCOT commented that the term "harmonize" in proposed subsection (d)(6) could be subject to a wide range of interpretations by various parties. ERCOT considered its role in ensuring the reliability of the electric grid to be its overriding primary responsibility. ERCOT supported the idea of identifying potential areas of improvement to market efficiency, but recommended striking the language related to harmonizing that task with reliability standards.

The commission agrees with ERCOT and modifies the rule accordingly. This provision is now subsection (d)(7).

Proposed subsection (d)(8): IMM testimony

TXU proposed revising the rule language in proposed subsection (d)(8) referring to IMM testimony, to clarify that when the IMM offers testimony in a commission proceeding, it should do so in support of the analysis and investigation it has conducted.

CPS Energy commented that it is unquestionable that the IMM's responsibilities encompass providing expert testimony. However, CPS Energy believed that proposed subsection (d)(8) implies that the IMM will offer testimony based on the desires of commission staff rather than testify fully consistent with the results of the IMM's independent investigation. CPS Energy suggested revising the rule to describe the IMM's testimony, as follows:

- (8) Providing expert testimony services in enforcement proceedings initiated by the commission or other commission proceedings.

In reply comments, Joint Commenters disagreed with CPS and added that CPS cited no authority for stating that the IMM's responsibilities unquestionably encompass providing expert testimony.

While the commission agrees with TXU and CPS that the IMM's primary role in an enforcement proceeding will be to present and defend its independent analysis, it may also be the case that the IMM will need to, among other things, respond to positions of other parties or discuss general issues of market manipulation or compliance as part of the enforcement proceeding. The commission agrees with the revision recommended by CPS to make it clear that enforcement proceedings are initiated by the commission. The

commission is also modifying the rule along the lines of TXU's suggested revision, to reinforce the idea that the IMM's testimony is to be based on its findings, analysis and expertise:

(9) Providing expert testimony relating to the IMM's independent analysis, findings and expertise, as part of the commission staff's case in enforcement proceedings initiated by the executive director in accordance with §22.246 of this title (relating to Administrative Penalties) or other commission proceedings.

Joint Commenters stated that proposed subsection (d)(8) referring to the IMM testifying on behalf of PUC staff, should be eliminated, or in the alternative should be amended to say that if the IMM were to testify, it would be at the request and under the control of the presiding officer.

In reply comments, OPC disagreed with Joint Commenters that proposed subsection (d)(8) should be deleted. OPC believed that the commission would benefit from hearing the testimony of the IMM in any contested case proceeding. OPC further disagreed with Joint Commenters' argument that PURA would not permit the IMM to testify. OPC believed that PURA §39.1515 gives the commission broad authority to define the manner in which the IMM would support the commission in its enforcement role. Referring to the two IMM functions described in PURA §39.1515 as detecting and preventing market manipulations, OPC contended that testimony by the IMM would fulfill such functions because it could prevent market manipulation. Lastly OPC did not see that PURA required the strict separation of functions that Joint Commenters recommended between the commission and the commission staff: OPC believed that PURA §39.1515 and §§39.155-157, in giving the commission broad authority in preventing improper

market manipulation, allowed the commission to delegate any aspect of that responsibility to commission staff.

The commission agrees with OPC that it is proper to specify that part of the IMM's duties is to testify in enforcement and other commission proceedings and disagrees with Joint Commenters' suggestion that subsection (d)(8) of the proposed rule, now (d)(9), should be deleted, or that the IMM should only testify if summoned to do so by the Presiding Officer. The commission generally agrees with OPC that the commission will benefit from the IMM's expert testimony in contested proceedings and does not see any reason to limit IMM testimony in the manner suggested by Joint Commenters. Moreover, the commission has specific authority to define the IMM's responsibilities.

The commission believes that, as a general matter, the IMM's independent expertise, analysis, and conclusions are appropriate to have as part of the commission staff's case in an enforcement proceeding, even though there may be certain wholesale electric market enforcement proceedings where the IMM's testimony is not needed. For example, the IMM's testimony may not be needed in enforcement cases where the violation at issue is a relatively straightforward matter of non-compliance with a specific protocol or rule requirement, but will almost certainly be needed in cases involving market manipulation, market power abuse, or other similar matters. Cases involving market manipulation and market power abuse are likely to be complex matters relating to the operation of the wholesale electric market and the operation of generating and transmission systems in the markets, for which the IMM's expertise will be invaluable. The broad purpose of PURA

§39.1515 is to put such expertise at the commission's disposal in preventing market abuses. Accordingly, the commission believes that it is appropriate to specify testifying as a necessary duty of the IMM. The commission declines to delete subsection (d)(8) as proposed by Joint Commenters. A more detailed response to each of the specific points raised by Joint Commenters follows.

Joint Commenters offered the following specific reasons in support of their conclusion that the IMM should not testify on behalf of the commission staff:

(1) It is contrary to PURA §39.1515, which distinguishes between the commission and the commission staff with respect to the IMM and establishes that the IMM is the market monitor for the commission, not the commission staff.

The statute does differentiate between the commission and its staff, but the commission does not believe that the fact that the IMM is the market monitor for the commission, as opposed to commission staff, prohibits the IMM from providing testimony as part of the staff case in an enforcement proceeding. Accordingly, the commission disagrees with Joint Commenters and concludes that the IMM may present its findings and analysis in an enforcement proceeding as part of the IMM's responsibilities.

(2) Being a witness for the commission staff is not an IMM function listed in PURA §39.1515(d). To the contrary, PURA §39.1515(d) dictates that the IMM is not to have any enforcement authority.

The commission disagrees that requiring the IMM to provide testimony is inconsistent with PURA §39.1515(d), which requires the commission to define the IMM's monitoring and reporting responsibilities by rule. As the IMM will be conducting the day-to-day monitoring of the market and reporting violations, potential violations, and potential market manipulations to the commission, it is logical and efficient to provide for the IMM to present its conclusions as to the occurrence of a violation or market manipulation as part of an enforcement case, and is within the commission's discretion to require it to do so.

(3) Testifying on behalf of the commission staff would require that the IMM adopt an enforcement-like role not contemplated by PURA §39.1515(d).

The commission disagrees that having IMM as witness in an enforcement proceeding confers enforcement authority on the IMM. The authority to initiate an enforcement proceeding and recommend penalties resides with the executive director of the commission, and the actual imposition of penalties or other remedies can only be done through commission order. Nothing in the rule alters or delegates this authority to the IMM, and providing for the IMM to present its findings and analysis as part of the commission staff's case is within the commission's discretion.

(4) IMM testimony for the staff would raise ex-parte concerns, and would impair the IMM's ability to perform its most critical statutory function, which is to report directly to the commission. According to Joint Commenters, under the Administrative Procedures Act (APA), the IMM would be able to communicate with the commission and act as the commission's

advisory staff if it was not participating in the proceedings, but would not be able to do so if it was testifying for the staff.

The commission disagrees that having the IMM participate in an enforcement case will prevent the IMM from performing its statutory function of reporting to the commission. The sequence of events leading to an enforcement action will permit the IMM to report to the commission before an enforcement action is initiated. The rule requires an immediate report to the commission of potential market manipulations, which in these circumstances could be a report either to the staff or the commissioners. An enforcement case would be initiated only some time later, after the staff has analyzed reports from the IMM and the executive director has concluded that an enforcement action is warranted. The ex parte restrictions do not exist unless and until a contested enforcement case is filed, which will occur well after the IMM's report of the violations or potential violations that led to the enforcement case. As stated earlier, it is logical and efficient to require the IMM to present and defend its analysis and findings as to the occurrence of a violation in the enforcement case. Additionally, once an enforcement case is filed, ex parte restrictions only apply to issues of fact or law in that case. Therefore, the IMM will not be precluded from discussing other matters, such as subsequent market events, with the commissioners.

(5) While PURA §39.1515(f) states that the IMM is to report directly to the commission, subsection (g) states that the IMM may communicate freely with commission staff on any matter without restriction. Such communication should sufficiently enable the staff to conduct its enforcement function using what it learns from the IMM.

Joint Commenters' proposal would result in an inefficient use of resources, as the IMM's analysis would have to be entirely duplicated by the staff's testimony in the enforcement case. Joint Commenters' argument is also inconsistent with point (4) above, where Joint Commenters argue that the IMM should act in an advisory role in enforcement proceedings, as they would then be precluded from communicating with the commission's legal and analytical staff prosecuting the case. It is within the commission's discretion to indicate an expectation that IMM personnel will participate in the commission staff's case on contested matters.

(6) IMM testimony would impede the confidentiality of IMM discussions with the commissioners. The APA specifies that contested case proceedings are subject to the Texas Rule of Evidence (TRE), and that discovery in such proceedings is subject to the Texas Rules of Civil Procedures (TRCP). Therefore, any information used by the IMM as the basis of his or her testimony, including discussions with individual commissioners, even if privileged, would be discoverable.

The commission disagrees with Joint Commenters that any privileged discussions with the commissioners would be discoverable. Commission Procedural Rule §22.141(a) defines the scope of discovery and provides that “[p]arties may obtain discovery regarding any matter, *not privileged* or exempted under the Texas Rules of Civil Evidence, the Texas Rules of Civil Procedure, or other law or rule, that is relevant to the subject matter in the proceeding.” (Emphasis added.) Moreover, in commission hearings the entry of a

protective order addresses the handling of confidential, non-privileged documents. Clearly, current laws and rules provide adequate protection for any privileged information.

(7) IMM testimony for the staff would raise fairness concerns. If the IMM agreed with the market participant, the law would erect barriers to discovering that. In contrast, if the IMM agreed with the staff, that opinion could be admitted in evidence.

The commission disagrees that having the IMM present its analysis regarding the occurrence of a violation in an enforcement case raises fairness issues. The commission staff is required to support its case with adequate evidence, of which the findings and analysis of the IMM is likely to be a critical component. That evidence can be tested, examined, and rebutted by opposing parties to the proceeding. To the extent that the IMM provides testimony as part of the commission staff's case, the IMM will be subject to discovery and available for cross-examination at the hearing if the respondent-market participant disagrees with the conclusions reached by the IMM. If the IMM does not provide testimony, then the testimony of other staff witnesses that support the staff's recommendations will be subject to discovery and available for cross-examination if the market participant disagrees with the conclusions.

In the limited cases where the IMM is not providing testimony, the commission does not believe, as a general matter, that it would be appropriate to shield any opinions or analysis conducted by the IMM on the specific matter at issue in the enforcement case, recognizing

that those opinions and analyses may be of limited relevance because the staff is not relying on them as the basis of the enforcement proceeding. The commission expects that reasonable access to the IMM will be provided, but cautions that parties should not attempt to abuse this access and that this access would not extend to compelling the IMM to conduct new or additional analysis.

(8) If staff used the IMM as a consulting expert, as opposed to a testifying expert, his or her opinions and knowledge of the facts, even if favorable to the market participant, would not be discoverable. Proposed subsection (d)(8) would also raise other privileges, such as the attorney work product and the attorney-client privileges, that would also add protection from discovery and would be unfair if the IMM were to agree with the market participant and disagree with the staff.

As discussed earlier, the commission believes that the IMM's findings and analysis is an important element of the executive director's decision to initiate an enforcement proceeding and will be given great weight in that decision. The commission does not believe having the IMM provide testimony in an enforcement case raises any fairness issues, as the market participants would have the opportunity to cross-examine the IMM and/or the commission staff providing testimony in an enforcement case, and the commission expects that a full view of the IMM's analysis, including any potentially exculpatory findings, will be discoverable by market participants. The IMM's purpose, consistent with PURA, should be to help the commission establish the most efficient, well-

functioning wholesale electric market possible; the purpose is not to seek enforcement actions or penalties for their own sake.

(9) IMM testimony would impair the IMM's ability to discuss all on-going monitoring matters in an effective and timely way with every market participant; and it would distract the IMM from performing its unique statutory functions.

The commission disagrees that the IMM's role in an enforcement case impairs its ability to conduct on-going monitoring. Joint Commenters' concern appears to assume that as a result of its expert witness duties either the IMM will be effectively understaffed or that the IMM will not be able to effectively and efficiently manage its office and other duties. The commission is required by PURA to assure that the IMM has the resources to perform all of its functions timely and effectively. Moreover, the commission does not believe that the IMM's involvement in a pending contested case would prevent the IMM from performing its functions.

In reply comments, Joint Commenters stated that, whether or not the IMM testifies, the rule should state that the IMM, unless required by law, may not communicate non-public information it receives from a commissioner or staff that pertains to an investigation or anticipated investigation or enforcement proceeding.

The commission agrees with Joint Commenters that the IMM may not communicate any confidential information or any information that pertains to an investigation, anticipated

investigation, or enforcement proceeding to the public. Therefore the commission modifies subsection (j)(2) to clarify that the IMM is not to communicate such information to any other entity in addition to the entities already listed in that subsection.

In reply comments, OPC suggested an amendment to proposed subsection (d)(9) to read: “Maintaining a market oversight website to share market information *and as much of the analysis as possible regarding investigations with the public while maintaining all confidential information redacted.*”

The commission believes that OPC’s suggestion is too broad and that it could be excessively burdensome for the IMM to report its analyses on the website. The commission prefers to allow the IMM to decide the contents of its website in consultation with the commission or commission staff at a later date. This will permit the IMM to maximize the effectiveness of its website, consistent with its duties under the statute and this rule and with its resources. Therefore the commission declines to include the suggested change.

Proposed subsection (d)(11): Performing any duties requested by the commission

In proposed subsection (d)(11), to the sentence “performing any additional duties required by the Commission” Joint Commenters would add: “within the scope of PURA §39.1515 or this section.” OPC would add “consistent with applicable state law.” Brazos Electric stated that this provision is too broad in allowing the commission to add any additional duties it requires and recommended that the commission delete this subsection. To the extent that new activities do not fall within those already listed within subsections (1) through (10), Brazos contended, the

commission should allow market participants the opportunity to review and comment on such new or added responsibilities. In reply comments, OPC in part concurred with Brazos, stating that any change in IMM responsibilities should proceed through the normal rulemaking process before the commission and allow for public comments and participation.

The commission partially agrees with Joint Commenters and adds the phrase “within the scope of PURA §39.1515,” but not the phrase “or this section” to proposed subsection (d)(11). Joint Commenters correctly note that “additional duties” may not exceed the scope of what the Legislature intended in enacting PURA §39.1515. Therefore, adding the phrase “or this section” will add nothing of substance to the meaning of the sentence. The commission disagrees with Brazos Electric’s and OPC’s suggestion that it should attempt to anticipate every possible duty the IMM will have to perform before the IMM actually assumes its responsibilities in the marketplace and declines to modify the rule.

OPC suggested the addition of a paragraph to proposed subsection (d) to state that “the IMM should keep the market informed as to the status of the wholesale market and any problems identified. This should be done through monthly reports to the ERCOT Technical Advisory Committee (TAC) and the Board of Directors.”

The commission agrees with OPC that the IMM should keep the market informed periodically as to the status of the wholesale market and any important problems identified in the market, and modifies proposed subsection (k) relating to reporting requirements to specify as much. The commission does not believe it necessary to codify a specific

frequency of reporting to TAC and the Board of Directors in the rule and prefers to leave that level of detail for the IMM to decide, in consultation with the commission.

Proposed subsection (e): Authority of the IMM

In proposed subsection (e)(2), Joint Commenters suggested adding: “that the commission would have authority to require” to the sentence “The IMM has the authority to require submission of any information and data it considers necessary to fulfill its monitoring and investigative responsibilities by ERCOT and by market participants.”

Brazos Electric expressed concerns that the proposed rule would allow the IMM too broad authority and asked that the commission narrow the scope of the IMM’s authority. In addition, Brazos Electric recommended the commission add a provision that would require that information deemed confidential by a market participant be kept confidential by the IMM.

In reply comments, OPC opposed Brazos Electric on both issues. In OPC’s view, the term “any information or data” is sufficiently narrowed by the subsequent qualifying language regarding information and data “the IMM considers necessary to fulfill its monitoring and investigating responsibilities.” OPC further noted that the commission’s Procedural Rules address a party’s designation and handling of confidential material sufficiently to not warrant additional limitations in this rule.

CPS Energy noted that the proposed rule oversteps the commission’s statutory authority in subsection (e)(2) in that the law only authorizes the IMM to require production of data from

ERCOT and does not extend that authority to production of data from market participants. CPS Energy also believed that the information required of the market participants was likely to be trade secret, confidential, proprietary, and/or competitively sensitive and the production of such information is likely to be burdensome and therefore the entity authorized to obtain the information, the commission, should formally request the information. CPS offered the following revision to the rule language:

(2) The IMM has the authority to require submission of any information and data it considers necessary to fulfill its monitoring and investigative responsibilities by ERCOT. If the IMM requires information from a market participant that is not available from ERCOT and the market participant notifies the IMM of its objection to the provision or the timing of the provision of such information in whole or in part, the IMM shall petition the commission to order the market participant to submit the necessary information or data to the IMM, unless alternative arrangements for the provision of such information are reached that are agreeable to the IMM and the market participant.

In reply comments, OPC opposed CPS Energy's argument, stating that PURA §39.1515(b) and (d) allow for the commission to grant broad authority to the IMM. OPC opined that this broad grant of authority allows for the commission to require such production of material from market participants.

ERCOT stated that the language provides no flexibility for cases where the information may not be readily available. Accordingly, ERCOT proposed qualifying language that would allow

ERCOT or market participants to “make every reasonable effort” to comply with the IMM’s requests for information and data. In reply comments, OPC supported the limitation suggested by ERCOT.

Joint Commenters suggested adding a “due diligence” provision, similar to the due diligence language in §25.503(f)(8) of this title, stating that market participants should not be held to a higher standard regarding information they provide to the IMM than information they provide to the commission or ERCOT.

The commission disagrees with CPS Energy and Brazos Electric that proposed subsection (e)(2) overstates the authority of the IMM in allowing it to require submission of information by the market participants. PURA §39.1515(d) makes the “commission responsible for ensuring that the market monitor has the *resources, expertise, and authority* to monitor the wholesale electric market effectively.” (Emphasis added.) The commission finds that in order to effectively monitor the wholesale market, the IMM must have authority to access the information and records of market participants in addition to the records and information available at ERCOT, since ERCOT may not have all the records and information about a market participant that are necessary to establish that a potential rule violation or market manipulation occurred.

The commission agrees with ERCOT and OPC that there may be times when exceptional circumstances may prevent ERCOT or a market participant from promptly complying with a request for information and data. Those instances are to be expected and the

commission believes imposing a requirement that compliance be *reasonably* prompt is not necessary and may actually provide a focus for further disagreement or litigation. Thus the commission believes that the changes suggested by Joint Commenters, Brazos Electric, and CPS for added market participant flexibility in responding to IMM requests for information and data are not necessary.

The commission does not agree with Brazos Electric's suggested provision that information deemed confidential by a market participant be kept confidential by the IMM. The commission agrees with OPC that this provision is unnecessary given the confidentiality protection afforded market participant information elsewhere in the proposed rule and in the commission's rules. The commission therefore declines to make the proposed change.

The commission does not agree with CPS Energy that the IMM should be required to petition the commission to obtain confidential market participant information not available from ERCOT. The rule already provides sufficient protection of the market participants' confidential information, and the commission believes that adding an additional process is unnecessary and burdensome and will impede the IMM's ability to investigate potential market manipulations and rule violations in a timely manner. The commission declines to add this change to the rule.

In proposed subsection (e)(3), Joint Commenters suggested changing "name a contact" to "name one or more points of contact." Joint Commenters further suggested that the point of contact may be a manned station such as the market participant's "real time desk."

The commission agrees with Joint Commenters that one or more points of contact may be necessary and added that language to the rule. However, because communications with the market participants are critical to the success of the IMM, the commission will leave the details concerning “point of contact” decisions to the discretion of the IMM. The commission believes it sufficient for the rule simply to require that the points of contact be sufficiently knowledgeable to answer any questions the IMM may have on any operational issues or market activities.

In proposed subsection (g)(1), Brazos Electric recommended the term “fee” be replaced by the term “rate” as PURA §39.151 uses the term “rate.” ERCOT proposed adding a sentence confirming that all IMM-related expenses shall be presumed reasonable in order to provide clarity for future fee proceedings.

The commission agrees with Brazos Electric and changes the rule accordingly. The commission declines to adopt the change proposed by ERCOT. Evaluation of the reasonableness of the IMM’s expenses will be accomplished through the contract administration process, and the appropriate recovery of those expenses is best addressed in ERCOT’s fee proceedings. As such, no change to the rule is required.

In proposed subsection (g)(4), Joint Commenters suggested specifying: ERCOT shall directly assign “IMM costs” or “costs arising from the IMM function” to the IMM whenever possible.

The commission agrees with Joint Commenters, because adding the proposed language will clarify the intent of the provision. The commission changed the rule accordingly.

In proposed subsection (h)(1), Joint Commenters proposed to add that the director of the IMM shall be qualified to perform one or more market monitoring functions described in subsection (c), to address the concern that the IMM could be an administrator type who is not qualified to perform any market monitoring function.

The commission agrees with Joint Commenters that the Director of the IMM will most likely have such expertise but does not agree that this level of specificity regarding the expertise of the IMM Director is necessary in the rule and declines to make the suggested change.

Proposed subsection (i): Ethics standards governing the IMM director and staff.

In proposed subsection (i)(3), CPS Energy urged that the rule language expressly state what restrictions would apply and recommended that the rule language track PURA §12.155 such that the rule imposes no greater post-employment restriction on the IMM and its employees than those imposed on commissioners and commission staff.

The commission agrees with CPS Energy that any prospective employee should know what post-employment restrictions apply before accepting employment. CPS Energy appears to argue that any retroactive application of post-employment restrictions may be difficult to enforce. To that end, the commission intends that post-employment restrictions, if any, will

be a condition of employment, the details of which will be negotiated and described explicitly in any employment agreement with the IMM or IMM employee. The commission believes that prescribing these restrictions in advance may make it more difficult to negotiate an agreement with the IMM for the services.

Proposed subsection (j)(2): Limitation on IMM communication with market participants

Joint Commenters stated that the language of proposed subsection (j)(2), “unless otherwise notified by the commission legal staff, the IMM may not communicate with a market participant ... concerning a particular subject matter once the commission legal staff notifies the IMM that the subject matter is, or may be, the subject of an investigation or enforcement proceeding” could prevent the IMM from communicating with a market participant who must be involved in identifying, correcting or mitigating a problem, and preventing future recurrences of a problem. Joint Commenters recommended procedures that would allow the ERCOT IMM to function similarly to the MMU in the PJM market, who according to Joint Commenters, notifies FERC immediately only upon determining that a *significant* problem has occurred, and otherwise resolves less important issues with market participants.

Joint Commenters claimed that the proposed subsection (j)(2) places the IMM in a data-gathering and reporting role, rather than a monitoring and prevention role as required by PURA §39.1515(a); that it could be interpreted as prohibiting the IMM from communicating with market participants to investigate and informally solve or limit the consequences of the problem; and that it would impede the IMM’s statutory monitoring duties. Joint Commenters emphasized

the need for the IMM to independently and informally engage in communication necessary to monitor the wholesale market effectively.

The commission notes that differences in the requirements that PURA places on the IMM and the requirements placed on other market monitoring units (MMU) by FERC necessitate differences in the manner of operations between the IMM and other MMUs. As such, the commission will not simply import the PJM MMU functions and operating procedures to the IMM. PURA requires the IMM to report all violations, potential violations, or potential market manipulations immediately to the commission, and not only those items that the IMM concludes are “significant”.

The commission, however, agrees that the comments received from Joint Commenters and others have helped to improve the proposed rule. The commission deletes the “or may be” language from subsection (j)(2) to establish a bright line for the moment at which the IMM and market participants should cease communication regarding a particular contested issue. With respect to deciding the contours of the “particular subject matter” on which communication with market participants will be forbidden, commission legal staff shall strive to define contested issues as narrowly as is practical, so as to interfere as little as possible with the IMM’s ability to continue with its monitoring functions. In the same vein, the commission notes that subsection (j)(2) is not a blanket restriction on communications between the IMM and a market participant; it merely requires that communications on certain constested issues occur in a more structured manner with approval of the commission’s legal staff once an investigation begins. The commission envisions that in the

case of an ongoing investigation or enforcement proceeding, commission staff and the IMM would work together to determine the appropriate scope and timing of additional communication with the market participant to meet the objectives of preserving the confidentiality of an enforcement investigation and mitigating the consequences of any ongoing violation, and also minimizing interference with the IMM's other duties. In addition, the commission agrees to modify proposed subsection (e) to clarify that the IMM has the authority to communicate informally with market participants to obtain information it needs to establish whether a potential rule violation or market manipulation has occurred, and to inform the market participant that its actions may violate market or commission rules.

ERCOT expressed concern that the proposed language in subsection (j)(2) may restrict ERCOT staff's ability to support the IMM's investigations. ERCOT recommended allowing its staff to communicate, in compliance with confidentiality requirements, to the extent reasonably necessary to pursue investigations.

The commission believes that the rule sufficiently provides for structured communications between the IMM and other entities, including ERCOT staff, with approval of the commission's legal staff once an investigation or enforcement proceeding is initiated. The commission therefore declines to make the recommended change to the rule.

In proposed subsection (j)(2), Joint Commenters proposed adding language that would require that negotiations with a market participant to resolve an issue remain confidential from the public but be disclosed to the commission.

The commission disagrees with Joint Commenters. The Legislature did not give the commission authority to create a new class of confidential information or exceptions to the Public Information Act. To the extent any information exchanged during discussions between a market participant and the IMM is already protected under existing law, the negotiations or parts thereof may be entitled to confidential protection. The commission declines to amend the rule.

Proposed subsection (k): Reporting Requirement

In reply comments, OPC suggested amending proposed subsection (k) to read as follows: **“Reporting Requirement.** The IMM shall prepare and submit to the commission the following reports. *Such reports shall be posted to its website. These reports shall be redacted where appropriate.”*

The commission agrees that there will be a high level of interest in the reports generated by the IMM and intends to make that information readily available. However, the commission declines to place a specific requirement in this rule, but will determine the most efficient and appropriate manner to ensure the reports are available to the public.

ERCOT was concerned that the language in proposed subsection (k)(2) might be too broad and recommended more clearly limiting the scope of the reporting requirement to the objectives and responsibilities set out in subsections (c) and (d).

The commission disagrees with ERCOT and believes that the language requiring the IMM to report on its assessment of the efficiency of ERCOT's management of the balancing energy market, ancillary services, and congestion rights markets, and on its evaluation of the effectiveness of congestion management by ERCOT is clear and specific, and that it is consistent with proposed subsection (d)(4), which requires the IMM to monitor and evaluate ERCOT's compliance with the protocols, and with new subsection (d)(5), which specifically describes which areas of ERCOT's system operations should be monitored.

Proposed subsection (l): Communication between the IMM and the commission

Joint Commenters stated that the language of proposed subsection (l)(1) (now subsection (l)(2)(A)) goes beyond the statutory intent in requiring that the IMM report to the commission "abnormal bids or offers, abnormal operational or market behavior by either a market participant or ERCOT" and proposed to delete this language. Joint Commenters explained that an abnormality can result from a simple mistake or miscommunication that, if corrected in time, would be of no consequence. Joint Commenters gave the example of the PJM MMU who, if a trader accidentally hits the wrong key when entering a bid, would simply call the trader to clarify whether that was the intent. Joint Commenters added that reporting to the commission at that level of detail is not a type of reporting listed in the statute and would be a waste of resources.

In reply comments, OPC supported the language proposed in the rule and opposed the changes proposed by Joint Commenters. OPC opined that the proposed change would amount to restricting communication between the IMM and the commission.

The commission believes that subsection (l) as proposed is unclear as to the various reports and communication between the IMM and commission. The commission amends subsection (l) in the following ways:

- 1) The language taken from PURA reiterating that the IMM may communicate with commission staff without restriction is now paragraph (1).**
- 2) Paragraph (2)(A) now requires the immediate reporting of violations, potential violations, or potential market manipulations, including market power abuse directly to the commission. PURA requires these items to be reported directly and immediately to the commission, even if the underlying cause was a mistake. A decision to initiate enforcement action will take into account whether the cause of the violation was an obvious mistake. Abnormal bids, offers, or behavior that the IMM finds are or might be a violation or market manipulation is necessarily subsumed within this requirement.**
- 3) a new paragraph (2)(B) has been added, which now requires periodic reports on abnormal bids or offers or abnormal market behavior where the IMM has concluded that the bid or behavior is a not violation, potential violation, or market manipulation. The commission agrees with Joint Commenters that an abnormality could be due to an honest mistake and further notes that bids, offers, or behavior that are judged to be “abnormal” may not in fact be**

violations or market manipulations. However, as part of the commission's oversight of the IMM and the wholesale electric market, it is important for the IMM to periodically report on the events that it has investigated or noticed in the market. This reporting is not required by PURA to be immediate, and the commission believes it important to distinguish this report from reports of violations, potential violations or market manipulation;

- 4) former paragraphs (2) through (4) have been renumbered accordingly; and**
- 5) paragraph (5) has been deleted as it is duplicative of new paragraph (2)(A).**

TXU stated that the IMM should have both the discretion and authority to approach market participants and ERCOT to directly question them regarding their activities and immediately inquire with a market participant or ERCOT, if the IMM observes anomalous market performance issues or non-conformance to ERCOT Protocols or Operating Guides. TXU added that the IMM should perform a thorough and complete investigation of circumstances to determine that intervention is warranted, before referring a market participant to the commission for enforcement.

Brazos Electric recommended that the commission modify proposed subsection (1)(5) to require that the IMM refer instances of possible market manipulation, market power abuses, and violation of commission rules or ERCOT protocols to the commission only after the IMM has made its own investigation to determine if the activity of a market participant is appropriate for the commission's review, to preclude the commission's time and resources from being wasted.

In reply comments, OPC believed that the commission should be informed as soon as possible of any abnormal activity. OPC opposed Brazos Electric's proposal that would require the IMM to decide whether information gathered during an investigation is appropriate for the commission to review. OPC preferred that the commission make that decision.

The commission agrees with TXU that the IMM should be able, at its discretion, to question market participants or ERCOT whenever the IMM observes anomalous market events or non-conformance to ERCOT Protocols to obtain information about the causes of such events and about the activities of a market participant surrounding the events. As discussed previously, the commission adds a new subsection (e)(2) to clarify that the IMM has such authority.

The commission agrees with OPC and declines to make the changes suggested by TXU and Brazos Electric regarding referrals to the commission. The commission believes that as soon as the IMM concludes that a violation or potential violation has occurred, it is bound by PURA to report it to the commission, even if the IMM has not yet fully completed its investigation.

Subsection (l)(6): Additional IMM responsibilities and authority

Joint Commenters suggested adding a new subsection (l)(6) that would better mirror the authority given the PJM MMU in the PJM Market Monitoring Plan and PURA §39.1515(f). This addition, Joint Commenters explained, is necessary to effectuate PURA §39.1515(d), which requires that the commission ensure that the IMM has "the authority necessary to monitor the

wholesale electric market effectively.” Joint Commenters’ proposed the following added language:

The IMM may take the following additional actions, to the extent it deems necessary, as a result of its monitoring activities:

- a. Engage in discussions to bring issues concerning ERCOT operating rules, standards, procedures, or practices to the attention of market participants and attempt to resolve informally compliance or other issues with market participants.
- b. Recommend to the commission modifications to any commission or ERCOT rules, standards, practices or procedures.
- c. Through a letter, request a market participant(s) to discontinue actions that the IMM believes violate any commission or ERCOT rules, standards, practices or procedures. The IMM shall provide such letters to the commission, subject to the protection of confidential, proprietary, and commercially sensitive information.
- d. If unable to achieve sufficient responsive action on matters through informal discussions or letter, and if and as appropriate and necessary, bring matters to the attention of the commission, except that the IMM immediately shall report directly to the commission any potential market manipulation and any discovered or potential violations of commission rules or rules of the independent organization.
- e. With the approval of the commission, make appropriate regulatory filings to address design flaws, structural problems, compliance, market power, or other issues, and make such recommendations as the IMM shall deem appropriate.

The commission notes that the PJM Market Monitoring Plan referred to by Joint Commenters is undergoing revisions following FERC's 2005 Policy Statement on Market Monitoring Units. Under the newly proposed changes to the PJM Market Monitoring Plan, several of the actions Joint Commenters are proposing to add to the ERCOT IMM rule are being modified to reflect an increased FERC investigative and enforcement role and a decreased MMU role when it is determined that a potential violation has occurred. In addition, it appears that MMUs under FERC jurisdiction continue to have some enforcement authority, unlike the authority granted the IMM under PURA §39.1515. As such, it is inappropriate to import elements of the PJM MMU Market Monitoring Plan into the ERCOT IMM.

Regarding Joint Commenters' proposed new subsection (l)(6)(a), the commission believes that the ERCOT IMM's role regarding compliance issues is limited by the statutory prohibition against the commission delegating to the IMM any enforcement authority and the statutory requirement to keep the commission's policymaking responsibilities separate from the responsibilities of the IMM. As discussed previously, the commission concurs that the IMM should be free to discuss behavior that it believes may violate commission rules or the protocols with market participants as the IMM is conducting its investigation, but does not envision that the ERCOT IMM will engage in negotiations with a market participant to resolve issues that constitute potential violations, or any other corrective activities, as such activities go beyond the IMM's statutory monitoring function, are not listed in PURA §39.1515, and could be construed as a delegation of enforcement authority to the IMM.

Regarding Joint Commenters' proposed subsection (l)(6)(b), the commission agrees that making recommendations for measures to enhance market efficiency and methods to correct market design flaws it has identified is consistent with the IMM's statutory mandate. Therefore the commission agrees to add a new subsection (d)(12) to specify that making such recommendations is a responsibility of the IMM.

Regarding Joint Commenters' proposed subsections (l)(6)(c) and (d), the commission believes that the Joint Commenters' proposed language would inappropriately delegate enforcement authority to the ERCOT IMM, and declines to adopt these changes.

Regarding Joint Commenters' proposed subsection (l)(6)(e), it is unclear what regulatory filings the IMM would be making beyond those currently required by subsections (k) and (l). To the extent the commission reviews the IMM's annual report and concludes that changes to the commission's rules or the ERCOT protocols should be made, as provided by PURA §39.1515(h), the commission will determine at that time the role for the IMM in evaluating such changes.

Subsection (m): ERCOT responsibilities and support role.

Brazos Electric suggested that for clarity the phrase "full access to its operations centers" be revised to "full access to ERCOT's operations center".

The commission agrees with Brazos Electric and modifies the rule accordingly.

ERCOT proposed changes to proposed subsection (m) such that the IMM's access to ERCOT would be enabled through procedures and interfaces developed by ERCOT and the IMM in a consultative process.

The commission agrees with ERCOT and modifies the rule accordingly.

ERCOT stated that it can meet the requirement under proposed subsection (m)(1), allowing the IMM to access electronic information, under normal operating circumstances, but not in the event of a failure of the relevant information technology (IT) systems. ERCOT recommended that the commission make an exception to the rare case when an IT system failure might prohibit "near real time" replication of data by allowing ERCOT to replicate the data as expeditiously as possible.

The commission agrees with ERCOT and modifies the rule accordingly.

In proposed subsection (m)(3) that allows the IMM to review and propose changes to the catalogs of information and data and data collection verification criteria, ERCOT recommended additional language requiring that commission staff concur with any system changes, and that the changes be assigned to ERCOT's project priority list.

The commission agrees with ERCOT that system changes may be needed in order for the IMM to perform its functions in an optimal manner. However, the commission declines to amend the rule as recommended by ERCOT with respect to how those changes should be

implemented. The commission envisions that the commission, ERCOT and the IMM will work cooperatively to appropriately prioritize the IMM's needs with other ERCOT projects.

All comments, including any not specifically discussed herein, were fully considered by the commission. In adopting this section, the commission makes other minor modifications for the purpose of clarifying its intent.

This section is adopted under the Public Utility Regulatory Act, Texas Utilities Code Annotated §14.002 (Vernon 1998, Supplement 2005) (PURA) which provides the commission with the authority to make and enforce rules reasonably required in the exercise of its powers and jurisdiction and specifically §39.1515, which requires that the commission select an entity that will contract with ERCOT to act as the commission's wholesale electric market monitor to detect and prevent market manipulation strategies and recommend measures to enhance the efficiency of the wholesale market and requires that the commission adopt rules relating to an independent market monitor.

Cross Reference to Statutes: Public Utility Regulatory Act §14.002 and §39.1515.

§25. 365 Independent Market Monitor

- (a) **Purpose.** The purpose of this section is to define the responsibilities and authority of the independent market monitor (IMM) for the ERCOT wholesale markets, establish the standards for funding the IMM, specify the staffing requirements and qualifications for the IMM, and establish ethics standards for the IMM. This section also specifies the relationship of the IMM to the commission, to ERCOT, and to market participants. The IMM shall operate under the commission's supervision and oversight, but the IMM shall offer independent analysis to the commission to assist in making judgments in the public interest.
- (b) **Definitions.** The following words and terms when used in this section shall have the following meaning, unless the context indicates otherwise:
- (1) **Independent Market Monitor (IMM)** — Depending on the context, the office of the IMM or the director of the IMM and its staff.
 - (2) **Market** — The course of commercial activity by which the exchange of goods or services is effected. As used in this section, the term may refer to an entire market or a portion of a market.
 - (3) **Market participant** — Any person or entity participating in the power region's wholesale markets, or engaging in any activity that is in whole or in part the subject of the ERCOT protocols, regardless of whether the person or entity has executed an agreement with ERCOT. This definition includes, but is not limited to, a load-serving entity (including a municipally-owned utility and an electric cooperative), a retail electric provider, a qualified scheduling entity, a power marketer, a transmission and distribution utility, a power generation company, a

qualifying facility, an exempt wholesale generator, a load acting as a resource, and any entity conducting planning, scheduling, or operating activities on behalf of such market participants.

(c) **Objectives of market monitoring.** The IMM shall monitor wholesale market activities so as to:

- (1) Detect and prevent market manipulation strategies and market power abuses; and
- (2) Evaluate the operations of the wholesale market and the current market rules and proposed changes to the market rules, and recommend measures to enhance market efficiency.

(d) **Responsibilities of the IMM.** The IMM shall gather and analyze information and data as needed for its market monitoring activities. The duties and responsibilities of the IMM may include:

- (1) Monitoring all markets in the power region for energy, capacity services, and congestion revenue rights, and the ERCOT protocols and related procedures and practices that affect supply, demand, and the efficient functioning of such markets;
- (2) Developing and regularly monitoring market screens and indices to identify abnormal events in the power region's wholesale markets;
- (3) Analyzing events that fail the screens and other abnormal activities and market events, using computer simulation and advanced quantitative tools as necessary;
- (4) Developing and regularly monitoring performance measures to evaluate market participants' and ERCOT's compliance with the ERCOT protocols and operating guides;

- (5) Assessing the effectiveness of ERCOT's management of the energy, ancillary capacity services, and congestion rights markets operated by ERCOT, and evaluating the effectiveness of congestion management by ERCOT;
- (6) Conducting market power tests and other analyses related to market power determination;
- (7) Analyzing the ERCOT protocols and other market rules and proposed changes to those rules to identify opportunities for strategic manipulation and other economic inefficiencies, as well as potential areas of improvement;
- (8) Conducting investigations of specific market events;
- (9) Providing expert testimony services relating to the IMM's independent analysis, findings, and expertise, as part of the commission staff's case in enforcement proceedings initiated by the executive director in accordance with §22.246 of this title (relating to Administrative Penalties) or other commission proceedings;
- (10) Maintaining a market oversight website to share market information with the public;
- (11) Preparing market monitoring reports as required under subsection (k);
- (12) Recommending to the commission measures to enhance the efficiency of the wholesale market and methods to correct market design flaws it has identified; and
- (13) Performing any additional duties required by the commission within the scope of the Public Utility Regulatory Act §39.1515.

(e) **Authority of the IMM.**

- (1) The IMM has the authority to conduct monitoring, analysis, reporting, and related activities but has no enforcement authority.
- (2) The IMM has the authority to question a market participant about activities that may violate commission rules or ERCOT protocols or may be potential market manipulations. The IMM may inform a market participant that its activities may be in violation of commission rules or ERCOT protocols or operating guides, subject to the restrictions established by subsection (j)(2) of this section.
- (3) The IMM has the authority to require submission of any information and data it considers necessary to fulfill its monitoring and investigative responsibilities by ERCOT and by market participants. Market participants and ERCOT shall provide complete, accurate, and timely responses to all IMM requests for documents, data, information, and other materials.
- (4) The IMM may require that each market participant designate one or more points of contact that can answer questions the IMM may have regarding a market participant's operations or market activities.

(f) **Selection of the IMM.** ERCOT and the commission shall contract with an entity selected by the commission to act as the commission's wholesale market monitor. The IMM shall be established as an office independent from ERCOT, and is not subject to the supervision of ERCOT with respect to its monitoring and investigative activities.

(g) **Funding of the IMM.** The budget and expenditures of the IMM are subject to commission supervision and oversight. Financial controls and reporting procedures shall

be implemented by the IMM and ERCOT to ensure that expenditures are consistent with the budget that was approved by the commission, and with this section.

- (1) ERCOT shall fund the operations of the IMM using money from the rate authorized by PURA §39.151.
- (2) The funding of the IMM shall be sufficient to ensure that the IMM has the resources and expertise necessary to monitor the wholesale electric market effectively, as determined by the commission.
- (3) ERCOT shall maintain separate accounts of expenditures in support of the IMM.
- (4) ERCOT shall directly assign costs arising from the IMM function to the IMM whenever possible. To the extent overhead and shared expenses cannot be directly assigned, ERCOT shall allocate such expenses to the IMM based on appropriate cost causation factors. ERCOT shall maintain all records and work papers necessary to substantiate all direct charges and allocations to the IMM.

(h) Staffing requirements and qualification of IMM director and staff.

- (1) The director of the IMM shall have the qualifications necessary to oversee performance of the duties and responsibilities in subsection (c) of this section. The staff of the IMM shall have the qualifications needed to perform the market monitoring functions in subsection (c) of this section. The IMM director and staff shall be subject to background security checks as determined by the commission.
- (2) The staff of the IMM shall collectively possess a set of technical skills necessary to perform market monitoring functions, which typically includes economics, with a focus on market analysis and market competitiveness; power engineering;

statistics and programming; and modeling, with a focus on optimization modeling.

(i) **Ethics standards governing the IMM director and staff.**

(1) During the period of a person's service with the IMM, the IMM director and an IMM employee shall not:

(A) have a professional or financial interest in a market participant or an affiliate of a market participant; or own shares in a company that provides consulting services to a market participant;

(B) serve as an officer, director, partner, owner, employee, attorney, or consultant for ERCOT or a market participant or an affiliate of a market participant;

(C) directly or indirectly own or control securities in a market participant, an affiliate of a market participant, or direct competitor of a market participant or affiliate, except that it is not a violation of this rule if the IMM director or an IMM employee indirectly owns an interest in a retirement system, institution or fund that in the normal course of business invests in diverse securities independently of the control of the IMM director or employee; or

(D) accept a gift, gratuity, or entertainment from ERCOT, a market participant, affiliate of a market participant, or an employee or agent of a market participant or affiliate of a market participant.

(2) The IMM director or an IMM employee shall not directly or indirectly solicit, request from, suggest, or recommend to a market participant or affiliate of a

market participant, or an employee or agent of a market participant or affiliate of a market participant, the employment of a person by a market participant or affiliate.

- (3) The commission may impose post employment restrictions for the IMM and its employees.

(j) **Confidentiality standards governing the IMM director and staff.**

- (1) The IMM shall protect confidential information and data in accordance with the confidentiality standards established in PURA, the ERCOT protocols, commission rules, and other applicable laws. The requirements related to the level of protection to be afforded information protected by these laws and rules are incorporated in this section.

- (2) Unless otherwise notified by the commission legal staff, the IMM may not communicate with a market participant or with an ERCOT board member, officer, or employee, or with any other entity concerning a particular subject matter once the commission legal staff notifies the IMM that the subject matter is the subject of an investigation or enforcement proceeding.

(k) **Reporting requirement.** All reports prepared by the IMM shall reflect the IMM's independent analysis, findings, and expertise. The IMM shall provide periodic updates to market participants regarding the operation of the ERCOT wholesale market. In addition, the IMM shall prepare and submit to the commission the following reports:

- (1) Daily, monthly, and quarterly reports on prices and congestion;
- (2) An annual report on the state of the market, which will include an assessment of the competitiveness of the market; an assessment of the efficiency of ERCOT's

management of the balancing energy, ancillary services, and congestion rights markets; an evaluation of the effectiveness of congestion management by ERCOT; an evaluation of whether there are inappropriate incentives, flaws, inefficiencies, and opportunities for manipulation in the market design; and any recommendations for improving the market design; and

- (3) Periodic or special reports on market conditions or specific events as directed by the commission.

(1) **Communication between the IMM and the commission.**

- (1) The personnel of the IMM may communicate with commission staff on any matter without restriction.
- (2) The IMM shall:
 - (A) Immediately report directly to the commission any potential market manipulations, including market power abuse, and any discovered or potential violations of commission rules or ERCOT protocols or operating guides;
 - (B) Periodically report abnormal bids, offers, operational activities, and market behavior that have not been reported in accordance with paragraph (1) of this subsection or subsection (k) of this section.
 - (C) Regularly communicate with the commission and commission staff, and keep the commission updated regarding its activities, findings, and observations;
 - (D) Coordinate with the commission to identify priorities; and

- (E) Coordinate with the commission to assess the resources and methods for monitoring the wholesale market effectively, including consulting needs.
- (m) **ERCOT's responsibilities and support role.** ERCOT and the IMM shall jointly develop procedures and interfaces to ensure that the IMM director and staff have full access to ERCOT's operations centers, staff, and records relating to operations, settlement, and reliability. ERCOT shall designate liaisons to facilitate communications with the IMM on ERCOT's operations and information technology.
- (1) ERCOT shall develop and operate an information system to collect and to store data required by the ERCOT protocols, and shall provide adequate communication equipment and necessary software packages to enable the IMM to establish electronic access to the information system and to facilitate the development and application of quantitative tools necessary for the market monitoring function. Data from ERCOT's source systems must be capable of being replicated in near real time and available for query by the IMM until data are archived and archived data are accessible for high-speed information searches. When an IT system failure prohibits "near real time" replication of data, ERCOT shall replicate the data as expeditiously as possible. Data archives must be designed to accommodate remote access by the IMM and the commission staff at any time.
- (2) On an ongoing basis, ERCOT shall implement necessary procedures for the accurate collection and storage of data in the data archives and accurate communication of those data for use by the commission staff and the IMM.

- (3) The IMM may review the catalogs describing information and data, and may review data collection verification criteria developed by ERCOT. The IMM may propose changes, additions, or deletions to the catalogs and criteria to facilitate the market monitoring function. In so doing, the IMM may require database items or evaluation criteria for inclusion in the pertinent catalogs.
- (4) ERCOT shall establish procedures to ensure that the IMM may access all data maintained by ERCOT relating to operations, settlements, and reliability.
- (5) ERCOT may provide administrative support and goods and services to the IMM, such as office space, payroll, and related services, and information technology support.

This agency hereby certifies that the adoption has been reviewed by legal counsel and found to be a valid exercise of the agency's legal authority. It is therefore ordered by the Public Utility Commission of Texas that §25.365, relating to an Independent Market Monitor, is hereby adopted with changes to the text as proposed.

SIGNED AT AUSTIN, TEXAS the 20th day of APRIL 2006.

PUBLIC UTILITY COMMISSION OF TEXAS

PAUL HUDSON, CHAIRMAN

JULIE PARSLEY, COMMISSIONER

BARRY T. SMITHERMAN, COMMISSIONER