

**MODEL CORPORATE GOVERNANCE FOR
REGIONAL TRANSMISSION ORGANIZATIONS
AND
INDEPENDENT SYSTEM OPERATORS**

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**MODEL CORPORATE GOVERNANCE FOR
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I. EXECUTIVE SUMMARY

A. Overview

The purpose of this report is to identify changes to regional transmission organization and independent system operator (collectively, “RTO” or “RTOs”) governance that will more effectively represent the interests of consumers, including the retail residential consumer class. Residential consumers contribute more than 40% of the country’s electricity revenues, and accordingly, a similar contribution towards the operation and management of the different RTOs.¹ All stakeholders in the RTO are bound to benefit from a more effective representation of the residential consumer class because this assists in adopting more transparent and effective cost control measures, enhances the linkages between the wholesale and retail markets, increases the participation of demand side resources, and could play a non-adversarial role in generation and transmission siting.

B. Existing RTO Structures Prevent Effective Participation by End-Use Consumers

NASUCA understands that critical decisions about a region’s electricity system are made by the RTO and its associated advisory committee. However, end-use consumers are not consistently able to provide effective input about their interests because the decision-making process is complicated and extremely time-intensive, and

¹ Energy Information Administration, United States Government, http://www.eia.doe.gov/cneaf/electricity/epa/epa_sprdshts.html , 1990 - 2007 Revenue from Retail Sales of Electricity by State by Sector by Provider (EIA-861).

most consumers and their advocates lack the resources required to meaningfully monitor and influence the stakeholder process. In its review of RTOs' performance, the Government Accountability Office ("GAO")² noted that some stakeholders reported that attending the stakeholder meetings was resource intensive and that often decisions within the RTOs did not place a sufficient emphasis on how they might ultimately affect the prices consumers pay for electricity. The GAO tabulated the total stakeholder meetings for various RTOs in 2007:³

RTO/ISO	California ISO	ISO New England	Midwest ISO	New York ISO	PJM	Southwest Power Pool
No. of stakeholder meetings	57	184	611	280	330	202

When many of the decisions made by the RTOs directly or indirectly affect consumers, it is impractical to think that consumers or their advocacy organizations can devote the resources to effectively monitor and influence the stakeholder process. The energy industry has effectively devoted resources to influence the RTOs and their associated stakeholder processes. Companies in the energy industry whose bottom line is directly affected by decisions made during the RTO stakeholder process have a specific reason to devote the resources to meaningfully affect the process. The lack of adequate retail consumer involvement in the RTO stakeholder process may lead to decisions that do not adequately recognize how these decisions may affect the price of electricity to consumers. Accordingly, in this position paper, NASUCA sets forth a model RTO

² GAO Report to the Committee on Homeland Security and Governmental Affairs, September 2008, *Electricity Restructuring, FERC Could Take Additional Steps to Analyze Regional Transmission Organizations' Benefit and Performance*.

³ See GAO Report, p. 34.

governance structure to address the barriers that prevent end-use consumers from effectively participating in the existing RTO structure.

II. RECOURSE TO THE FEDERAL ENERGY REGULATORY COMMISSION'S AUTHORITY IS HELPFUL BUT MAY BE TOO LATE AND REQUIRES RESOURCES MANY RESIDENTIAL CONSUMER ADVOCATES DO NOT HAVE

The jurisdictional authority of the Federal Energy Regulatory Commission (“FERC” or “Commission”) could provide relief for residential consumers from costly RTO tariffs, market rules, markets, and practices that require Commission approval. Without proper representation of consumers’ interests in RTO governance, consumers have only one recourse: litigation at FERC. This presents a lose-lose scenario. Consumer advocates’ funding limitations restricts effective participation at FERC. Funding restrictions also prevent effective participation within the RTO stakeholder process. The combination results in inadequate representation of consumer interests. The solution is to include persons with consumer expertise in the governance structure of the RTO. Adequate inclusion of RTO board members with expertise in representing consumer interests would ensure consumer issues are addressed much earlier in the RTO process. This has the potential for avoiding formal FERC litigation later in the process. All stakeholders, and the RTO, would benefit from Board members with expertise in residential consumer issues, thus permitting the Board to consider the residential consumer perspectives independently as well as through the Advisory Committee process. It is important that the Board be proactive in addressing residential consumer issues and not simply reactive.

III. CORPORATE GOVERNANCE

A. Introduction

Coordination of reliable transmission power grid operations and the administration of wholesale markets are the responsibilities of the RTOs. RTOs were established by the Commission in its Orders 888, 2000, and 2001.⁴ Key features of RTO responsibilities are ensuring non-discriminatory transmission access, managing unbiased interconnection of transmission facilities with generation, providing market monitoring services to ensure neutral or mitigated markets for participants, and “facilitating competition among wholesale suppliers to improve transmission service and provide fair electricity prices.”⁵ Of the four characteristics of the RTO, key is independence, particularly of the Board. In Order 2000 FERC stated, “...the principle of independence is the bedrock upon which the ISO must be built”[a]n RTO needs to be independent in both reality and perception.”⁶ NASUCA understands the value of having truly independent RTOs, but also believes it is important to assure RTO leadership have the experience and expertise to fully understand the interests of all their stakeholders.

⁴ *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 Fed. Reg. 21,540 (May 10, 1996), FERC Stats. & Regs. ¶ 31,036 (1996), order on reh'g, Order No. 888-A, 62 Fed. Reg. 12,274 (March 14, 1997), FERC Stats. & Regs. ¶ 31,048 (1997), order on reh'g, Order No. 888-B, 81 FERC ¶ 61,248 (1997), order on reh'g, Order No. 888-C, 82 FERC ¶ 61,046 (1998), aff'd in relevant part sub nom. *Transmission Access Policy Study Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000), aff'd sub nom. *New York v. FERC*, 535 U.S. 1 (2002); *Regional Transmission Organizations*, Docket No. RM99-2-000, Order No. 2000 (Issued December 20, 1999); *Revised Public Utility Filing Requirements*, Order No. 2001, 67 FR 31043, FERC Stats. & Regs. ¶ 31,127 (April 25, 2002); reh'g denied, Order No. 2001-A, 100 FERC ¶ 61,074, reconsideration and clarification denied, Order No. 2001-B, 100 FERC ¶ 61,342 (2002).

⁵ *The Value of Independent Regional Grid Operators*, a Report by The ISO/RTO Council at 7 (November 2005). (emphasis added).

⁶ FERC Docket No. RM99-2, 89 FERC ¶ 61,285 (“Order No. 2000”) at 199 (Issued December 20, 1999).

While cross-sectional representation is essential for the comprehensive understanding of the issues facing the Board, this does not mean the Board members' role is to be the representative of any particular sector.

RTOs are unusual entities. Although nominally FERC-regulated utilities, they are a new creation and their responsible operation requires them to be responsive to an unusually wide range of competing stakeholder interests. Public confidence in these new organizations demands that RTOs must prove themselves accountable to the public interest. Thus, while their corporate organization is important, the essential precondition to any successful RTO must be a culture of openness and engagement with RTO stakeholders. At the Board level, we have consistently seen that RTOs with structures for open and public meetings more readily command the respect and confidence of their stakeholder communities. We therefore urge in the strongest possible terms that RTO Board meetings should wherever possible be open to the public, and should include options such as remote listening by teleconference.

While RTOs are unusually corporate entities, they typically operate in a traditional corporate structure with a Senior Management that reports to a Board of Directors (or Board of Managers) ("Board"). The Board is ultimately responsible for the operation of the RTO. In many cases Board members are required to have experience in finance and utility operations – generation, transmission, or other regulated industries. The experience required to qualify someone to sit on the Board is governed by the RTO corporate documents (Articles, Bylaws) or corporate practice. The purpose of qualifying Board members is to provide assurances that the Board has a variety of expertise and

experience to assure that they can independently discharge the RTO responsibilities as defined by FERC and codified in tariffs and relevant law.

In many of the RTOs, Board members lack the necessary experience and expertise to understand residential consumer interests, and such interests are not adequately addressed or represented in the stakeholder process.⁷ Even though the RTO is charged with providing and ensuring fair electricity prices, there is a lack of consistency among the RTOs as to the experience and expertise required to be present within the Board. In particular, there is a nearly universal lack of experience at the Board level with expertise in representing end-users – including residential consumers. As explained earlier, residential consumers pay a significant portion, roughly forty percent, of the costs of operation and administration of the RTOs. Residential consumers also pay a significant portion of the energy and capacity costs of the market; however, residential consumers do not necessarily have a meaningful voice in determining the “fairness” of their share of costs.

In many of the RTOs, end-user interests (mainly other than residential consumers because of the financial limitations of residential consumer advocates) appear to be represented somewhat sporadically through participation in committees, task forces, and working groups. While consumer interests have the theoretical opportunity of participating at such levels, it does not assure that consumer interests will be represented at all levels of RTO governance, which is essential to a more efficient and equitable RTO operating structure. The importance of understanding issues at the Board level should not be taken lightly, as it is the Board that sets the corporate culture, prioritizes and identifies

⁷ Even where the RTO may provide for such representation, financial limitations of customer representatives do not necessarily make this a meaningful process.

issues it deems as vital to the RTO, and interacts with senior management in setting the goals and objectives of the organization. Whether consumers are theoretically allowed to vote in the RTOs' stakeholder structure does not assure consumers a meaningful role in setting in the course of the RTO at the Board. Only the Board, with the advice of senior management, has this right and responsibility to be a final determining vote on any issue. Therefore, in evaluating what fair electricity prices are for the RTO, it is essential that the Board include members who have real expertise and experience in representing consumers.

The general structure of RTO often includes a senior advisory committee ("Advisory Committee") made up of sector specific stakeholders. The Advisory Committee plays a vital role in its direct interaction with the Board. It provides a link between the Board and the subcommittees tasked with addressing discrete issues, advising the Board, and carrying-out or implementing the decisions of the Board. The Advisory Committee communicates issues "bottom-up" from the subcommittees, through the member committees (like the advisory committee) and to the Board. Consumer representation on the Advisory Committee is vital to the information the Board receives and to the importance level assigned to the subcommittees. It becomes quite evident that adequate consumer representation on only the Advisory Committee fails to ensure there is the understanding of consumer interests on the Board - where consumer interests are balanced against the interests of other stakeholders, such as generators and transmission owners.

B. Model Corporate Governance Structure

The RTO Board must include members who have experience representing consumers, in sufficient numbers to avoid marginalizing the perspective and contributions of these members. This would require at least two seats on the RTO Board (or about 20% of the Board) for members who have expertise and experience in representing consumers, at least one of whom has expertise in the interests of retail residential consumers. To support the Board in addressing consumer issues a standing Board committee for consumer issues should also be established (along with Finance, Audit, and Human Resources, etc.).

With respect to senior management of the RTO, the corporate structure of the RTO must include the perspective of the residential consumer advocate. This would be accomplished by according the same support and the same gravity as are accorded other core functions of the RTO, for example (but not limited to), finance, transmission planning, and market development. This may require establishing a department in the RTO charged with the responsibility for addressing and furthering the interests of the consumer. Consumer membership in the committee or working group would be dictated by the same rules as membership in any other committee or working group. Such structural change would be accomplished through the amendment of the RTO governing documents, such as the Articles of Incorporation or Bylaws, and perhaps the RTO Operating Agreement or Tariffs. The governing documents should set forth the minimum standards required to assure that a Board member has experience representing retail residential consumers.

C. Supporting the Contributions of Public Representatives of Residential Consumers

A key element in having a Board with a comprehensive perspective on its industry is to include sufficient members with cross-sectional experience. Most RTO Boards do not have requirements in place to ensure this cross-sectional representation of knowledge and experience for their Board members. The perspective of retail consumer is essential (and apparently FERC agrees).

As was discussed previously, the public representatives of residential consumer interests have limited resources that severely limit their ability to participate in a meaningful way in either the RTO stakeholder process or in proceedings at FERC. Meaningful residential consumer representation requires the ability to provide input and viable alternatives in both of these forums. Because of the complexity of RTO issues, adequate access to funding is necessary to engage consultants and permit travel to the RTOs. Participation can also be limited by the level of membership fees for consumer representatives. To address these matters and encourage greater participation, funding should be established for use by public consumer advocates to engage consultants that will assist in their participation in RTO processes and in FERC proceedings.⁸ A nominal increase in RTO fees would provide meaningful resources for public representatives of consumers to present deliberate, considered, expert information supporting the consumer positions. This would not be unlike the RTOs' support of state commissions in the

⁸ It would also be very helpful if FERC would hear the positions of the parties in FERC proceedings instead of deciding many important issues on the pleadings of the entity making the FERC filing. In many cases, consumers are not even provided the opportunity to provide evidence to FERC, either because it is not allowed, or because there is insufficient time to engage an expert (even if there were resources to do this) and make a filing before a decision is rendered.

RTOs, footprint (for example, Organization of PJM States, Inc. in PJM and the Organization of MISO States in the Midwest ISO).

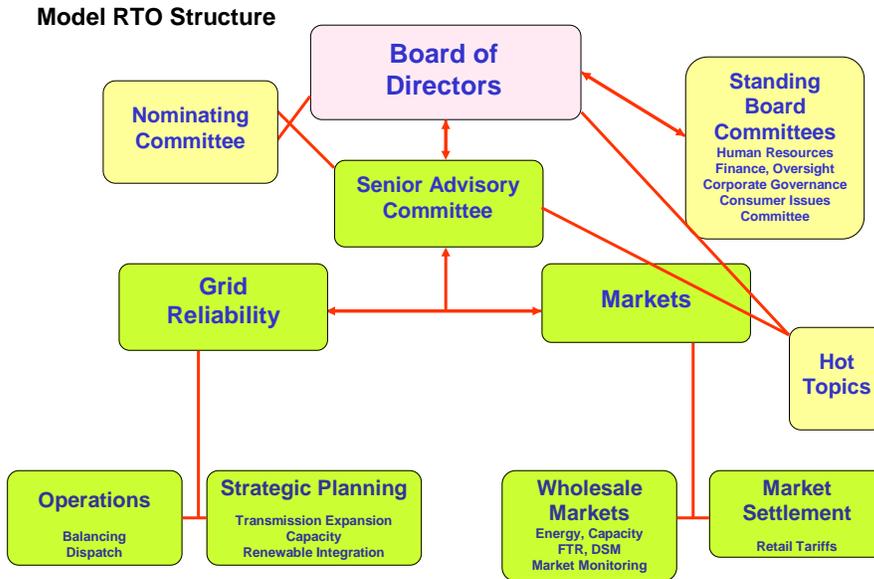
Finally, it is important to remember that the interests and priorities of the public consumer advocates differ from one another depending upon the circumstances of each state. For this reason, consumer advocates are not always able to speak with one voice,⁹ and the funding should not be established such that all consumer positions could not be presented and considered. It is important that there is not an effort to limit (or minimize) the positions of consumer representatives presented to RTOs or to FERC.

D. Best Practices Summary: Model RTO Corporate Structure

All the RTOs in the country were reviewed to determine how they individually approached corporate governance, stakeholder representation, and membership issues. Once the RTOs were reviewed, the model RTO structure was developed based on the best practices of the various RTOs. The model RTO structure and qualifications of the Board, which are discussed in detail below, are depicted in Figures 1 and 2.

⁹ This logic also supports more than one consumer interest member of the Board.

Figure 1: Model RTO Structure Diagram



1. The Board: Board Member Structure and Qualifications

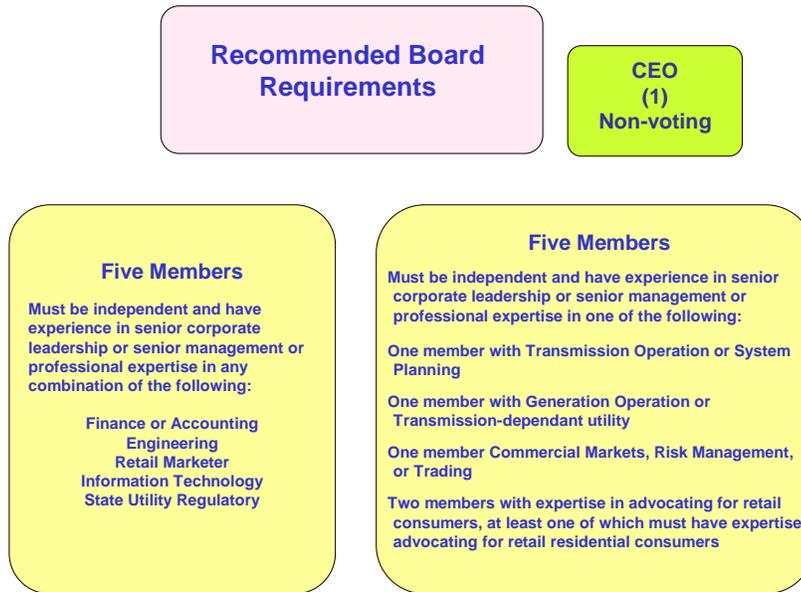
The Board must be independent and not affiliated with the RTO members. The Board should have the experience necessary to govern the complex issues of the RTO and preferably have expertise in the core areas necessary to consider the RTO members' major interests. The Board should be comprised of ten voting members, and should include the CEO as a non-voting member.

To assure the Board collectively has the necessary experience, its members should have professional experience and expertise in the following:

- a) Five directors that have either or both:
 - ✓ Corporate Leadership at the Senior Management or Board level; and

- ✓ Senior Management experience expertise in any combination of the following areas, Finance or Accounting, Engineering, State Utility Regulation, Information Technology, and Retail Markets.
- b) Three directors that have experience in at least one of the following such that each of the categories are represented:
 - ✓ Transmission System Operation or Planning;
 - ✓ Generation or Operations in Transmission Dependent Utilities;
 - ✓ Market/Risk (which can be satisfied by Commercial Markets, Trading, or Risk Management); and
- c) Two directors that have experience in demand-side consumer issues, at least one of which has expertise representing residential electric consumer interests.

Figure 2: Board Qualifications



c) Standing Committees of the Board

Standing Committees of the Board should include a Consumer Issues Committee (in addition to other typical committees e.g., Finance, Audit, Human Resources). The Board should have at least two members on each standing Committee. The CEO may attend the meetings of any standing committee, but may not be a voting member of any Standing Committee.

d) Advisory Committee

The purpose of the Advisory Committee is to provide recommendations to the Board. All issues presented to the Board by stakeholders must be presented through the Advisory Committee. This ensures proper issue identification and flow, and especially that resource-constrained sectors will have one point in the stakeholder process where it is possible to comment on all developing stakeholder issues. The Advisory Committee

will have two standing subcommittees – Grid Reliability and Markets. These Advisory Committee and two Standing Committees comprise the senior members’ committees.

The Advisory Committee will have the authority to create additional subcommittees, task forces, and work groups in order to assist it in providing its recommendations to the Board. This simplifies the stakeholder process because stakeholders will know that all grid reliability issues, for example, must be addressed at the Grid Reliability Committee and Advisory Committee before being presented to the Board.

There should also be a process that allows the flexibility to address high priority issues within the existing framework of the RTO structure without formal establishment of new committees. The “Hot Topics” function is an effective way to achieve this. The idea behind “Hot Topics” is that a special committee is established to address high priority issues or special interest issues directly from the Board or the Advisory Committee. This structure permits the Board to receive more immediate input on any issues identified that require either its immediate attention or understanding. Hot Topics can be regularly scheduled or requested on an as-needed basis.

The Chairs of each of the three senior committees shall each be from a different member sector so that no sector can chair more than one of the three senior committees. The Vice-Chair for each of the three senior committees shall be from a different sector than the Chair of that same committee, but there may be overlapping sector representation between all the Chair and Vice-Chair positions across the three senior committees.

The Advisory Committee will be comprised of members from each of the following market segments:¹⁰

- ✓ Transmission Owners;
- ✓ Generation/Suppliers;¹¹
- ✓ End Use; and
- ✓ Electric Distributors.

The votes of these market sectors will each represent 25% of the Advisory Committee votes. In addition to voting on issues that come before the Advisory Committee, the sectors will also elect the Chair and Vice-Chair of the Advisory Committee.

e) Standing Committees of the Advisory Committee

The two Standing Committees (Grid Reliability and Markets) will provide for more streamlined issue management. The Grid Reliability Committee will be responsible for the Operations and Strategic Planning subcommittees. The Markets Committee will be responsible for the Wholesale Markets and Market Settlement subcommittees. This structure will separate the issue flow into and minimize the required number of meetings in which stakeholders will need to participate without sacrificing the importance of the issues at hand.

E. Board Voting, Terms, Removal and Nominations

The parity of members' interests will be protected by the proposed governance structure. For this reason, it is not necessary to address granular issues of Board voting. However, should that proposed balance be upset for any reason, issues of quorum (for

¹⁰ Two sectors pay the costs for the services provided by the other two sectors.

¹¹ Members of this sector will be generation owners and/or entities that buy and resell generation.

example, actions requiring a simple or supermajority to pass) would need to be reexamined.

The Board members' terms of office should be staggered, and typically would be three years. Board members must be subject to removal for non-participation or for cause by a majority vote of the Advisory Committee and five members of the Board.

Board members should be nominated by a Nominating Committee that recommends candidates for election to the Board. The Nominating Committee should be comprised of six members representing all sectors appointed by the Advisory committee and at least one Board member selected by the Board. The CEO shall not serve on the Nominating Committee. The Board Members will be elected by a majority vote of the Advisory Committee.

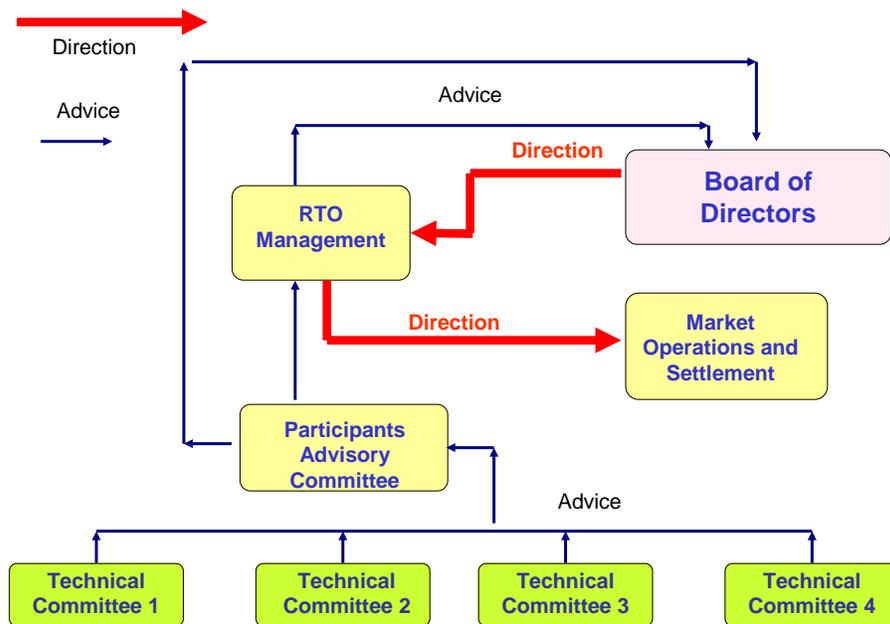
IV. CONCLUSION

A. The Structure for the RTOs: Direction vs. Advice

RTOs across the country tend to have very similar organizational structures. The organizational structure typically consists of a Board that is responsible for governing the organization and determining the course of the RTO to be executed by management. The Board is advised by a principal members committee that is comprised of the various stakeholders (Advisory Committee in this document). The Advisory Committee is often informed and advised by a host of other technical committees reflecting the opinions of the different stakeholders regarding specific issues. This general structure is illustrated in Figure 3. While it is essential for retail residential consumers to be represented in the Advisory Committee (which provides an opportunity to advocate their interests in RTO issues), having a

member on the Board who has actual experience representing residential consumers is also essential because the Board considers the stakeholder issues and determines the direction of the RTO on all issues, including the issues affecting retail residential consumers. Typically the Boards of RTOs have expertise in all areas except experience in representing retail residential consumers, and in most cases, experience with retail utility regulation. This is why these perspectives are necessary on any RTO Board and the perspectives have been included in the model structure.

Figure 3: The General Structure of the RTOs



The Advisory Committee alone cannot adequately represent the interests of residential consumers who are responsible for approximately 40% of electricity revenues. Stakeholders that are responsible for paying for such a significant portion

of RTO operations and market costs should not be excluded from effectively participating in market designs and operations, the determination of the reliability standards, or enhancing cost control from a top-down perspective. Currently, retail residential consumers lack the resources to provide meaningful participation in the RTO in generation and transmission siting, enhancing the linkages between the wholesale and retail markets or increasing the participation of demand response resources. It is in the public interest to change this paradigm.

B. Partial Representation of Consumers by the Load Serving Entities or Regulatory Commissions Is Inadequate

Unless the Board includes persons with direct first-hand experience representing residential consumer interests, the interests of residential consumers can only be achieved through a “bottom-up” process through the Advisory Committee. Load serving entities, large end-users, publicly owned entities, or regulatory commissions cannot adequately represent the interests of consumers. Load serving and publicly-owned entities represent all stakeholders served by these entities, which is a different interest than the interest of retail residential consumers. The same is true of other commercial and industrial consumers. Their interests are not always congruent with those of the retail residential consumers. As with the Advisory Committee, the Board lacks the expertise and perspectives of those who actually pay for the single-largest segment of RTO costs.

The identification or recognition and assignment of issues are paramount to the proactive management of any organization. This concept is no different for the proper and efficient functioning of an RTO. Issues can be identified by various participants, or even bystanders, that are at various levels internal or external to the organization.

Typically, the Board sets the overall scope and direction of the organization. In order to achieve the goal the Board expects management to implement the goals with Board oversight. This is a “top down” process because it represents top down information or issue flow. However, in this approach there is no guarantee that the issue will move to the stakeholders, nor is there any opportunity for issues that are not known to the Board to be identified.

Much of the Board’s interaction with stakeholders in an RTO is through the committee structure. The stakeholders communicate issues through the senior Advisory Committee to the board. Issue identification gains consensus in the subcommittees, and then flows up to the Advisory Committee and then to the Board. This is the “bottom up” side of the process because it represents an information or issue flow from the subcommittees to the Board. If sector representation cannot consistently participate throughout the various committee structure there will not be a complete flow and consideration of sector issues.

In a model RTO, proper issue identification at both the Board level - the “top down” side of the process and committee level (bottom up) is essential to ensure all sector perspectives are considered throughout the organization structure.

The residential consumers should have the benefit of not only bottom-up input to RTO governance but they should also have a voice in the “top-down” governance of the RTO. The model RTO governance structure addresses these issues in an effective and logical manner.