Preamble: This is a draft "Principles and Key Issues" paper for the States considering the prospect of a western regional ISO. Its use would be by the commissioners of the six states as they educate their Governor's policy advisors, state energy offices, and other stakeholders. This is not necessarily a policy-makers' document, nor does it represent the position of all western state commissioners on governance issues. It is meant to be a document primarily for State Commissions, meaning that this tries to balance the policy-making imperatives of Governors and Legislators, with the concerns of affordability, reliability, and reasoned outcomes that Commissioners try to ensure as they fulfill their mission to serve the public interest in setting just and reasonable rates and ensuring consistency with their state policies.

PRINCIPLES AND ISSUES FOR A WESTERN REGIONAL ISO

Guiding Principles

- A regional ISO in the West will focus on the efficient operation and dispatch of the electric power system over a broad region of the Western states, thereby increasing efficiency in the use of both renewable and traditional baseload resources in daily, hourly and sub-hourly markets. This is achieved primarily through the greater use of Security-Constrained Economic Dispatch, or SCED, and the technology platform and services that the California ISO (CAISO) has developed over the past decade or two.

- A regional ISO must be based on mutual respect and cooperation among, and self-determination by, the participating states, and it must respect the sovereign power of each state to determine its energy resource mix and policy preferences.

- A regional ISO must be neutral, to provide impartial service to all participants in its footprint. CAISO is a creature of California statutes and is responsible to the California Governor and Legislature. The ISO cannot operate as an independent regional body and maintain its current relationship with the State of California. Therefore, the establishing documents for CAISO, pursuant to California law, need a "re-start" perhaps with a revised charter and bylaws with regional oversight mechanisms.

- The governance, policies, and procedures of a regional ISO should be negotiated regionally among participating states, CAISO, participating utilities and interested stakeholders. The current process requires several key decisions, including governance, to be made by the current CAISO Board and the California Legislature before new participants can join the ISO. This approach may compromise the appearance, if not the fact, of a neutral and independent regional ISO.

- The regional ISO's focus will be on offering benefits to consumers and end-users in each of the States, with respect to both costs and policy preferences. Any Western state utility wishing to participate in this ISO will be required to show significant net benefits to their State Commission(s) or other governing authorities to justify its status as a PTO (participating transmission owner). Such studies should be comprehensive, coordinated, and thoroughly vetted by stakeholders in the State, and other regional bodies.

- A regional ISO is intended to encourage the flow of electricity across state borders at appropriate times, so that neither over-generation nor unanticipated shortages or interruptions cause harm to other entities or ratepayers in those states.

- A regional ISO should protect the reliability of the Bulk Electric System, which is regulated by FERC and NERC, while at the same time helping to ensure that distribution level service regulated by State Commissions continues to be reliable and affordable.

- A regional ISO should be a Good Neighbor among the balancing authorities in the Western states and cooperate to the maximum extent possible with entities like BPA and WAPA, as well as public power and other IOUs that choose not to join this ISO, to address WECC-wide interconnection issues, seams issues, and wide-area situational awareness in this dynamic environment.

- Decision-making authority should be "bottoms-up," meaning that individual States continue to set their own policies wherever possible. Areas requiring uniformity across the expanded footprint, such as transmission cost allocation and resource adequacy rules, should be decided by a Regional/State Committee of regulators. Only those matters that must be decided at the ISO level should be province of the governing board of the regional ISO, and those decisions should respect state policy priorities of each sovereign state to the greatest extent possible.

Governance Priorities

Under a regional ISO structure, there are at least three potential levels for decision-making – at the ISO level, at the regional level through a Regional/State Committee with representation from each of the states, or at the individual state level. Careful attention must be given to the allocation of responsibility for various issues among these three levels, as indicated by the list of issues set forth above. As a general

principle, decision-making authority should reside at the state level wherever possible (resource planning, resource mix and retail ratemaking, for example), at the Regional/State Committee level for those matters that require uniformity across all of the states (such as transmission cost allocation, planning reserve margin and associated "counting" rules), and at the ISO level for market operations and technical matters. To the greatest extent possible, governance should be structured to avoid federal pre-emption of state laws or regulations on electric resource choices, as has occurred recently in New Jersey and Maryland (and affirmed by the Supreme Court in the *Hughes v. Talen* case decided on April 19).

- Independence of the Board of the ISO: Board members should have no direct financial interest in any of the transmission organizations or utilities that participate in the regional ISO. The composition of the Board should largely rely on Order 2000 for the details of what constitutes "independence" of the board, direct financial interests and passive ownership, and definition of a market participant. No single state should dominate governance.

- Composition and number of regional ISO Board members: this should not be resolved now, but instead be determined by a collaborative process between CAISO, a Regional/State Committee, utilities wishing to become a PTO, and other stakeholders. Undoubtedly, this will be a larger board than the current five members appointed by the Governor of California, subject to California Senate confirmation. There may be a two-step process in which the Board is larger in a "transition or hybrid phase" to the six Western States, until it settles into a more routine process later with a smaller board. Could be anywhere between 5 and 13 members.

- Transparency and Due Process: the proceedings and deliberations of the ISO should be open to the public and consistent with the open meetings and public records or freedom of information acts (as much consistency as possible) in each of the six States.

- Inclusive process: given the diversity of utilities and stakeholder interests in the Western states, all parties should be included as much as possible in the process leading to decisions by the decision-making body of a regional ISO. A robust advisory and stakeholder process should be established to ensure that all groups are included in this process, including not just the existing CAISO stakeholder process, but existing processes in the other 5 States as well.

- Non-profit status: a regional ISO should be a non-profit entity, established as a 501(c)(3) under the Federal Internal Revenue Code, and should not be unique to any particular Western State, as it transitions away from its current California-centric focus (the CAISO is currently established as a California

non-profit public benefit corporation, which may need to be changed). The ISO should NOT be a for-profit entity; otherwise, that would compromise the principle of independence and attempting to ensure the most efficient economic dispatch on a non-discriminatory basis among all the Generators and Transmission Owners in the Western States.

- Accountability: although there will inevitably be tension between independence and accountability, it is important -- especially in the "transition phase" -- to ensure broader accountability to the non-California states which have PacifiCorp as a regulated utility (OR, WA, ID, WY and UT). As it broadens, this will apply to NV and AZ as well – potentially. Therefore, care should be taken to design accountability to each of these States as utilities in these states join, and to ensure that appropriate Member Classes (by state or region) are reflected in the governance structure – either through the Membership categories, the Nominating Committee, and the executive search process for Members of the revised Board of Directors.

- A Regional/State Committee of regulators must have the ability to make Section 205 filings at FERC on key issues, such as transmission cost allocation, resource adequacy rules, and seams issues with adjacent BA's, among others.

- Good Neighbor policy: as mentioned above, especially with large, federally owned balancing authorities such as BPA and WAPA, care should be taken to ensure that appropriate mechanisms are built in to ensure consultation with these bodies – such as advisory committees, the current regional issues forums (RIF), and coordinated mechanisms among the advisory bodies to ensure timely and efficient outcomes as well as broad accountability.

- Efficiency principles: although a broad stakeholder process is essential and independence is a very high priority, there should also be consideration of the efficiency of decision-making by the Board, and not imposing excessive burdens and costs on the Board and the relevant committees as the ISO broadens to additional states and service territories. Ultimately, the consumer and end-users of the electricity should benefit from the broader market and increased geographical footprint, and the governance bodies should reflect those principles and not unduly burden the new Board.

- Voting vs. ex-officio status: care should be taken so that there is no conflict of interest and independence is ensured – both at the Board level and at the Nominating Committee, Audit Committee, and other key Committees. Ex-officio membership in various Committees is allowed, but voting status should ensure independence and rigor.

Key Issues That Need To Be Addressed

- ISO Costs and Benefits Analysis: as stated above, this is the key threshold issue that CAISO, PacifiCorp, and any transmission owner wishing to participate in this market structure will have the burden to prove to each State Commission or other governing authority (in the case of public power).

- Assuring fair, well-functioning markets: The current CAISO market monitoring and enforcement function is not well understood outside California and its own stakeholder process. There will be generalized concerns about market manipulation that must be addressed. The regional ISO, together with the State/Regional Committee, must ensure that efficient dispatch is achieved in daily, hourly, and sub-hourly markets across the Western states, both for increasing amounts of renewable energy (RE), traditional baseload generation as it becomes more flexible, and the potential for energy efficiency and demand response (non-wires solutions).

- How to protect existing state public policy preferences, such as the RPS mandates (or voluntary goals) for RE, energy efficiency (EE), and demand response (DR) tariffs and policies, and other state laws, *without imposing such policies or their costs on other states*. Whether and how the GHG reduction requirements in one state (such as California's cap-and-trade program, and the Emissions Performance Standards in several states) could affect both generation and demand side resource measures (DSM) in other states.

- The extent of State control or decision-making over utility investments in generation, demand-side resources, and transmission.

- New transmission planning and siting: Particularly with respect to transmission, the six states potentially involved in the regional ISO each have different statutes and rules for the commissions (and siting authorities) regarding the need for transmission, and transmission siting and permitting rules. Some States require CPCNs for new lines, and some do not, instead relying on traditional ratemaking and prudency reviews. How are these to be coordinated with the existing Transmission Planning Process (TPP) within the CAISO as it expands to a broader regional footprint? How will these processes be coordinated with the existing planning and stakeholder process of TEPPC and WECC? Would states cede their authority to approve or disapprove utility transmission investments?

- Cost allocation: Who will have oversight of the cost allocation methodologies – namely, the Transmission Access Charge (TAC) – as it is developed through the CAISO stakeholder process, and more importantly, as it is implemented (avoiding the rate pancaking issue). Should the States, specifically a Regional/State Committee, be delegated a more specific role as a collective body in determining cost allocation for new transmission lines?

- Resource Adequacy (RA): Should there be an ISO-wide Planning Reserve Margin (PRM)? If so, how is it set -- by the ISO or by the States working in collaboration with regional bodies such as the RTF (Regional Technical Forum, of the Northwest Power and Conservation Council), and the respective State Commissions? The same with respect to load forecasts and the counting conventions used to determine if the PRM has been met, including the counting of biddable and non-biddable Demand Response as these policies have developed in the California market, and are emerging in the Pacific Northwest and other markets?

- Should Local RA requirements be uniform across the footprint, or should States retain the authority to establish their own local criteria? What about Flexible RA requirements—set by CAISO, by the states collectively, or by each state individually? Under what circumstances, if any, should the ISO have the ability to engage in "backstop" procurement when it perceives resource insufficiency, and allocate the resulting costs to entities it sees as deficient?

- Demand response (DR) policies and potential aggregation: DR policies vary across the region, usually in the form of tariffs approved by State Commissions in each of the states. California has been developing new policies for more DR aggregation in its markets, together with CAISO, and the potential for DR aggregation from the distribution level to the Bulk Electric System level will likely increase as the market footprint expands.. How are these to be developed and coordinated, and how are the cost-effective benchmarks established?

- The core functions of a regional ISO are the efficient management of the bulk transmission grid, operation of ancillary and related energy market services, and power system planning. CAISO performs several ancillary functions in furtherance of California policies on energy, the environment, and public health. How can a regional ISO assure that the cost and burden of performing non-core, legacy functions for the benefit of one state are recovered from customers in that state (this could not only be the policy preference of California, but another state as it attempts to encourage certain energy resources through incentives and public policies)? For example, could an "unbundled" Grid Management Charge (GMC) address this issue?

- How to protect the rights of public preferences customers of BPA and WAPA and others, namely the PUD's, the municipal utilities, and rural cooperatives, as this market is developed and built out? Many of these entities are transmission-dependent utilities that rely on BPA, WAPA, or other transmission owners for the delivery of electricity to loads in their respective BA's.

- Seams issues: As the broader market develops based on LMP prices at nodes throughout the region, there will inevitably be friction and potential price disparities between the regional ISO and BPA, as one example. These issues will need to be addressed and resolved preferably through some agreed-upon mechanisms, including some arbitration or dispute resolution bodies, with State Commissions, Transmission Owners, and the ISO.

- Transmission planning and coordination: how to coordinate this planning among various entities and bodies, both at the Bulk Electric level and the distribution level. This would impact the WECC planning process, which involves the TEPPC of WECC, as well as the existing planning process (TPP) that has existed within CAISO.

- Order 1000 planning and coordination issues: there are various sub-regional bodies within the West that have submitted FERC Order 1000-compliant plans for open and transparent transmission planning – such as Columbia Grid, NTTG, CAISO, CCPG (Colorado), and SWAT (Southwest Area Transmission). On a voluntary basis, they have been coordinating between themselves on transmission planning in the West. How will these efforts fit in to the broader regional ISO, and in the WECC planning process?

- Similar treatment and low barriers to entry: currently, PacifiCorp is seeking to participate in a broader regional ISO in the West, but if the market is successful, in the future there will likely be other transmission owners and utilities in the West that will seek to participate in this broader market. Will policies be developed, such as a most-favored nation (or state) clause, that will allow additional utilities and BAs to join the broader ISO market on similar terms? How will consistency with the principles enshrined in Order 2000 of FERC be established in the revised charter and bylaws of the ISO?