

Energy Imbalance Market

Governance Proposal

August 13, 2013

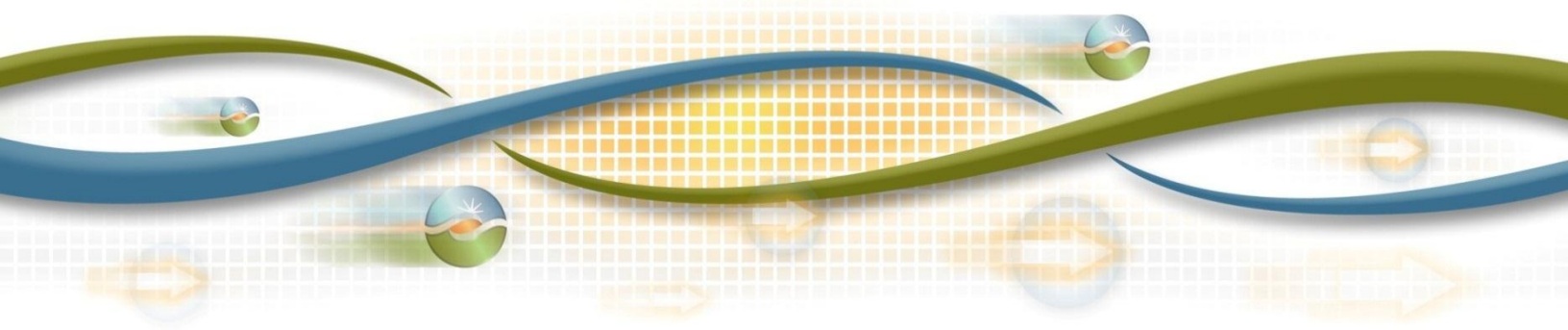


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1. Introduction and Executive Summary

The California ISO (ISO), as part of its proposal to offer Energy Imbalance Market (EIM) services to other balancing authorities in the west, has committed to work with EIM stakeholders through the stakeholder process to establish an EIM governance structure that allows EIM entities and EIM participating resources to have a meaningful decision-making role in EIM. EIM stakeholders must play a key role in fostering a market that meets their current needs, and in influencing future changes to that market. Any EIM governance structure should have the objective of preserving for EIM participants, both at the outset and in the future, the significant and tangible benefits of the EIM. This paper presents an EIM governance straw proposal that seeks to build such a governance structure through a two-step process, with the first step completed before EIM becomes operational and the second step completed as soon thereafter as practicable.

The first step is to establish a transitional EIM stakeholder advisory committee (the “Transitional Committee”) that would advise the ISO Board of Governors (“Board”) and ISO management on matters related to the start-up and initial implementation of the EIM, as well as propose a path to an independent EIM governance structure. The ISO proposes that the Transitional Committee have seven members at the outset and be established under existing Board authority as an advisory committee pursuant to the ISO’s Bylaws.¹ Accordingly, the Transitional Committee would be able to begin its work quickly, without the need for FERC approval, as the market rules and processes are being tested, and can immediately begin designing a proposal for an independent EIM governance structure. A charter for the Transitional Committee developed in the ISO’s stakeholder process would be submitted to the Board for approval by December 2013, with the Transitional Committee scheduled to become operational in April 2014. The membership of the Transitional Committee would be established through a selection process, described in Section 4 below, that is intended to ensure a committee that is both broadly representative and capable of providing advice informed by substantial experience and expertise in relevant areas. The ISO proposes that the ISO management identify an ISO staff person who would perform a liaison function for the committee, attend committee meetings, and facilitate the provision of support to the committee. This will ensure that the Transitional Committee has the benefit of ISO market design expertise and that it is informed regarding, and can accomplish its goals in conjunction with, the existing ISO governance and management structures. Finally, the ISO will provide the committee with logistical support for committee meetings, as well as legal advice and subject matter expertise, as appropriate, which will be coordinated through the committee liaison.

¹ See Amended & Restated Bylaws of California Independent System Operator Corporation, Article IV, Section 2. A copy of the ISO Bylaws can be found on the ISO’s website at http://www.caiso.com/about/Pages/OurBusiness/Publications_CorporateDocuments.aspx.

The second step in the process, and one of the key implementation-related responsibilities of the Transitional Committee, will be to develop a proposal for an independent EIM governance structure with specific defined authority over EIM on a going-forward basis. The ISO Board would review and approve the proposal and the ISO would require FERC approval for tariff revisions to implement the proposal. The ISO sets forth some basic parameters for the independent governance structure in Section 5 below. The Transitional Committee will advise the ISO Board and management on development of a complete framework for EIM governance.

The exact schedule and process for developing the proposal for the independent EIM governance structure will be determined by the Transitional Committee through an open process as discussed below. While the Transitional Committee's work should be completed as soon as practicable, it could also provide important input as all parties gain experience with actual operation of the EIM market. Thus, this proposal envisions that the independent EIM governance structure will be established and begin operation within two years of the commencement of the Transitional Committee. This should allow sufficient time for experience with the EIM to inform the Transitional Committee's proposal.

This two-step proposal is designed to establish an EIM governance structure that can evolve and mature in tandem with the evolution of the EIM, meeting both immediate and longer-term governance needs. To that end, Section 3 of this paper discusses a set of guiding objectives that were used in developing this proposal and that the ISO believes should be central to the governance proposal that is ultimately implemented.

2. Stakeholder Process

In the April 4, 2013 Energy Imbalance Market Design Straw Proposal and Issue Paper, the ISO discussed various options for EIM market rule oversight and expressed an intent to engage stakeholders further on this issue. In response to stakeholder comments requesting a more in-depth discussion of this topic, the ISO committed in its May 30, 2013 Revised Straw Proposal to publish in August a proposal regarding EIM governance that would be considered in a parallel stakeholder process specifically dedicated to that issue.

The EIM governance proposal set forth in this paper presents the ISO's proposal for developing a structure for EIM rule oversight, and this paper constitutes the initiation of the proposed parallel stakeholder process. The ISO intends to complete this process in time to allow for the formation and commencement of the Transitional Committee by April 2014.

The ISO is committed to provide ample opportunity for stakeholder input into the EIM Governance Proposal. This stakeholder process will shape the final governance structure through a series of proposals and written stakeholder comments. Stakeholders should submit written comments to EIM@caiso.com.

The planned schedule for the EIM governance stakeholder initiative is as follows:

- August 13, 2013: Proposal published for stakeholder comment
- August 20, 2013: Stakeholder meeting (Portland)
- September 6, 2013: Stakeholder comments on proposal due
- October 4, 2013: Revised proposal and draft Transitional Committee charter published for stakeholder comment
- October 11, 2013: Stakeholder conference call on proposal and charter
- October 25, 2013: Stakeholder comments due on revised proposal and draft charter
- November 7, 2013: Revised proposal and revised charter for Transitional Committee published for additional stakeholder comment
- November 14, 2013: Stakeholder conference call on proposal and charter
- November 25, 2013: Stakeholder comments due on revised proposal and revised charter
- December 18, 2013: Seek ISO Board approval of committee and charter
- March 28, 2014: Seek ISO Board decision establishing committee membership
- April 2014: Initial meeting of EIM Transitional Committee

3. Guiding Objectives for Governance Proposal

In developing the EIM governance proposal, the ISO has considered the following three objectives to be of paramount importance:

- a. Prompt and Direct Input:** The governance structure should promptly provide an effective, efficient and meaningful mechanism for stakeholder input directly to the ISO Board on EIM decision-making. This will ensure that the Board makes well-informed decisions during the start-up and early implementation phase of EIM, and that stakeholders' voices are heard in this process.
- b. Adaptable Structure:** The governance structure should be designed to be adaptable, so that it can evolve as necessary to address the changing needs of EIM as it matures and grows.
- c. Promote Successful Implementation:** The governance structure should promote the successful implementation of EIM. To that end, the initial governance structure should be established under existing authority so as not to delay the overall implementation of the EIM initiative. The governance structure should also consider and seek to address the needs and interests of entities that have committed to participating in EIM, potential future EIM participants, existing ISO market participants, and other relevant stakeholders. The governance structure should also embrace a duty to the success of the EIM initiative as a whole.

The proposed two-step process attempts to meet each of these objectives. The first objective is met by establishing an initial advisory committee of interested stakeholders that can provide input to the ISO Board and to ISO management during the start-up and early implementation phase. This ensures that the Transitional Committee has direct and ongoing communication with the Board throughout the implementation period.

The second objective is met by including in the Transitional Committee charter the responsibility to develop a proposal for an independent EIM governance body that would meet the needs of EIM beyond the initial implementation phase. This second phase of the process will allow for an efficient and flexible EIM governance structure that can develop as conditions warrant, based on the experience and knowledge gained in the start-up and early implementation phase. For example, as discussed in Section 5 below, the ISO envisions that, unlike the Transitional Committee, the ISO would seek FERC's approval to establish an independent governing body with certain decision-making authority regarding EIM market rules, which could include specified filing rights under the Federal Power Act. Such a structure requires that the membership of the EIM governing entity be independent, and it would thus be made up of a diverse group of individuals that are not employed by or affiliated with any EIM market participant. The individuals qualified to serve would also be prohibited from any financial interest in a market participant. Although the ISO's proposal would establish certain broad parameters with respect to such issues, the proposal intentionally avoids prescribing the specifics of this structure to allow such decisions to be informed by the work of the Transitional Committee and the experience gained through EIM operation.

The third objective is met by providing a mechanism for broad and robust stakeholder involvement and engagement in the initial phase, followed by a design for independent governance that establishes an efficient and effective oversight structure that permits the ISO to continue to manage the market on a day-to-day basis in a way that is responsive to business, regulatory and stakeholder needs. Potential participants must accept, as part of their fundamental role, a responsibility to consider and promote the success of the EIM enterprise as a whole in the context of their decision-making.

4. EIM Transitional Committee

This section proposes the structural and substantive parameters for the formation of the Transitional Committee and its charter. It is based upon principles of “good governance” and the overall objectives of the proposal as detailed above. The overall structure of the Transitional Committee, as well as the process for establishing membership and duties of the committee, will ultimately be incorporated into a Transitional Committee charter, which will be submitted to the ISO Board for approval with the proposal to form the committee. As set forth in the stakeholder schedule above, the next revised proposal will include a first draft of the Transitional Committee charter for stakeholder consideration.

4.1. Formation

The ISO proposes a Transitional Committee that would be formed by a resolution of the ISO Board, as allowed under existing ISO bylaws. This allows implementation of the resolution and work of the committee to begin quickly and in a capacity to inform the Board and management as the ISO works on EIM implementation and market simulation throughout 2014. In addition, this structure enables work on the design of an independent EIM governing structure to begin quickly.

4.2. Committee Structure

The ISO proposes a structure of seven Transitional Committee members at the outset, with potential members nominated by a broad cross-section of EIM stakeholders. The members could vary by occupation, expertise and affiliation, and would not need to be affiliated with a stakeholder to qualify. Because the EIM potentially has important impacts throughout the Western Interconnection, the ISO proposes that a broad group of stakeholders within the interconnection should be involved in the nomination and selection process, with the stakeholders grouped into functional sectors, modeled after the process utilized for the ISO’s Board nomination process. The nomination process proposed is a two-step selection process in which all relevant stakeholder sectors nominate candidates and then rank the candidates for ultimate appointment by the ISO Board. The proposed selection process is discussed more fully below in section 4.2.2.

4.2.1. Number and Term

The ISO proposes a seven member committee because this size is large enough to provide broad representation of stakeholder interests while still small enough to allow its members to work closely with one another to accomplish the committee’s goals. The ISO proposes an odd number of members because this enables the committee to make decisions without having to institute a tie-breaker mechanism.

The ISO further proposes that the Transitional Committee charter would contain a provision permitting the ISO Board to increase the size of the committee by up to two additional members in the event that additional entities enter into energy imbalance market implementation agreements, thereby committing to becoming EIM entities. This provision would ensure that entities that have an enhanced stake in EIM by virtue of such a commitment have a ready means

for participating on this committee. The ISO intends to discuss the specifics of the process for increasing the committee size in the draft charter that will be published with the second draft of this governance proposal.

The ISO further proposes that the committee would be assisted by an ISO staff person, designated by ISO management, who would perform a liaison function for the committee, attend committee meetings, and facilitate the provision of support to the committee. This individual would not vote on any matters considered by the Transitional Committee, and instead would participate only in an advisory capacity. This would preserve stakeholder control over the committee process and decision-making while ensuring that the Transitional Committee has the benefit of ISO market design expertise and insight, which will be highly valuable for the committee as it advises the ISO Board on EIM matters.

Because the EIM Transitional Committee is designed as an interim advisory committee with one of its principal objectives to propose an independent EIM governing structure, the terms for its membership should be limited to the time necessary to accomplish its objectives. Based on the ISO's experience with its stakeholder process, the ISO believes a two-year term should be adequate time for the Transitional Committee to gain experience with the EIM, to prepare a proposal for an independent EIM governing structure for the ISO Board, and for that proposal to be implemented through appropriate tariff amendments. The charter will provide for the Transitional Committee's dissolution upon establishment of the independent EIM governing structure, if completed in less than two years. If two years proves inadequate to complete the proposal, or if other circumstances dictate that more time is needed, the charter will provide, upon ISO Board approval, for extended terms for existing Transitional Committee members or for the nomination and appointment of new members.

4.2.2. Nomination and Appointment

This proposal calls for the Transitional Committee members to be selected through a nomination and appointment process. EIM stakeholders will provide a list of recommended candidates for the ISO Board's consideration, and the ISO Board will appoint from that list. The ranking process could be modeled after the ISO's Board selection process, whereby a group of representatives from each stakeholder sector separately ranks the candidates, including both sector-nominated and self-nominated candidates. The sector rankings are then combined to constitute one list of ranked candidates. While the Board will maintain discretion as to member appointments, the Transitional Committee charter will mandate that the Board limit the selection to the stakeholder-ranked list, and give due consideration to stakeholders' rankings. This process would comport with the ISO bylaws and provide an opportunity for the Board to review the candidates' qualifications and make an informed decision as to appointments.

In order to ensure the EIM participants will have a voice on the Transitional Committee, the ISO proposes that the Transitional Committee charter would state that at least one of the committee members must be an individual from an EIM Entity. This EIM Entity committee member would be selected from the pool of nominees established in the sector nominating process.

The first step in the committee selection process would consist of obtaining nominations for committee membership. The process would include individual self-nominations as well as at least two nominations by each stakeholder sector, as discussed below, which would be organized according to the committee charter.

Once a list of nominees is compiled, the next step would for the sectors to rank the candidates for consideration of appointment by the ISO Board. For this step, each stakeholder sector would rank all nominees. This would likely be accomplished by engaging sector liaisons who could organize relevant stakeholders in their respective sectors to rank the candidates according to preference. The exact process used to establish the sector-specific ranking would be decided by the sector liaisons for each sector. This process should ultimately result in a list of ranked candidates that would be provided to the ISO Board for use in making appointments to the committee.

The process can be summarized as follows:

- Open nominations, including any self-nominations, and at least two nominations per stakeholder sector;
- Each stakeholder sector, through sector liaisons, will rank all nominees (both self-nominated and sector nominated). Thus all nominees will be ranked by each sector, creating six separate rankings of the list. These ranked listings will be compiled and submitted to the ISO Board for ultimate appointment of seven voting members;
- ISO Board will appoint seven Transitional Committee members from the list of ranked candidates, including at least one member from an EIM Entity.

The committee, once appointed, would be empowered by its charter to select its chair by majority vote of the committee members.

4.2.3. Sectors

Based on the existing EIM framework, ISO proposes the following six stakeholder sectors be used for nominating individuals to serve on the EIM Transitional Committee:

- Investor owned utilities
- Publicly owned utilities
- Generators and marketers
- Alternative energy providers
- EIM participants
- Government agencies and public interest entities

For the first four sector categories, the ISO proposes that any entity who fits within the category description and has participated in the ISO's markets since 2009 (either internally or by

importing, exporting, or wheeling power through the ISO's markets) would be eligible to participate in the sector nomination process. For the fifth sector category, the ISO proposes that any entity who is within an EIM entity's balancing authority or an EIM entity itself would be eligible to participate in the sector nomination process. For the sixth sector category – government agencies and public interest agencies – the ISO proposes that any such agency or entity may participate in the nominating process, provided that the agency or entity is located within, or represents members within, the Western Interconnection. In the event that any entity may properly be classified as falling into more than one of the identified sector categories, the entity would be required to choose only one category through which to participate in the sector nomination process.

The ISO believes these sectors will provide a broad array of EIM stakeholders an opportunity to participate in the committee selection process and, therefore, a voice in EIM governance. Moreover, this grouping includes regional governmental entities, which may have a special interest in the EIM in that these jurisdictions may be impacted by the regional EIM, and a voice on the committee selection would allow for their collective input. The ISO's proposal also seeks to logically align similar interests in each sector, which should facilitate a balanced nomination ranking process that gives due weight to the rankings of each sector.

4.2.4. Qualifications

The minimum qualifications for Transitional Committee eligibility should be directed toward establishing a diverse and sophisticated committee to advise on EIM matters, and to develop a proposed permanent governance structure. Thus, qualifications should include requirements that members have broad and relevant industry and market design experience, as well as expertise in areas most relevant to the EIM development. Further, based on the regional aspect of the EIM, Transitional Committee membership qualifications should include geographic diversity so the various regional interests are represented.

All potential candidates should possess a proven reputation for excellence in their areas of expertise, and optimally should reflect a diverse geographic background (e.g., members from multiple balancing areas) and viewpoint (e.g., no two government officials from the same administration and no two committee members from the same corporation or affiliated group).

These qualifications will serve a dual purpose. First, they should guide the sectors in ranking nominated candidates. Second, the ISO Board will consider these qualifications when appointing Transitional Committee members within the rankings. Thus the Board will exercise discretion, within the bounds of the qualifications, when selecting members for appointment to ensure that the committee has the appropriate mix of expertise and background among its members, while respecting the stakeholder rankings.

4.3. Meetings

For the Transitional Committee to effectively advise the ISO Board, it should conduct meetings at least as frequently as the ISO Board. Also, its meetings should generally precede ISO Board

meetings so that the committee may advise the ISO Board in a timely manner. The charter will also provide for additional meetings, as deemed necessary by the committee.

The ISO Bylaws require that, as an advisory committee to the ISO Board, the Transitional Committee comply with the ISO Open Meeting Policy. That policy mandates that all general session committee meetings provide an opportunity for public comment, be noticed according to the policy, and be accessible to the public.

Committee meetings must be held at a location where the public can attend, either in person or via telephone or some other electronic means such as the Web. The ISO headquarters may serve as a meeting location, however, the charter will provide for alternative meeting locations so that the committee can meet as needed while minimizing travel for the committee members and other interested parties who may wish to attend or need to present at committee meetings. The Open Meeting Policy also provides for closed executive session meetings for specific enumerated matters, which include presentation or discussion of confidential and proprietary or security-sensitive information, as relevant to the EIM matters. Further, the ISO corporate secretary will assist the committee in fulfilling its open meeting obligations.

4.4. Roles and Responsibilities

The charter will address the following matters with respect to the roles and responsibilities pertinent to the functioning of the Transitional Committee.

Transitional Committee

The Transitional Committee will serve two roles. First, it will advise the ISO Board on all matters related to EIM. This role will include providing advice on all EIM market design initiatives, all matters pertaining to the setting of EIM transmission access charges or rights, if any, and other EIM-related matters. ISO management will develop and present EIM-related proposals to the Board, as happens today, and the committee will advise the Board as to its position on ISO management's proposal. The committee will be allowed to request, as needed, a spot on the Board agenda for all matters it is interested in presenting. As a Board advisory committee, recommendations and advisory opinions should be presented in written memos issued in advance of a scheduled ISO Board meeting and in presentations at regularly scheduled ISO Board meetings. The charter will set forth voting requirements, for a quorum of two-thirds of the committee members and an affirmative vote of a majority of the members then appointed for a majority opinion. To ensure that the ISO Board is fully advised of all positions, if the committee develops a majority *and* a minority position on any particular EIM issue, it should advise the ISO Board of both positions in writing.

Second, the committee will develop a detailed proposal for an independent EIM governance structure. The charter for the Transitional Committee will provide certain general parameters for this structure, as discussed more fully below. Although the exact timing would be established by the committee, the ISO expects that the committee will submit the proposal to the ISO Board for consideration within approximately 18 months after the committee is first seated. This timing is

intended to allow the proposal to be implemented within approximately two years after the committee is seated.

Transitional Committee Members

Transitional Committee members will have the responsibility of complying with the committee's mission, which will be detailed in the mission statement in the committee's charter. The mission will consist of working at all times in the best interest of the Transitional Committee, in the interest of facilitating an effective and efficient EIM, and for the success and potential regional growth of the EIM.

Also, from time to time, committee members may require access to confidential information of the ISO or EIM participants to fulfill their duties. Accordingly, they will be obligated, as members of an ISO advisory committee, to maintain the confidentiality of such information, and will be bound by non-disclosure requirements, in a non-disclosure agreement or as prescribed by the charter, so that the ISO may fulfill its tariff obligations regarding the handling of confidential information.

ISO Board of Governors

The ISO Board will have the responsibility of giving Transitional Committee opinions and positions serious consideration on any EIM matter. To that end, it will engage the committee on a regular basis when EIM matters are being considered, and will reserve, as needed or as requested by the committee, space on the agenda of such meeting items for the committee's input.

ISO Management

ISO management will continue to develop and present all EIM market rule change proposals to the Board, though with the benefit of input received from the Transitional Committee. Specifically, management will coordinate with the Transitional Committee on the stakeholder process for EIM proposals to enable the committee to develop its advice for the Board, and will consider any EIM proposals made by the Transitional Committee. Further, as discussed above an ISO-designated staff member will attend committee meetings, perform a liaison function, and facilitate the provision of support to the committee.

Additionally, ISO management will provide administrative support for the Transitional Committee so that it may conduct its business and fulfill its obligations. This support will include advice and assistance by the corporate secretary in fulfilling the committee's Open Meeting Policy obligations, as well as general office and communications support to ensure that the committee can satisfy its objectives.

4.5. Compensation, Reimbursement

The ISO proposes that Transitional Committee members serve without compensation and that members' affiliated entities should be responsible for all costs and travel expenses associated with the committee (e.g., meeting attendance and committee work).

5. Independent EIM Governance Structure

To achieve the second phase of the EIM governance implementation, the charter will require the Transitional Committee to develop a proposal for an independent EIM governance structure comprised of non-stakeholders. Moving to a structure comprised of participants who are independent of individual stakeholders will make it possible to satisfy FERC requirements for the ISO Board to delegate substantial authority over EIM, and provide for a governance structure that will allow for efficient, meaningful and nimble EIM market oversight. The Transitional Committee charter will provide some basic guidelines and parameters for such an EIM governing structure, but only at a very general level. Major policy and design aspects of the proposal will be for the Transitional Committee to develop through its own process. The proposal developed by the committee for an independent EIM governing structure will be submitted to the ISO Board for consideration and approval.

5.1. Independent Membership

To enable the ISO board to delegate a level of EIM tariff authority, FERC regulations mandate that members of the EIM governing structure be independent from EIM stakeholders. This membership characteristic will put the EIM governance structure in a position to exercise EIM decision-making authority. Accordingly, independence is a necessary requirement for the Transitional Committee's proposal which will be included in its charter. Within the guidelines and principles in the charter, the Transitional Committee will have discretion to craft its proposal as to all other aspects of the EIM governance, such as the structure of the independent EIM body, including the qualifications for membership, the number of members, their terms, their selection process – including as relevant a nomination and election process – how they will make decisions, and other design elements.

5.2. Specific Delegated Authority

A principal consideration in the design of an independent EIM governance structure is to provide the relevant body with specific authorized EIM tariff authority. This authorization would occur through an amendment to the ISO tariff. While the precise details of this authority will be for the Transitional Committee to propose, the ISO envisions that some guiding principles will be set forth in the charter, such as: 1) the authorization must provide a meaningful and clear role for the EIM body; 2) the structure must remain nimble, to allow for efficient decision-making; and 3) the structure cannot create the potential for dueling filings at FERC and must include a mechanism to resolve any disagreements between the EIM governance body and the ISO Board. This includes a mechanism to sort through changes to the ISO market that would have effects on the EIM market structure and vice versa.

6. Conclusion

In developing this proposal, the ISO has reviewed the best practices of other similar organizations and believes that this proposed structure and process provides for a viable and efficient means of providing meaningful stakeholder input on EIM matters. The proposal will provide a nearly immediate means for stakeholders to provide important input, as well as a path to an independent EIM governance structure with specific authority regarding EIM issues.

The governance structure discussion will likely require a varied set of stakeholder input, including both stakeholders that are already involved in EIM market design issues, as well as others who may not yet have been involved in the ISO's ongoing EIM stakeholder process. The ISO welcomes, and strongly encourages, broad participation in the governance discussion from all interested parties throughout the region and looks forward to productive dialogue and feedback on these issues.