



WHO OWNS THE RTO?

Why RTO Governance is an Achilles
Heel in the Clean Grid Transition

VINCE DUANE – PRINCIPAL, COPPER
MONARCH LLC

TONY CLARK – SR. ADVISOR, WILKINSON
BARKER KNAUER LLP

NOVEMBER 2021

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Executive Summary

Independent System Operators (ISOs) and Regional Transmission Organizations (RTOs) are curious creatures. They are regulated by the Federal Energy Regulatory Commission (FERC) as public utilities, but they aren't public utilities that a lay person would recognize. They are member-stakeholder driven organizations, yet they serve a quasi-governmental function that facilitates the delivery of the lifeblood of the nation – electricity. They are private entities, purported to be independent, yet they are increasingly stretched to the breaking point by state policy imperatives. And they occasionally find themselves serving as the jurisdictional tool of choice for FERC to impose agendas that, if applied equally to non-RTO transmission owners, would extend the limits of FERC authority under the Federal Power Act.

Except in those single state ISOs where the organization is a *de facto* (but usually unclear) extension of the executive branch of state government, RTOs do not have a mandate to execute

The [RTO] structures have always been bureaucratic, but they also dissipate any locus of control, blur ultimate accountability and not surprisingly, often fail to reach consensus

the policy objectives of state government – but their rules and tariffs interact with state public policies in ways that move billions of dollars in investments, sometimes frustrating these policy objectives. Conversely, RTO tariffs that bend to state public policy demands may frustrate the design of the markets themselves. Finally, RTOs are organized such that their customers, in the broadest sense imaginable, are also their owners, with ownership rights varying in practical degree and in all cases ambiguously stated legally. These customers exercise shared control over RTO decisions and RTO management – notwithstanding the supposed independence of RTOs. The peculiar RTO corporate structure is akin to the organization of a cooperative

corporation, to the extent that each member typically exercises the same voting control, without regard to the member's respective financial commitment and interest in the RTO. The structures have always been bureaucratic, but they also dissipate any locus of control, blur ultimate accountability and not surprisingly, often fail to reach consensus, leaving important questions of market design and operational protocol to be resolved by FERC through administrative litigation.

Our conclusion here is that the governance regimes of the more member-driven RTOs are probably too fragile and lacking in executive authority to undertake the kinds of market reforms necessary to meet the transitioning electricity industry. This means we stand in a very different place than others who typically argue the cure for governance woes in these RTOs is more stakeholder democracy and weaker executive authority. As for those more quasi-governmental RTOs, their executive authority is stronger because they benefit in having a mandate to deliver on the clear state policy preferences of a single state or several like-minded states. The concern

facing these more politically driven institutions is whether their political patrons can make those difficult decisions that necessitate an ineluctable and politically inconvenient trade-off among reliability, affordability and climate interests and whether they will stand behind these decisions and support, and not scapegoat, their RTO if such a trade-off looks unwise in hindsight.

We claim no magic elixir to cure what ails RTOs, but we will topple, or at least shake vigorously, two pillars of RTO governance to see if in we can identify institutional alternatives to the RTO with different governance models that can respond more effectively and sustainably to the demands of tomorrow's carbon-constrained grid. The two institutional hallmarks of the RTO examined by this paper are: independence and member-driven accountability. In short, we contend:

- Independence as a governing principle for RTOs isn't working. It sits inconsistently and awkwardly alongside fiduciary duties and other well-established doctrines of accountability attendant to governance in both corporate and governmental contexts.
- Member-Stakeholder Driven Governance isn't working either. Having customers run the business contributes to criticism that RTOs are run like country clubs for the benefit of their private members. What this line of criticism ignores, of course, is that RTO customers are much more diverse than club members and the issues they try to tackle more consequential than setting the dress code for the members' dining room. The real problem is the size of the membership, its lack of a shared purpose and vision when it comes to the RTO's function, and the complicated nature of the decisions facing RTOs. Adding to the maelstrom is a burgeoning group of stakeholders, whose individual interests and perspectives are even less aligned than the traditional membership itself. These factors cripple management's ability to manage the RTO, and the Board of Directors' ability to effectively and independently govern it.

We claim no magic elixir to cure what ails RTOs, but we will topple, or at least shake vigorously, two pillars of RTO governance

We've chosen to examine RTO governance in two parts. Part 1 is diagnostic. It analyzes facts and observed outcomes leading us to the conclusions above that independence is no longer a viable precept of governance and that both member-driven and quasi-governmental RTO models face different, but real challenges to implementing industry transformation. We view these infirmities as a sort of Achilles Heel for the RTOs in the clean grid transition. Part 2 turns to possible fixes and suggests conceptually an alternate institutional path towards realizing the benefits that come from regional coordination of operations and planning. We will publish Parts 1 and 2 separately, but our Part 2 "spoiler alert" is that short of Congress committing to a radical public ownership of the grid and a public ownership of grid operations, planning and market administration – a course we do not regard as feasible or desirable – then it's time to dust off forgotten TRANSCO ideas and variants on that theme.

PART 1: THE NETTLESOME PROBLEM OF RTO GOVERNANCE AND WHY IT CAN'T BE IGNORED

(This is Part 1 of a two-part paper. Part 2, offering alternate governance structures for regional grid operation, will be published in several weeks.)

1. Introduction

Who owns the RTOs? It's not a question we hear often asked. Perhaps because the question escapes a ready answer. Perhaps because RTOs operate in a not-for-profit manner, it invites some to say, "who cares"?¹ But surely, it's an important question.

In larger RTOs, annual transaction volumes clear in excess of \$30 billion annually. Private and public concerns have entrusted billions of dollars of investment in power plant and transmission infrastructure to the operational control of RTOs. And most importantly, two-thirds of the country's businesses and homeowners rely on these organizations playing a critical role in keeping the lights on.

With all this at stake, we should have a clear understanding of who is in control and who is accountable when it comes to RTO decision-making. Ownership as a legal and commercial concept confers rights and imposes obligations. This holds equally whether talking about the owners of a corporate organization (which all RTOs are) or the owner of a Ford F-150 pick up. The essence of ownership is control - the hand on the steering wheel. For this reason, we ask: "who owns the RTO?"

So, who is driving when it comes to RTO decision-making? Who decides to slow down when extreme weather makes the road ahead treacherous? And who is responsible in the event of an accident? What we see today is a struggle for control of the RTO among the federal government, state governments, market participants and other stakeholders. In our last paper, we discussed a suite of challenges RTO markets face as they confront changing policy expectations and a transitioning generation mix. In order to meet these challenges, we reasoned RTO markets "will have to be re-thought from the ground up." The purpose of this paper is to examine who precisely is going to do this heavy lifting and how empowered will they be to make the necessary and effective redesign to the current model.

¹ A comment made at the time ISOs were emerging in this country describes "an ISO's owners (as) the current owners of transmission facilities and assets;" but because these parties also owned generation and retail service, the "decision was that the owners (transmission owners) would not be permitted to control or oversee an ISO's day-to-day operations." Graniere, Robert J. *Responsibilities of An ISO In A Market With Bilateral Contracts For Electric Power*, National Regulatory Research Institute, pp. 50-51 (March 1999) <https://ipu.msu.edu/wp-content/uploads/2016/12/Graniere-Ind-System-Operator-99-06-Mar-99.pdf>. This description of the history may be accurate. But it illustrates a confusing and legally unstable effort to distinguish between ownership and control. And it illustrates the disarranged perception that one finds all too often in descriptions of the legal character of the RTOs. Quite simply: control (day-to-day or otherwise) is the hallmark of, and indivisible from, ownership.

For example, some thoughtful ideas have been advanced promising to fix the price formation problems that arise when the penetration of zero-marginal cost renewable generation compromises the fungibility assumption underpinning the single clearing, locational marginal pricing engines driving RTOs.² While thoughtful, none can claim to solve these problems through a mere tweak here or a silver bullet there. To the contrary, there’s nothing “rifle shot” about these fixes – they’re complex in design and sweeping in scope. And they will undoubtedly prove contentious.

If we agree any path forward to reconfigure RTO markets to meet an industry in transition will involve a major home renovation beginning with the foundation, we must grapple with the practical question of *how* this will get done. Without exploring at length, the history and evolution of each RTO, we hope we are being fair when we say there are, broadly speaking, two types of RTOs today:

- The member-driven company, and
- The quasi-governmental extension of the regulator, governor, or legislature.

We recommend FERC abandon the pretense of “independence” as a workable notion of governance and accept that system operators should be accountable to their owners (be they private firms or governmental actors)

In truth, all RTOs share to varying degrees both attributes: some being more member-driven, while others more quasi-governmental. Understanding the governance of the RTO means understanding who controls decision-making. Practically speaking is it management and the board or diffused among members, or even across a broader set of stakeholders? Does it instead sit with one or more public utility commissions or governors’ offices? And what is the quality of the decision-making produced by this governance model? How do we reconcile the notion of an “independent” system operator and market administrator with an expectation the RTO must also be “member-driven” and/or accountable to its stakeholders or governor’s office? Where can we expect to find in the RTO environment the leadership necessary to force action, build support and overcome parochial objection?

Answering these questions will allow us to assess whether RTO governance regimes are up to the task of implementing – from the bottom-up for member-driven entities or top-down for quasi-governmental – the kind of

market redesign and grid expansion ideas being offered to enable the RTO to manage the electricity transition.

² Examples of clever, but complex and involved, ideas to reform RTO markets include: E3’s paper on bilateral clean energy markets, <https://www.ethree.com/wp-content/uploads/2021/05/E3-Scalable-Clean-Energy-Market-Design-2021.05.25.pdf> and ideas discussed at the September 14, 2021 FERC Technical Conference Regarding Energy and Ancillary Services Markets, AD 21-10-000.

We've chosen to address these questions by examining two hallmarks of RTO governance (i) independence and (ii) accountability/responsiveness to stakeholders. The tension between the two concepts is obvious and has been long acknowledged.³

This paper arrives at a single conclusion: RTOs have come to a point in their history where this tension has reduced independence to a hollow governance proposition and diffused accountability to the degree an RTO is better described today as either “member-driven” or, where accountability is owed to its governmental bosses, then “quasi-governmental.” In both cases, “independence” as a governance principle is at best a discordant undertone continuing to ring from the direction of a conductor that has long left the podium.

From this conclusion, we recommend FERC:

- Abandon the pretense of “independence” as a workable notion of governance and accept that system operators should be accountable to their owners (be they private firms or governmental actors).
- As a prerequisite to accepting the first recommendation, require system operators to articulate a clear and legally recognized regime of ownership – like any other private or public corporate entity.
- Regulate system operators straightforwardly, as “public utilities” for the benefit of their customers, instead of engaging in a fiction that the public interest can be largely assumed based on customers and other stakeholders having some ill-defined right to participate in governance and shared control over decision-making.
- Affirm market monitor independence and separate the function wholly from the oversight of the system operator (including from its board of directors).
- Encourage and anticipate a world where some system operators are regulated no longer as RTOs but as transmission company-owned entities united by common purpose or as agencies of single state governments or as regional state authorities.

2. Why Independence as A Governing Principle Once Worked and Why That's No Longer the Case

Twenty-years ago, a strong policy favoring the design of organized wholesale electricity markets was issued from FERC, complemented by a movement in some states to cede regulatory control to the “visible hand” of these designed markets. Because these markets were in fact visible,⁴ someone was needed to formulate their rules (the complex design and price models) and then

³ See FERC Order No. 2000, Docket No. RM99-2-000, 89 FERC ¶ 61,285, at 227–30 (Dec. 19, 1999) (discussing approaches to RTO board structure).

⁴ As we noted in our last paper, wholesale electricity markets do not arise organically. Nor are prices in these markets formed simply where supply (offers) meets demand (bids). RTO markets are instead described as “designed” and “organized,” and price formation is dependent on rules and algorithms in addition to supply and demand. The hands of the market designer, market administrator and price regulator are very visible in these markets quite in contrast to the “invisible hand” markets of the sort described by Adam Smith.

administer those rules. At that time debate swirled as to the form this entity might take and its character; something we'll explore in our Part 2 release. In any case, the non-profit, independent system operator quickly became the default entity, not just to provide non-discriminatory open access transmission, but to administer centralized bid-based, security constrained electricity markets. But instead of creating a template based on carefully considered ideas as how best to organize, structure and govern this entity, the RTO generally evolved directly from (PJM, NYISO, SPP) or out of (ISO-NE) existing power pools and regional reliability services organizations.⁵

Orders No 888, 889 and 2000 added to these existing structures a governance principle centered around "independence." FERC's vision of independence would have benefited by a more explicit explanation of:

- how independence would work within legally accepted corporate governance structures,
- and why, in meeting this standard, it would be entitled to a "light-handed" form of regulatory oversight,
- and most importantly, what "light-handed" actually meant.⁶

Though nebulous around the details, the vision was cohesive: in return for being independent from, subject only to advisory input from its members, the RTO would be entitled to "light-handed" regulation.⁷ And the bargain made sense: by setting up a financially disinterested professional entity, independent from the varying economic agendas which individual market participants are duty-bound to advance, the Commission could reasonably presume that proposals filed by the RTO reflected informed but objective expertise and professional judgment as to the best way to implement a policy direction.

This was not to say the RTO would always be right. But rather, that it would always try to discern and "do the right thing" – an entreaty one of us can attest PJM members often invoked to

⁵ ERCOT, the first ISO in this country, also formed out of the same type of industry collaborative. Of course, its evolution was shepherded by the Texas legislature and not FERC. Having these existing entities transform into ISOs was expedient, but in hindsight it was a "cutting of the corner" such that today we find RTOs in a place where their governance is fragile and their lines of accountability unclear and conflicting.

⁶ Reviewing the extensive Order 2000 record makes clear FERC tried valiantly to remove ambiguity as to the meaning of "light-handed" and resolve conflicts relating to ownership/control and independence. The record makes clear FERC attended to the task of governance, but the task it faced was to resolve the irreconcilable, at least with the tools it was given. Thus, while these governance ambiguities and conflicts remained after the Final Rule, they were tolerable for so long as FERC "had the RTO's back" so to speak. Once that patronage ceased, and the RTO had to turn inwards to its institutional rules and structure to govern direction and decision-making, these problems percolated to the surface.

⁷ "(W)e believe that some degree of deference can be granted on certain issues to independent RTOs that have appropriate procedural mechanisms in place to ensure fair representation of viewpoints." Order 2000, Docket No. RM99-2-000, p. 98. (December 20, 1999).

persuade PJM management and staff toward a course of action, particularly when that course was unpopular with a significant stakeholder segment.⁸

Twenty years ago, FERC provided a kind of “regulatory tailwind” that supported the RTO. This resulted in stakeholder debate typically being confined to *how* a proposal should best be executed, as opposed to whether it should proceed at all or whether a totally different direction should be taken. Stakeholders more often took the practical position that constructive engagement in debating RTO market design, planning and operating rules was the smart tactic. The alternatives – dilatory maneuvers, parochial or “pocketbook” advocacy or outright obstruction – would likely be swept aside by a FERC inclined to subtly (but unmistakably) give some deference to an RTO whose position reflected its professional independent judgment.⁹

If one thinks of this tailwind as a clear policy direction from FERC and the sail capturing this tailwind as RTO independence, one gets a picture of how FERC supported the judgment and decision-making of the RTO to execute on FERC’s policy in favor of organized regional electricity markets. The tailwind out of Washington, was never quite the equivalent of the Roaring Forties. But today it has essentially died out altogether. Without this consistent tailwind, the sails at PJM and ISO-NE are often empty and these RTOs find themselves sailing in doldrums, relying on a membership rowing in different directions and a struggle among stakeholder interests to grab the tiller. In contrast, in ERCOT, CAISO and to a lesser extent NYISO, membership rowing is a mere hobby as these RTOs now harness winds blowing out of

⁸ Reflecting on the “ideal” for governance of an independent RTO recalls the famous words of statesman Edmund Burke:

Your representative owes you, not his industry only, but his judgement; and he betrays you instead of serving you if he sacrifices it to your opinion. -- Edmund Burke, Speech to the Electors of Bristol, November 3, 1774

Sadly, the “ideal” of RTO independence has withered in the absence of a *de jure* or *de facto* mandate empowering the RTO to exercise this judgement.

⁹ In 2003, as a new lawyer attending his first PJM Members Committee meeting, one of us was struck by stakeholder endorsement of a particular rule change and how individual company representatives, (typically officers or senior directors at that time) opined that while the rule in question might not be in the immediate best interest of their organization, they were happy to support it as in the best interests of PJM and the overall system. When the vote was announced in the room, stakeholders cheered enthusiastically and shared congratulations with each other.

Just four years later, the stakeholder dynamic and cooperative governance process had degraded, as suggested by these comments in the Order 719 rulemaking from transmission dependent utilities:

The RTO stakeholder process today typically involves middle-level employees of stakeholder companies, because the committees have no decision-making power. Employees at this level are likely to be most concerned about protecting their company’s narrow interest and may lack the broad perspective of senior executives in fashioning practical accommodations without the need to consult back home. TAPS believes that the current structure contributes to polarization and deadlock.

Comments of the Transmission Access Policy Study Group, to Order 719 ANOPR (Sept. 14, 2007) at pps. 39-40, https://www.tapsgroup.org/wp-content/uploads/2013/01/070914commentstrm0719_ad077.pdf.

Austin, Sacramento or Albany. SPP, and to a lesser extent, MISO, derive their locomotion from a relatively homogenous membership who row in step with state policy winds that in turn typically blow in a prevailing direction.

Of course, this analogy is imperfect and the characterization of individual RTOs overly broad. But in a generalized sense it does illustrate two points:

1. how fragile and impotent RTO corporate governance is if the RTO is left to its own institutional devices (its charter, operating agreement, parliamentary processes and the like), and
2. how independence was meant by design to mean independence from members and stakeholders, and even a buffer from state interests.¹⁰

Explaining why the RTO policy tailwind out of Washington died out, notwithstanding an occasional gust pushing discrete policy predilections, say demand response, competitive transmission, or energy storage and distributed resources, would fill a separate paper. FERC slowly became a more political body as it drew closer scrutiny and second guessing by Congress and the states. The failed standard market design rulemaking (SMD) became a four-letter watchword at the Commission justifying understandable institutional caution. The federal courts reminded FERC that its authority to regulate public utility, including RTO, governance was indirect (at best) under the Federal Power Act.¹¹ Also, due to accelerating technology and new policy imperatives, regulators and stakeholders increasingly disagree in their understanding of what it means for the RTO to “do the right thing.” But perhaps what set the table for the eventual demise of the tailwind/independence paradigm was the issuance in 2008 of FERC Order 719.

Earlier we noted that the FERC *circa* Order 2000 would have done well to explain more carefully how independence would work alongside legally recognized roles, rights and duties associated with boards, officers, employees and shareholder/members of corporation and companies.¹² For example, how was independence intended to work with say, the business

¹⁰ Back in the day when FERC was a *de facto* policymaker for, and more than just a regulator of, organized wholesale markets, the perspective in some quarters was that the RTO also stood independently from the states, particularly when states through authorities or municipal agencies participated in the RTO markets. With FERC largely vacating the policymaking field, and states reasserting or reclaiming policymaking authority, no one any longer would characterize any of the RTOs, from CAISO and ERCOT at one end of the spectrum, to PJM and ISO-NE at the other, as being “independent” from the states.

¹¹ *California Independent System Operator Corp. v. FERC*, 372 F.3d 395 (2004).

¹² FERC brushed aside the issue of ISO “ownership” reasoning that “(b)ecause ISOs are typically non-profit and non-share corporations, we generally did not have to consider the effect of ownership interests on the independence of the ISO.” Order 2000, p194 (December 20, 1999). Obviously, we believe understanding who owns the RTO is important and the question of non-profit, non-share irrelevant to the question of independence. History has borne this out. Because the question of ownership was dismissed and the matter left unresolved (or “solved” through a false and unworkable distinction between ownership and control, (*see* footnote 1, *supra*) what we see today is a struggle among stakeholder interests for control of the RTO. Because the entities that control the RTO are those to

judgment rule or board and officer fiduciary duties of loyalty? FERC made one thing clear at that time: the RTO (*as a whole*, including its employee, officer and board constituents) had to be independent from market participants.¹³ Order 719 muddied these waters considerably and with unfortunate consequences to RTO governance generally.

Order 719 set out to enhance RTO responsiveness to its stakeholders. In this it succeeded, but not without inflicting collateral damage to executive authority the RTO had to “do the right thing” in the name of independence. Instead of proscribing rules or principles applicable to the RTO, which after all was the regulated public utility, FERC instead trained a peculiar focus on the “independent board of directors” and placed it in the role of hearing and responding directly to stakeholder ideas and issues.

In doing so, it greatly expanded the role of the RTO board putting them squarely in a role of customer service agents, if not an outright complaints desk.¹⁴ FERC’s insistent focus on “board independence” and forgetting or dismissing the fact that the *whole RTO* – including employees and management – had to be independent is curious.¹⁵ In fact, Order 719 went a step farther by emphasizing the RTO board’s independence *from the RTO* (it’s employees and management) at least to the same degree as the RTO’s independence *from* market participants.¹⁶

[FERC] greatly expanded the role of the RTO board putting them squarely in a role of customer service agents, if not an outright complaints desk

whom the RTO will be accountable.

¹³ FERC insisted on a single set of rules to protect against conflicts of interest and financial entanglement applicable equally to each constituent element – employees, officers and directors. It still does. But today little evidence suggests FERC, when considering an RTO’s section 205 filings, treats the filing with any special deference than it would a section 205 filing by a non-independent public utility. Indeed, in at least one RTO (PJM) the RTO as a public utility, purportedly independent from its membership, must illogically file under section 206 (with a *higher* burden to carry) if it seeks to file certain tariff changes without a supermajority member approval.

¹⁴ *See, e.g.,* NYISO Compliance Order, 133 FERC ¶ 61,072 Para 27 (October 21, 2010) (“RTO/ISO stakeholder bodies are comprised of numerous entities that frequently have divergent interests and positions. *RTO/ISO boards* must account for these divergent points of view in making *their management decisions*.” (emphasis added)).

¹⁵ The maxim bad facts make for bad law, might explain Order 719’s misplaced emphasis on the board of directors as the font of RTO independence. Around this time, PJM was engaged in a public and heated debate as to the role and responsibility of its market monitor, at the time a division within the RTO, and its relationship to the executive management. These issues were picked up in Order 719 where it was dictated that monitors must be accountable to RTO boards and not to RTO management. So, the mood of the moment at the time of Order 719 was emphasis on the “independent board of directors” with an undercurrent that perhaps management and the rest of the RTO wasn’t in fact all that independent, despite Commission rules designed to provide otherwise. This view took hold in the governance provisions of the final rule, notwithstanding a confusing but short-lived foray in the into the merits of “hybrid” boards having stakeholder representation earlier in rulemaking process.

¹⁶ The importance of board independence, normally considered in the context of a public company’s independent directors being separate from management and acting in the best interests of the company’s shareholders, shows how far afield RTO corporate governance is from more familiar institutions. Here, the Commission order espoused a somewhat unnatural notion of corporate governance: namely, that independence mostly meant the RTO board

Corporate boards that we are all accustomed to seeing in both non-profit and for-profit settings are not super-managers – they work collaboratively with management towards shared objectives. A board doesn't replace its judgment for that of its executive management in deciding *how* to

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execute on the agreed upon business of the firm. A board typically is responsible for ensuring management stays in compliance with legal, accounting and prudent financial standards and that it discharges the agreed-upon strategic direction for the company. If management fails in any of these regards, the board changes management. A corporate board isn't a legally distinct entity from its corporation and not "independent" of management in the sense suggested by Order 719, which conceived of boards almost as though they stood apart as an external auditor or even regulator of the RTO.

In the decade or so since Order 719, RTO boards, at least those operating in member-driven RTOs, have been challenged to decide highly complicated and technical market design details, hearing impassioned and detailed counterpoint about the arcane (but impactful) intricacies of RTO operation from RTO management, monitors, members, states and other stakeholders. Keep in mind, boards are part time workers expected to bring a seasoned managerial perspective. They are not typically electricity market design gurus – indeed such expertise would be eyed with suspicion by many RTO members as inevitably displaying a bias in favor of either asset owners or consumer interests, etc. The migration of

roles and responsibilities normally and properly performed by corporate management to corporate boards in the RTO world is a culmination of the Order 719 legacy and FERC's continuing adherence and misguided search for independence in a corporate context where it naturally doesn't exist.¹⁷

should be independent from RTO management, but without clarity as to whom they were accountable – or perhaps an ill-defined competing notion of accountability. In any case, the governance role for board members had shifted from mostly advisory and strategic oversight to something more executive and directive.

¹⁷ To be fair, the Commission never envisioned Order 719's push to enhance responsiveness would mutate into the kind of struggle for control of the RTO that we see today, particularly in member-driven organizations like ISO-NE and PJM. Order 719 extolled the "board advisory committee" as a tool to enhance responsiveness. Left unconsidered by FERC (and apparently most in the industry) was that, without a tailwind out of Washington DC, the ill-defined and fragile rules in the RTO's organizing legal documentation defining ownership and control left a vacuum that entities like board advisory committees, state PUC and consumer advocate committees, as well as member committees and market monitors would seek to fill.

Today few believe the RTO to be truly “independent.”¹⁸ And let’s be honest and admit that few really want the RTO to be independent – at least not in an Edmund Burke sense (*see* footnote 8, *supra*). What we see today instead is a fight for *control* over the RTO, not an effort to assure and protect its independence.

It’s time for FERC to acknowledge this reality and abandon this principle – a principle it hailed as the “bedrock upon which the ISO must be built.”¹⁹ It must concede instead that the RTO (the whole RTO kit and kaboodle: employees, management and board) must be accountable to identifiable owners that exercise governance and control over the entity in the same way owners control corporations, or Ford F-150 pickups for that matter.²⁰

To be perfectly clear, we are rejecting “independence” – at least as it is understood in this context – as a feasible, central organizing principle for RTOs, because “independence” has come to mean a lack of clear lines of responsibility, authority and accountability. At the same time, we acknowledge “independence” is also used to describe non-discriminatory treatment to support fair access and competition. Our quarrel is with “independence” as a governance principle, not regulation requiring what some might call “independent” operations. We agree the system operator, however constituted and governed, must produce non-preferential, non-discriminatory and competitive operational outcomes. And the way to assure this is through regulation – not “light-handed” but the full and proper exercise of the Commission’s authority under the Federal Power Act.

Ownership, governance, control and accountability? We observed earlier that while the precise question of ownership is considered esoterica among RTOs, in a post-independence world, control over these organizations gravitates towards one of two poles: either (i) member driven or (ii) quasi-governmental. Let’s consider what this means for RTOs of both sorts, in particular returning to the threshold question of whether we can expect these entities to undertake and successfully execute the foundational redesign of markets, operations and planning required to advance the transitioning industry.

3. The Member-Driven RTO

Customers in MISO, PJM, ISO-NE, NYISO & SPP, be they market participants, interconnection customers or transmission customers typically qualify, for a nominal fee, as members of the RTO. Unlike customers of Amazon, or Pacific Gas & Electric for that matter, these RTO customers are given varying degrees of governing control (e.g., rights to: vote on RTO product

¹⁸ See, e.g., *R Street Institute*, James, M., et. al., How the RTO Stakeholder Process Affects Market Efficiency, (October 2017) (speaking of the RTOs “as institutions capable of self-interest” and arguing therefore that FERC should “shift the weight and deference given to RTO proposals to those advanced by stakeholders and the market monitor.”) <https://www.rstreet.org/wp-content/uploads/2017/10/112.pdf>.

¹⁹ Order 2000, p.193 (December 20, 1999)

²⁰ This requirement will mean the entity performing grid operations, planning and administering markets will no longer be, by definition, an ISO or RTO. In the last section of this paper, we anticipate the form these new grid operators and administrators might take and explore how the industry might get to this place.

offerings, decide certain RTO business actions and processes, elect RTO board members and change and file with FERC to seek approval of the RTO tariff). These rights redound from becoming a member and elevate the customer into a role more commonly associated with that of an “owner.”

Customer/owner business forms are not the default way of structuring business organizations in the United States, but they are not uncommon. Mutual organizations have a history in insurance and banking (insurers or banks owned by their policyholders or depositors), in financial trading (stock and commodity exchanges owned by their seat holders) and in agriculture and energy (cooperatives owned by their buyers or sellers). These entities are typically non-profit, returning excess returns to their customers, and often qualify as tax-exempt.

Why is the customer/owner model rarely employed by large commercial enterprises? Contrasting customer-governed ISOs with more traditional corporate organizations (those governed by shareholders) one commentator answers, “(t)he corporate form of business dominates most of the world's economies primarily because it is governable;” he continues:

The economics of finance and voting strongly suggest that the outcomes in a nonprofit ISO will be both inefficient and inconsistent relative to those of a corporation. History leaves ample room for pessimism. There has been no important economic institution with voluntary participation that has enjoyed long-term viability under ownership and governance arrangements resembling those proposed for ISOs.²¹

Mutual organizations, be they country clubs, homeowner’s associations, mutual insurance companies and electric cooperative corporations, can be effectively governed where there is a uniform agreement as to the mission of the organization.²²

With relative common interests among the members, cooperative organizations abound. For example, agricultural cooperatives have existed for many decades, and there is an extensive literature on the experience with such organizations. More to the point of the ISO, however, would be the experience in cooperative self-governance in the presence of more heterogeneous interests. Here the experience is less extensive, and the

²¹ Michaels, R., *The Governance of Transmission Operators*, 20 *Ener. L.J.* 233, 234 (1999). For those open to assessing whether today’s RTO governance structures are up to the task of tackling current and expected reform needed to advance decarbonization, increased electrification, operational resilience and advanced energy technologies, Professor Michaels’ 1999 article should be required reading.

²² Even electric cooperative organizations are facing governance challenges resulting from industry transition. See Reyes Jr., L., *5 things I learned from exiting my G&T power provider, and the 300 things I've gained*, *Utility Dive* (Sept. 9, 2021) at https://www.utilitydive.com/news/5-things-i-learned-from-exiting-my-gt-power-provider-and-the-300-things-i/606289/?utm_source=Sailthru&utm_medium=email&utm_campaign=Issue:%202021-09-09%20Utility%20Dive%20Newsletter%20%5Bissue:36592%5D&utm_term=Utility%20Dive.

lessons sound a note of caution for developing the rules for governance of an ISO.²³

Professor Hogan’s “note of caution” was sounded at a time when there was a widespread endorsement for reform that would expose industry to competitive market forces in order to address a singular challenge facing industry at the time (high costs and poor regulatory

The “heterogeneous interests” that worried Hogan in 1996 have amplified by orders of magnitude as the industry 25 years on faces dramatically different expectations

outcomes). This was a time when the range of ISO members essentially spanned generators and wholesale buyers of electricity and transmission owners and transmission dependent utilities. The “heterogeneous interests” that worried Hogan in 1996 have amplified by orders of magnitude as the industry 25 years on faces dramatically different expectations, including the movement to remake the way electricity is generated and expand electric service to economic and social activities that have combusted fossil fuels since their inception. Add to this, a burgeoning expanse of heterogenous stakeholder interest, including: advanced technologists, financial trading firms, private equity asset investors, merchant transmission developers, demand response

aggregators, well-organized political, environmental and social advocates (including organizations empowered by social media) and of course, renewed interest from state and federal law and policymakers.

With all these interests banging at the door of the member-driven RTO, it’s no surprise those claiming they can’t get in or, more likely find that once inside, it’s a crowded room where their voice is lost in the general cacophony, complain that member-driven RTO governance is “clubby.” This line of criticism leads in two different directions. First is the observation that the member-driven RTO is accountable to no one because it is accountable to everyone.²⁴ Second is

²³ William W. Hogan, Carrie Cullen, Hitt Janelle Schmidt, *Background Paper, Governance Structures for an Independent System Operator (ISO)*, Harvard Electricity Policy Group (June 6, 1996) at p.7, available at: <https://scholar.harvard.edu/whogan/files/iso0696.pdf>.

²⁴ See, e.g, Michael H. Dworkin and Rachel Aslin Goldwasser, *Ensuring Consideration of The Public Interest in the Governance and Accountability of Regional Transmission Organizations*, 28 *Ener. L. J.* 543, 578 (2007) (“The first part of the problem (the RTO accountability problem) is that many entities can (and do) claim that the RTO is accountable to them.”).

Some commentary suggests the answer is to double-down on the problem, and either empower a greater universe of stakeholders with no effort to differentiate between highly interested and invested stakeholders and those less so, or alternatively embrace fully a state ownership model to replace self-interested stakeholders. See, e.g., Christina Simeone, *PJM Governance – Can Reforms Improve Outcomes?* (May 19, 2017), Kleinmann Center for Energy Policy, University of Pennsylvania. <https://kleinmanenergy.upenn.edu/paper/pjm-governance>.

an alternate thesis that member-driven RTOs are accountable to only one set of members – a fairly homogeneous set of entrenched incumbents.²⁵ We tend to think the first conclusion is closer to the mark as we’ve both heard plainly sincere complaints from transmission and generation owning incumbents that their member-driven RTOs don’t listen to them, particularly not in light of the investment in plant they have entrusted to the RTO. But there are examples, SPP comes first to mind, of member-driven RTOs whose relatively homogenous members pursue similar business objectives under reasonably uniform state regulatory and political backdrops. Either way – chaotic post-second world war Italian parliament²⁶ or closed country-club – neither grades out as successful corporate governance and neither model is likely up to the task of reform needed to meet the decarbonizing industry transition.

With all these interests banging at the door of the member-driven RTO, it’s no surprise...that once inside, it’s a crowded room where their voice is lost in the general cacophony

4. The Quasi-Governmental RTO

Unlike member-driven RTOs, market participants in quasi-governmental RTOs do not control and in no sense are regarded as owners of the RTO. Market participants in these RTOs at best play an advisory role, according to either explicit rule or *de facto* practice. Single-state RTOs are closest to the quasi-governmental end of the spectrum and benefit from having state lawmakers and regulators set policy direction. Here, accountability of the RTO to the state is expressly provided by statute. Membership is not voluntary but required by state law.

²⁵ See, e.g., Shelley Welton, *Rethinking Grid Governance for the Climate Change Era*, 109 Cal. L. Rev. 209, 252 (2021) (“RTOs’ membership-club format has not led to entrepreneurial efficiency - to the contrary, incumbents use these institutions to block cost-reducing reforms. At the same time, this governance structure has created a growing rift between the objectives of market operators and the democratically determined objectives of state and federal regulators.”).

²⁶ In 2008, NPR Radio broadcast the following conversation with Christopher Winner, editor and publisher of the *American Magazine*, a monthly news magazine based in Italy:

Political dysfunction is a proud Italian tradition, Winner notes. There have been 61 governments since World War II. Why can't Italians commit to a single administration? Winner explains that Italy's is a parliamentary government, with an emphasis on parties. "Everyone wants their voices to be heard," he says. Compare the situation to other countries in the region. Until the mid-1970s, both Portugal and Spain had dictators. Well into the 1960s, Greece operated under a military regime. "Italy has been enjoying the fruits of democracy, which means agreeing to disagree," Winner says. "And Italians do that quite well."

New Italy Sings Same Song of Dysfunction, The Bryant Park Report, National Public Radio World (March 10, 2008) <https://www.npr.org/templates/story/story.php?storyId=88030713>.

Today, when describing an RTO as “quasi-governmental” the government in question invariably is a state or a group of states organized to advocate for or even try to direct RTO outcomes. This was not always the case. One used to hear often the expression that RTOs were “creatures of FERC.”²⁷ And while this was never wholly correct, the

From the perspective of a transmission owner, joining and remaining an RTO member has become a decidedly asymmetrical bargain

aforementioned tailwind in the early 2000s did impart a degree of *federal* quasi-governmental character to all RTOs. The original perception was that all RTOs, even among those which today we label “member-driven” RTOs, owed their allegiance to either a state or federal governmental agency.²⁸ But in the case of multi-state FERC-regulated RTOs, once “allegiance” is dissected into legal concepts of organization, ownership and governance, it’s clear the RTO as an organization was never legally grounded in the FPA and FERC’s jurisdiction over RTO corporate matters is limited. In a corporate sense, all RTOs are in fact creatures of *state* law, either as private companies organized under a state corporations law or public (governmental) corporations chartered by specific state legislation.²⁹ While FERC has

broad statutory authority to proscribe RTO *functions*, this is distinct from its authority over *corporate* matters as FERC has been reminded by the federal courts: “render(ing) obvious a point that much energy law scholarship seems to gloss over: RTOs are not a special ‘quasi-governmental’ body in the eyes of the law.”³⁰

The days of FERC conditioning its approval of utility mergers on RTO membership and providing a return on equity incentives tied to RTO membership look to be over. Indeed, one could make a case that the tailwind has been replaced with a headwind. From the perspective of a transmission owner, joining and remaining an RTO member has become a decidedly asymmetrical bargain. In return for ceding operational and planning authority over their

²⁷ Testimony of Elizabeth Moler (former FERC Chair), *Impacts of H.R. 3795, “The Over-the-Counter Derivatives Market Act of 2009*, Hearing before the United States Congress, House Committee on Energy and Commerce, Subcommittee on Energy and Environment, (December 2, 2009) (“RTOs and ISOs largely evolved from voluntary regional power pools. FERC has 15 years experience regulating them. They are creatures of FERC’s jurisdiction under the FPA. . .”).

²⁸ See, e.g., Tomain, Joseph P., *The Past and Future of Electricity Regulation*, *Environmental Law*, vol. 32, no. 2, 2002, pp. 435–474. (“The Board of Directors of the ISO will have a fiduciary duty running either to the state or to the federal government, whichever gives the ISO its charter.”) www.jstor.org/stable/43267561. Accessed 10 Aug. 2021.

²⁹ The private companies, LLCs or non-stock companies, are organized under Delaware law or under the law of the state in which they are headquartered.

³⁰ Welton, *supra* note 25, at 233 (citing Atlantic City and CAISO cases). To be clear, Welton makes the point here that RTOs are not quasi-governmental *federal* entities. We believe he would accept that at least CAISO and ERCOT are quasi-governmental *state* entities. The charter for each of these RTOs is specified specifically in the California Public Utilities Code and the Public Utilities Regulatory Act of Texas respectively. Pending governance reforms at ERCOT remove any doubt as to who is in control given that market participant seats will be abolished and a politically appointed selection committee will choose a board.

transmission facilities to an RTO ineffectively governed by competing interests, transmission companies in RTOs face greater regulatory burdens from FERC than their counterparts in non-RTOs. PJM recently summarized the “asymmetric cost-benefit equation” facing transmission owners in PJM:

*RTO membership entails assuming additional regulatory and practical responsibilities. It entails surrendering functional control of the entity’s assets to an independent entity that is required to consult with a broad array of stakeholders before making policy changes that can affect the operation, use and planning for those assets.*³¹

These observations simply make the case that RTOs can no longer accurately be described even as a *de facto* instrumentality of the federal government. Somewhat counterintuitively, FERC’s vacating of this playing field has resulted in RTOs becoming *more* quasi-governmental in character as states have moved to fill the policy leadership vacuum. From the standpoint of governance, this trend means single-state RTOs can be fairly described as quasi-governmental extensions of the state.³² And in multi-jurisdiction/member-driven RTOs, states in which the RTO operates demand “their” RTO advance their state-specific electricity policy objectives. And where political persuasion of RTO board and management proves insufficient, initiatives are underway to explicitly increase state authority over the governance of heretofore member-driven RTOs.³³

So, is this the way to go – to hand RTO reins over to the state? A future where the RTO is more closely controlled by its state regulators and lawmakers promises to sharpen the policy directive facilitating transformation of the electricity industry – at least for single state RTOs and perhaps, where a region shares policy preferences. This theoretically would be an improvement from sailing in the policy doldrums or whiplashing from one initiative to the next trying to satisfy every RTO constituency. But this approach to governing the RTO still faces serious questions:

- Regional Scale? An advantage RTOs bring is a scope of operations that permits dispatch over a wide geography to take advantage of scale and portfolio diversity. Gaining and retaining scale beyond state lines when the state controls the RTO seems improbable. And in multi-state jurisdictions, multiple states sharing governance (in the nature perhaps

³¹ Comments of PJM Interconnection, Electric Transmission Incentives Policy Under Section 219 of the Federal Power Act, Docket No. RM20-10-000., p25-26 (June 25 2021). <https://www.pjm.com/-/media/documents/ferc/filings/2021/20210626-rm20-10-000.ashx>.

³² As noted, the accountability of ERCOT and CAISO to the state is explicitly written into the charter documents of these organizations. Recent specific operational challenges and their political consequences in these RTOs have only consolidated state control. Similarly, with New York positioning itself as a leader in energy and climate policy through its “Reforming Energy Vision” initiative, member control over NYISO has been pushed more to the sidelines with the RTO answering increasingly to Albany.

³³ See, e.g., Mark Pazniokas, *Governors want sunlight on the secretive ISO New England*, CT Monitor (Oct. 15, 2020), <https://ctmirror.org/2020/10/15/governors-want-sunlight-on-the-secretive-iso-new-england/>; Letter from Harold B. Gray, President of Organization of PJM States, Inc., to PJM Nominating Committee (Mar. 21, 2021), <https://www.pjm.com/-/media/about-pjm/who-we-are/public-disclosures/20210315-opsi-letter-re-the-nc.ashx>.

of a regional port authority, for example) seems only possible where there is mutual dependence to achieve shared objectives. Few historical examples offer encouragement that this approach to governing the RTO would work.

- **Political Parochialism?** Engineers charged with reliably operating the grid speak of maintaining balance between load and generation. Beyond that is the need to maintain another balance: one that considers reliability imperatives, economic objectives, and increasingly, environmental constraints. With state control over the RTO, this balance will become trickier as social, employment, economic development, patronage and other parochial political interests invariably will creep into the mix.
- **Willingness To Assume Accountability?** With control comes accountability. While RTOs make their own share of mistakes, their corporate ambiguity and political obscurity has made them useful “bad guys” to blame for circumstances or decisions that might be unpopular in some quarters, but ones which RTOs have little choice but to make. And where RTOs do err, once one gets past the finger-pointing stage, it’s often the case that stakeholders and regulators, including states and the FERC in some cases, share in the contributory negligence. After all, rules around resource adequacy and other impactful questions of market design, decisions as to who can become a member and on what terms, and where and when to site needed transmission – just to name a few examples, are calls made with heavy if not overriding stakeholder or regulator control. Often the calls reflect suboptimal compromise or “least common denominator” solutions. In any case, they are put to the RTO to administer and when lousy outcomes result, it can be the RTO left holding the bag. Clear state ownership of RTO governance will create a clear locus of accountability back to the state, something elected officials will likely regard as an unwelcome consequence.
- **Policy Continuity?** Many aspects of RTO operation are long dated. Rule change has a period of gestation and the use of modeling and forecasting to support important design elements of markets and planning constructs means that evaluating the efficacy of such design often can occur only years later. The prospect of a different political party controlling the statehouse presents a challenge to an RTO who derives its mandate and policy direction from the state. The years of work undertaken by the Alberta Electric System Operator (AESO) and its stakeholders to launch a capacity market, which was abruptly terminated once a new provincial government was formed, illustrates the problem.³⁴

³⁴ This statement from the province’s conservative party describes the former government’s (the National Democratic Party) initiative to introduce a capacity market (at AESO’s request) as “ideological meddling.” <https://www.alberta.ca/release.cfm?xID=642387D0ECA3E-ED8E-6B02-885D35312EBBB3EE>

A review of ERCOT's operations offers a glimpse into how a state-controlled RTO would perform. Take, for example, Texas Competitive Renewable Energy Zones which were a policy dictate of the Texas legislature, which directed the Texas PUC to facilitate the building of renewable zones and transmission lines in ways that hastened wind penetration but fundamentally undercut the working of the Texas market design. Or more recently, in the wake of storm Uri, ERCOT's understandable decision to operate the grid very conservatively with an expensive overcommitment of resources to guard against the politically intolerable prospect of emergency alert communications or calls for conservation. This is the challenge. State-controlled RTOs solve the accountability problem. But making tough calls, involving trade-offs among competing politically sensitive issues, not to mention attracting and retaining the skills needed for system and market operations leaves us skeptical that state-controlled RTOs (particularly if regional operations are required) will have more than isolated success.

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5. Conclusion to Part 1

Our examination of current governance constructs for RTOs has been dour. Because the state-driven model will face political constraints and struggle to advance regionalism, we expect they will over time look and act less and less like RTOs as we currently know them. The member-driven model in multi-state RTOs has become ungovernable or is approaching that place.

Our next installment (Part 2) explores the prospect of transforming member-driven RTOs into a more traditional private-ownership corporate model and makes a case for other non-RTO constructs to advance the regional coordination required by a transitioning industry. As such, we hope our discussion of RTO governance ultimately ends on an optimistic note.