45

BEFORE THE
PUBLIC UTILITY COMMISSION OF OHIO

In The Matter Of Commission's Investigation Into The Value of Continued Participation in Regional Transmission Organizations.	))))	Case No. 09-90-EL-COI

REPLY COMMENTS
BY
THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

JANINE L. MIGDEN-OSTRANDER
CONSUMERS' COUNSEL

Jacqueline Lake Roberts, Counsel of Record
Assistant Consumers' Counsel
Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, Ohio 43215-3485
614-466-8574 (Telephone)
roberts@occ.state.oh.us

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TABLE OF CONTENTS

PAGE

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I. INTRODUCTION

The Office of the Ohio Consumers' Counsel ("OCC") is pleased to provide these reply comments ("Reply") to the Public Utilities Commission of Ohio ("PUCO" or "Commission") in the above captioned proceeding. OCC has organized its Reply in four sections that address demand response, capacity markets, marginal losses, and long term contracts.

OCC reviewed the comments filed by other parties to this proceeding, files this Reply in response to issues raised in their comments, and reserves the right to address issues raised in reply comments that were not raised in the initial comments.

II. PJM AND MISO MARKET MONITOR

The Industrial Energy Users-Ohio (IEU) claims the independent market monitors (IMM) have limited authority and little or no remedial authority, citing the Edison Mission Energy case.[1] OCC is as disappointed as IEU about FERC's decision in that

[1] FERC Docket IN08-3.

case which involved anticompetitive bidding practices. Nevertheless, the outcome in this case was the decision of FERC and not the decision of the PJM IMM.

Although it is true that the PJM and MISO IMMS have relatively limited authority and scope," and "little or no remedial authority," this does not mean that the public cannot rely on them to protect the integrity of wholesale electricity markets. The effectiveness of the IMMs must be considered in conjunction with the Federal Energy Regulatory Commission (FERC), whom they advise and assist. The FERC does have sufficient authority and scope of jurisdiction, as well as significant remedial authority.

By way of example, the IMM for PJM has detailed and inside knowledge of how the PJM Market Rules operate and a long history of pro-active and ex ante involvement in processes, such the design of and development of inputs into PJM's mitigation program. The IMM for PJM continually engages in rigorous and continual analysis of the performance of PJM's markets and is deeply involved and reasonably influential in the stakeholder process where the PJM Market Rules are developed and updated. Provided that the IMMs have the ability, incentive and willingness to engage in unfettered communications with PJM staff, Market Participants, stakeholders, the public and, most essentially, complete access to the FERC, the IMM can enable stakeholders to protect their interests and, most importantly, provide a lever for the FERC to apply its enforcement authority to deter and redress market misconduct.

As it stands now, the IMM for PJM believes that its independence is sufficiently protected, that its ability to engage in unfettered communications is robust and that its resources are adequate to fulfill its duties. The IMM for PJM can provide an effective deterrent to market misconduct, and the FERC has the leverage necessary to effectively

exercise its authority to protect the integrity of the organized markets. However, these critical attributes for IMM's effectiveness are subject to continuing assault. In particular, there is a persistent pattern of attempting to control where, when and to whom the IMM can communicate. An example is the contentious proceeding at the FERC concerning PJM's proposal s purportedly in compliance with Order no. 719. Although the IMM is confident that the public can rely on the arrangements for the IMM for PJM today, continued vigilance will be required to preserve it.

III. DEMAND RESPONSE

Several parties provided comments regarding demand response resources (Question #11).[2] OCC believes that this is a crucial, underutilized resource in both the state and throughout the RTOs. Therefore, we recommend that the PUCO commission a study to assess market barriers to demand resource participation in Ohio for all stakeholders including utilities, consumer advocates, demand response providers, the business community, and other interested parties. In addition, we would like to offer the following responses to the comments presented by other parties in this area.

AEP's[3] comments regarding demand response exaggerate the potential costs and ignore the benefits that the PJM[4] demand response programs can provide to Ohio retail customers. At their core, AEP's proposals would eliminate the growing industry of curtailment service providers ("CSPs") that have worked directly with customers to

[2] *Entry*, PUCO Case No. 09-90-EL-COI (March 4, 2009).

[3] Columbus Southern Power Company and Ohio Power Company.

[4] PJM Interconnection LLC.

provide demand response resources to the wholesale markets. The impact of expanded participation of demand response in wholesale markets has been lower real-time energy prices in RTO[5] wholesale markets.[6] AEP wrongly focuses on small cost shifts among a large base of retail customers as a justification for preventing retail customer participation in wholesale markets as "demand resources."[7] AEP's concerns are misplaced for several reasons:

- Phantom demand response: AEP imagines retail customers who are able to receive demand response payments without reducing load.[8] This issue has largely been addressed by changes to the baseline calculation methodology for demand response. The changes to the methodology for calculating baselines now provide for frequent updates, as well as the ability of PJM to question any submitted claims, was supported by PJM stakeholders (including CSPs) and approved by the Federal Energy Regulatory Commission ("FERC").[9] No one supports providing payments for phantom demand response;
- Magnitude of cost shifts: AEP refers to cost shifts that can occur when demand response resources reduce consumption during peak

[5] Regional transmission organizations and independent system operators.

[6] *Quantifying Demand Response Benefits in PJM*, Brattle Group Report, January 29, 2007. *See also,* ISO New England report to the FERC on demand response ER03-345-012, December 19, 2008.

[7] AEP Comments at 21-23.

[8] AEP Initial Comments at 21, footnote 3.

[9] *Order,* FERC Docket No. ER08-824-000 (June 12, 2008).

hours.[10] The participating customer is charged a retail (average) rate for the electricity and gets paid the hourly LMP.[11] The difference in the two amounts is allocated to the load serving entity and the costs are socialized across all LSE[12] customers. For a single customer with a large demand reduction, the benefits of this apparent cost shift may seem large. When the actions of *all customers* who reduce load in peak hours are considered, the benefits to an individual customer are much less (each individual customer is paying for the cost shifts caused by all the other customers, and this reduces the benefit to the individual customer). Moreover, the cumulative impact of the load reductions on the LMPs for all the LSE's customers substantially outweighs the small cost shifts that may occur among customers. As more and more customers participate in demand response programs these cost shifts become less of a concern. Finally, the generator that provides a system benefit by increasing output during a given peak hour is not as beneficial to the system as a customer who reduces load during that same peak hour because of the location of the load reduction. It seems only reasonable that the load resource should receive the same payment (LMP) as would a generating resource for this service.

[10] AEP Initial Comments at 22.

[11] Locational Marginal Pricing.

[12] Load serving entities.

- Market benefits: One of the significant benefits of demand response programs is to reduce the volatility in hourly LMP prices and to protect the market place from market power abuse. Volatility is reduced because demand resources are able to reduce consumption whenever prices rise above a threshold; each demand response provider may have a different threshold, but the cumulative impact is to provide a safety valve against sudden price increases due to sudden load increases or system outages. Demand response resources can also effectively frustrate any supplier's attempts to manipulate prices through the exercise of market power. As prices rise, demand response resources reduce their loads and LMP prices are pulled back toward competitive levels.
- Price benefits: Even customers who are not directly exposed to real-time energy prices receive benefits from lower volatility and lower real-time prices that can be reflected in the rates charged by vertically integrated utilities. Customers who take service from competitive suppliers will also see a price benefit. Standard offer contracts are selected based on bids from suppliers who use both the real-time and day-ahead markets to set the level of their bids to provide standard offer service.
- System benefits: Demand response programs are an integral component of the future "smart grid." For decades, the utility industry has struggled with the need to have adequate resources for

> fixed amounts of daily load. Load was viewed as inflexible and largely price inelastic. Demand response programs have demonstrated that there is in fact a great deal of flexibility in customer demand and substantial price elasticity, if sufficient power market information is available. In the near future, regional system operators such as MISO[13] and PJM will be making daily commitment and dispatch decisions based on submitted offers to supply generation resources and demand resources (load reductions). The system demand in a given hour will depend on *price*, as well as weather and customer consumption patterns. Smart grid technology will use two way information and power flows, managed by a neutral grid operator, as the key to more efficient electricity production and use; demand response is a key component of that smart grid.

We concur with FirstEnergy's comments (p.19-20) that demand response expands the list of resources that can be used to meet reliability needs on a least cost basis. We agree that the current effort in MISO to include demand response as a reliability resource is a welcome and positive step. We encourage MISO and its stakeholders to consider the broad range of demand-side resources (demand response; energy efficiency, and distributed generation) and the impacts that those resources can have on reliability requirements and system planning.

[13] Midwest Independent System Operator Inc.

We agree with DP&L's[14] comments that participation in PJM (or MISO) demand response programs should count towards the reduction goals established by SB 221.[15]

IV. PJM'S CAPACITY MARKET

Numerous respondents addressed PJM's capacity market construct, the Reliability-Pricing Model ("RPM"). Some commenters (Electric Power Supply Association, PJM Power Providers, DP&L, COMPETE Coalition) approve of RPM, although some expressed concern about the relatively low clearing price in the most recent auction for the 2012/2013 planning year. However, this clearing price correctly reflects a surplus of capacity in most of the PJM footprint, although it appears to have temporarily thwarted PJM's efforts to ensure a capacity price every year that approximates an administratively determined capacity cost of new generation.[16]

Other commenters[17] note that while PJM's capacity appears to be adequate for reliability purposes, this has come through RPM at an exceptionally high price to electricity customers. PJM itself claims that the auctions have been successful from a reliability perspective, but largely skirts the issue of cost.[18] PJM echoes the recent Brattle Report's tepid conclusion that the cost has been "consistent with" PJM's own administratively-determined value for the net cost of new entry ("net CONE") which is

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[14] Dayton Power and Light Company.

[15] *DP&L Comments* at 17; R.C. 4928.64 and 4928.66.

[16] The $110.00/MW-day RTO resource clearing price for PJM represents a decrease of $64.29/MW-day from the 2010/2011 BRA (http://www.pjm.com/~/media/markets-ops/rpm/rpm-auction-info/20080515-2011-2012-bra-report.ashx).

[17] OCC Initial Comments at 22, 23; Industrial Energy Users-Ohio ("IEU") Initial Comments at 59.

[18] PJM Initial Comments at 37.

the anchor for PJM's administrative demand curve.[19] PJM also claims, ironically, that RPM has protected customers from "unwarranted high capacity prices."[20] It is hard to reconcile this statement with the dramatic increase in capacity costs that has been the result of, and indeed the very purpose of, the RPM construct.

The OCC has maintained from the start of the RPM process that while RPM may be successful in attracting and retaining needed capacity, this approach would result in unnecessarily and unacceptably high costs for customers.[21] The two primary reasons for high costs are (1) the single clearing-price auction for capacity, which means that even fully amortized resources that are highly profitable in energy markets receive subsidy for capacity as resources that would be otherwise uneconomic; and (2) PJM's unwarranted faith in its administrative determination of net CONE, despite clear market evidence that it is far too high. In fact, experience shows that RPM exists in an environment in which a truly competitive market is impossible. For example, in no part of the region can the RPM market pass PJM's own three-pivotal-supplier test. This requires all capacity market bids throughout the PJM footprint be subject to bid mitigation. The efforts to make RPM look like a market, while consistently returning PJM's desired market clearing price, have resulted in a set of market rules so convoluted and contorted as to make it difficult to accept the idea that auction outcomes reflect actual market forces. In

[19] Id at 38.

[20] Id at 37.

[21] Maryland Public Service Commission, et al vs. PJM Interconnection LLC, EL08-67 (OCC was a compliant); PJM Interconnection, L.L.C. Docket No. ER05-1410-000 *et al;* PJM Interconnection, L.L.C. Docket No. EL05-148-000 *et al.* (PJM's proposal for a reliability pricing model).

addition, RPM has probably had a chilling effect on long-term contracting for capacity[22] because the uncertainty and complexity of RPM. This is exactly the opposite of what the market should be designed to support. RPM was created because PJM's LMP electricity pricing construct produces insufficient energy market revenues to support the small number of MW of capacity that are needed only a few hours each year during peak load conditions.[23] Some economists propound a theory that this represents "missing money" for all resources,[24] despite the fact that the vast majority of resources are more than adequately compensated for their fixed and variable costs through LMP.[25] Prior to RPM, a small number of capacity resources had to be supported through reliability must-run contracts that were negotiated individually with each resource owner. RPM replaced this construct with a more market-based approach, which is an extremely convoluted and administratively cumbersome market (as noted above) explicitly predicated upon setting a target price - net CONE - at a level predetermined by the market administrator.

Markets are not an end in themselves; they are valuable if they return efficiencies and result in greater savings for customers. Imposing RPM on the inherently uncompetitive generating capacity market has resulted in much higher costs for customers, and much greater windfall profits for generation owners (as described herein) than they would have experienced had the needed capacity simply been supported

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[22] See, generally, filings in FERC Dockets Docket Nos. ER05-1410 and EL05-148, and specifically, for example, *Notice Of Intervention, Protest And Request For Hearing of The Michigan Public Service Commission* (October 19, 2005).

[23] *Application* at 5, PJM Interconnection, L.L.C, Docket Nos. ER05-1410 and EL05-148.

[24] See, for example, P. Cramton and S. Stoft, "The Convergence of Market Designs for Adequate Generating Capacity with Special Attention to the CAISO's Resource Adequacy Problem", 2006. (http://www.cramton.umd.edu/papers2005-2009/cramton-stoft-market-design-for-resource-adequacy.pdf)

[25] In the pre-market days, "capacity resources" were supported as part of a portfolio of generating assets and vertically-integrated owners were compensated on the basis of average cost. In the "market" environment, it seems that every individual resource must be economically self-sufficient, and new market constructs must be invented to increase all generators' revenue until this goal is reached.

through RMR[26] contracts. The questionable premise behind RPM—that all capacity requires the same amount of subsidy on a per-MW basis as capacity-only resources—has cost customers – including Ohio retail customers in PJM -billions of dollars each year of the RPM auctions.[27]

Numerous commenters noted that RPM has successfully brought thousands of megawatts of new demand resources into the capacity market. While OCC agrees that this is a substantial benefit which may be at least partly attributable to RPM, it should serve to highlight another questionable premise underlying RPM: that CONE should be determined by PJM's administrative estimate of the cost of a new gas-fired peaking unit to the exclusion of any other type of generating unit. If there is any benefit at all to a market construct, it should be that it allows the market to find the most efficient resource to meet consumer needs—in this case, the optimal resource to meet reliability needs at the lowest cost. At most, only a small proportion of the capacity retained or produced by RPM has been new gas peaking units similar to PJM's proxy peaker used to define Net CONE. PJM's reliability requirements can clearly be met with lower cost resources, so it is hard to understand why PJM insists on using such a high-cost resource for its administrative price-setting approach.

Finally, the OCC notes that the obstacles preventing FRR[28] entities, such as AEP, from selling excess capacity into the RPM market is a shortcoming in RPM that was also highlighted in the Brattle Report. If PJM's desire is to attract the least-cost resources available to meet reliability needs throughout the PJM footprint, it is hard to understand

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[26] Reliability-must-run contracts.

[27] *See,* Affidavit of James F. Wilson attached to the complaint in FERC Docket EL08-67, where the excess capacity payments were calculated to be $11.2 billion for three years.

[28] Firm Reservation Rights.

why PJM would exclude available and deliverable resources from consideration simply because they reside in an area that does not otherwise participate in the RPM auctions. This approach disadvantages Ohio resources and customers in particular by disallowing Ohio resources in the market, but also harms other customers in PJM by limiting the resources that can participate in RPM auctions.

V. TRANSMISSION COST ALLOCATION

Numerous parties filed comments regarding transmission cost allocation (Question #9).[29] Most commentators distinguished between the traditional approach to cost allocation for transmission resources (specific beneficiaries pay) to the new approach approved by the FERC for cost allocation for transmission resources included in RTO plans (all load pays pro-rata). For Ohio, this means that retail customers pay for all the existing transmission facilities in Ohio and a load-ratio share of new transmission facilities of 500 kV or higher.[30] Given the fact that most of the new transmission facilities proposed by MISO and PJM provide no direct benefits to Ohio retail customers, there is a widespread concern that the new transmission cost allocation rules impact Ohioans unfairly.

OCC supports the efforts of Ohio EDU's and this Commission to find a way to mitigate the disproportionate impacts on Ohioans produced by the FERC approved changes to the traditional transmission cost allocation approach. Because FERC has created a transitional issue with its socialization of transmission costs among all loads, some type of transitional solution needs to be developed. One option would be to provide

[29] *Entry*, PUCO Case No. 09-90-EL-COI (March 4, 2009).

[30] *See, FirstEnergy Comments* at 18; *DP&L Comments* at 16, and *AEP Comments* at 19-20.

an explicit transition period whereby socialized costs for new transmission facilities (500 kV or higher) are phased in over a reasonable period of time. For the first few years, transmission cost allocation would be supported by the direct beneficiaries known at the time of construction; for the remaining years, costs would move towards 100 percent socialization.

A second option would be to add the remaining costs of existing transmission facilities to the category of socialized transmission costs that are assigned on a load-ratio basis. This option could include existing facilities that are below 500kV. By expanding the categories of transmission facilities that are eligible for regional support, all RTO stakeholders could benefit from the investments they have made that support regional reliability.

The OCC shares DP&L's concern that postage stamp (socialization) cost allocation for new 500 kV facilities in PJM is a violation of the "beneficiaries pay" approach. It is reasonable to suggest, as DP&L implicitly does, a form of cost allocation for new large transmission facilities in PJM that recognizes broad "eastern" and "western" sub-regions as one possible solution. Such a solution was not an outcome of the intensive hearing process at FERC in 2007, likely due to the presence of competing cost allocation issues that burdened the proceeding, such as existing vs. new facility cost allocation, and methods for determining "beneficiary pays" approaches for lower voltage facilities. This aspect of transmission cost allocation at PJM is imperfect and may only be altered through a concerted effort of the western PJM stakeholders and State Commissions.

VI. LONG-TERM CONTRACTING

Long term contracts can provide price stability and risk management options relative to short-term purchases. Today, the terms of electricity purchase contracts are generally dominated by the expectations of the RTO spot market price, including the expected impact of anticompetitive bidding and environmental costs. OCC concurs with IEU that existing PJM and MISO policies and practices have not provided the right incentives for promoting long-term contracts. Sufficient incentives to transact in the bilateral market will not exist as long as sellers can be confident of high profits in the spot markets for both capacity and energy.[31]

One of the primary barriers for healthy long term contracting in RTO markets is the profit expectations for generators from centralized energy and capacity markets. As a result, a price agreed to in the long-term contract would have to include a premium on a long term investment with a greater uncertainty. Current electricity markets are subject to substantial uncertainty regarding future policies and regulations. Regulatory uncertainty makes electricity market very unstable and unpredictable and adversely affects the willingness to invest. For instance, a generator emitting carbon would find long term contracting very risky because of uncertainty about future carbon policies. Such generator would require a higher contract price to protect itself from high carbon costs in the future. On the other hand, it would not be beneficial for an LSE to enter into a high priced long term contract and pay upfront for a generator's potential high carbon costs before any actual carbon regulation is in place.

[31] Many parties, including AEP, AMP Ohio, FE, IEU, expressed similar thoughts in their comments to PUCO. However, only FE and P3 claimed that PJM's RPM provides sufficient price signals for facilitating long-term contracts.

Thus a primary solution for improving bilateral markets is increased competition, which can be achieved by building new generation by state authorities and utilities, or through expanded use of demand resources and energy efficiency. In fact, this appears to be one important factor in the recent low clearing price in the 2012/13 Base Residual Capacity Auction in PJM, which should provide a signal to generators that they should look to bilateral contracts to cure their own exposure to price volatility. For this dynamic to take its course, however, PJM must not respond to lower prices by finding a new means of artificially inflating capacity prices and price expectations.

Other significant barriers to long-term contracting, in both the energy and capacity markets, are the current instability in market rules and a lack of predictability of factors that will significantly impact the costs of electric generation in the future. Anything this Commission and FERC can do to reduce uncertainty in electricity markets and clarify rules would help to improve the climate for bilateral contracting.

Acknowledging some of the problems present in bilateral markets, PJM held two stakeholder forums in September 2007 and January 2008, addressing the issues of facilitating long-term contracting opportunities in the PJM's footprint, existing barriers for entering into long-term contracts and potential solutions. FERC has also raised the issue of promoting long-term contracts in its Order 719. One of the proposals from compliance filings with the FERC suggested that an RTO maintain a bulletin board that could act as an information clearinghouse for entities that can offer long-term contracts

and entitles that are seeking long-term contracts.[32, 33] While not a full solution, this is an option worth pursuing.

PJM has created a bulletin board on its website and offered the use of its bulletin board to all the other RTOs who are members of the ISO/RTO Council and their members/market participants at no cost to encourage greater beneficial cooperation between RTOs and to provide access to a larger pool of buyers and sellers of long term contracts for power.

APPA proposes another solution for the problems occurring in bilateral markets.[34] The problem of high risk premiums included in the contract price could be eliminated by creating resource portfolios for LSEs that include longer term contracts of ten years or greater. The market would respond by providing more long-term contracts which should produce greater price stability and would minimize the need for these risk premiums. These longer term contracts would also provide better support in financing new investment projects. APPA also claims that for the bilateral market to prosper, it should rely more on individually negotiated agreements rather than standardized contracts developed mainly for trading purposes and not providing sufficient support for new generation and demand-side resources.

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[32]Docket No. ER09-1051-000, ISO New England Compliance Filing for Order 719 at 58 (April 28, 2009); Docket No ER09-1063, PJM Compliance Filing for Order 719 at 33 (April 29, 2009); Docket No. ER09-1049-000, MISO Compliance Filing for Order 719, April 28, 2009, at p.28-29.

[33] DP&L, EPSA and FE also support the idea of bulleting board being a facilitating tool for bilateral markets. In addition, FE suggests that the FERC Order 719 bulletin board requirement should apply not only to RTO members; utilities that are not RTO members should also have access to the bulletin boards.

[34] APPA's Competitive Market Plan. A Roadmap for Reforming Wholesale Electricity Markets. February 2009. Available at http://www.appanet.org/files/PDFs/EMRICompetitiveMarket.pdf.

VII. CONCLUSION

There are many improvements that can be made to the administration of the wholesale markets and transmission planning and cost allocation that would have enormous benefits to the ultimate customers of electricity by greatly reducing their costs without sacrificing system reliability. One of the underlying problems with PJM and MISO decision-making is the failure to seriously consider the impact of the cost of their decisions on electric customers. This is a direct result of having Board members and senior management that do not have experience or expertise in issues faced by the ultimate consumers of electricity. FERC, in Order 719, required RTOs and ISOs to make appropriate changes to their governance and stakeholder process to address this. Unfortunately, neither organization saw the need for changes in this area. Both MISO and PJM should amend their filings and embrace the recommended changes to their governance structures.

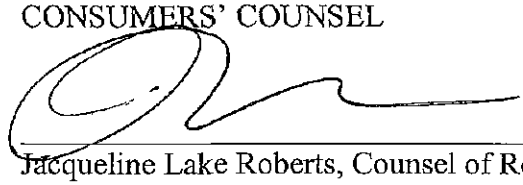
The National Association National Association of State Utility Advocates ("NASUCA") formed a special task force to study the governance function and stakeholder process of all RTOs and ISOs in the country ("Report").[35] OCC calls for MISO and PJM to adopt the recommendations outlined in the study. Should the RTOs adopt the recommendations in this Report, the culture of MISO and PJM would change and the interests and concerns of the ultimate consumers of electricity (as FERC directed) would be represented in the decision-making processes of these organizations. OCC requests this Commission support the changes proposed in the Report which would

[35] NASUCA Model Corporate Governance for Regional Transmission Organizations and Independent System Operators, Appendix A attached to these Reply Comments.

greatly increase the protection of the customers this Commission is charged with protecting – the retail customers.

Respectfully submitted,

JANINE L. MIGDEN-OSTRANDER
CONSUMERS' COUNSEL

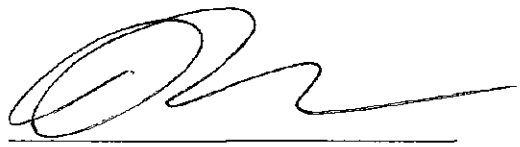


Jacqueline Lake Roberts, Counsel of Record
Assistant Consumers' Counsel

Office of the Ohio Consumers' Counsel
10 West Broad Street, Suite 1800
Columbus, Ohio 43215-3485
614-466-8574 (Telephone)
roberts@occ.state.oh.us

CERTIFICATE OF SERVICE

I hereby certify that a copy of the Reply Comments by the Office of the Ohio Consumers' Counsel has been served upon the following parties via regular U.S. Mail, postage prepaid, this 24th day of July, 2009.



Jacqueline Lake Roberts
Assistant Consumers' Counsel

SERVICE LIST

Duane Luckey
Attorney General's Office
Public Utilities Commission of Ohio
180 E. Broad Street, 9th Fl.
Columbus, OH 43215

David F. Boehm, Esq.
Michael L. Kurtz, Esq.
Boehm, Kurtz & Lowry
36 East Seventh St., Ste. 1510
Cincinnati, OH 45202

Daniel Shields
Federal Energy Advocate
Public Utilities Commission of Ohio
180 E. Broad Street
Columbus, OH 43215

Dan Dolan, Vice President, Policy
Research/Analysis
Electric Power Supply Association
1401 New York Ave, N.W., 11th Fl.
Washington, D.C. 20005

Glen Thomas
PJM Power Providers Group
1060 First Avenue, Suite 400
King of Prussia, PA 19406

William L. Massey
Covington & Burling LLP
1201 Pennsylvania Avenue, NW
Washington, DC 20004-2401

Matthew D. Vincel
The Legal Aid Society of Cleveland
1223 West 6th Street
Cleveland, OH 44113

John W. Bentine
Matthew S. White
Chester, Willcox & Saxbe, LLP
65 East State St., Ste. 1000
Columbus, OH 43215-4213

Theodore Robinson
Staff Attorney
Citizen Power
2121 Murray Avenue
Pittsburgh, PA 16217

Randall V. Griffin
Judi L. Sobecki
The Dayton Power and Light Company
1065 Woodman Drive
Dayton, OH 45432

Steven T. Nourse
Marvin I. Resnik
AEP Service Corporation
1 Riverside Plaza, 29th Fl.
Columbus, OH 43215

M. Howard Petricoff
Vorys, Sater, Seymour And Pease LLP
52 East Gay S., P. O. Box 1008
Columbus, OH 43216-1008

Samuel C. Randazzo
Lisa G. McAlister
Joseph M. Clark
McNees, Wallace & Nurick LLC
21 East State St., 17th Fl.
Columbus, OH 43215

Amy B. Spiller
Elizabeth Watts
Duke Energy Business Services, Inc.
221 E. Fourth St., 25 AT II
Cincinnati, OH 45202

Michael R. Beiting
FirstEnergy Service Company
76 South Main Street
Akron, OH 44308

Morgan E. Parke
FirstEnergy Service Company
76 South Main Street
Akron, OH 44308

Thomas E. Lodge
Kurt P. Helfiich
Carolyn S. Flahive
Ann B. Zallocco
Thompson Hine LLP
41 South High St., Ste. 1700
Columbus, OH 43215-6101

Keith L. Beall
Senior Attorney - State Regulatory
Midwest ISO - Legal Dept.
P.O. Box 4202
Carmel, IN 46082-4202

Kerry M. Stroup
Manager, State Government Policy
PJM Interconnection LLC
1569 Broadview Terrace
Columbus, OH 43212

Lisa Coulter
Frost, Brown, Todd LLC
10 W. Broad St., Ste. 2300
Columbus, OH 43215

APPENDIX A

Model Corporate Governance for Regional Transmission Organizations and Independent System Operators

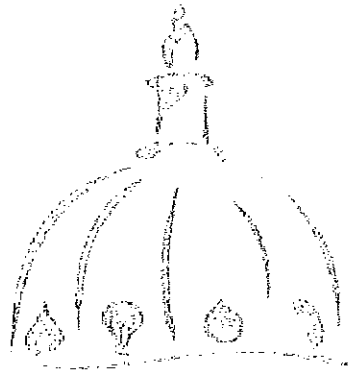
http://www.nasuca.org/Model%20Corporate%20Governance%20RTO%20ISO-6-19-09.pdf

MODEL CORPORATE GOVERNANCE FOR

REGIONAL TRANSMISSION ORGANIZATIONS

AND

INDEPENDENT SYSTEM OPERATORS



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A report by NASUCA's Special Committee on RTO Governance

TABLE OF CONTENTS

PAGE

MODEL CORPORATE GOVERNANCE FOR REGIONAL TRANSMISSION ORGANIZATIONS AND INDEPENDENT SYSTEM OPERATORS

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.[36] 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

[36] 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")[37] 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:[38]

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

[37] 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.*

[38] *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.[39] 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."[40] 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."[41] 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.

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[39] 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).

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

[41] 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.[42] 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

[42] 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.[43] 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

[43] 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).

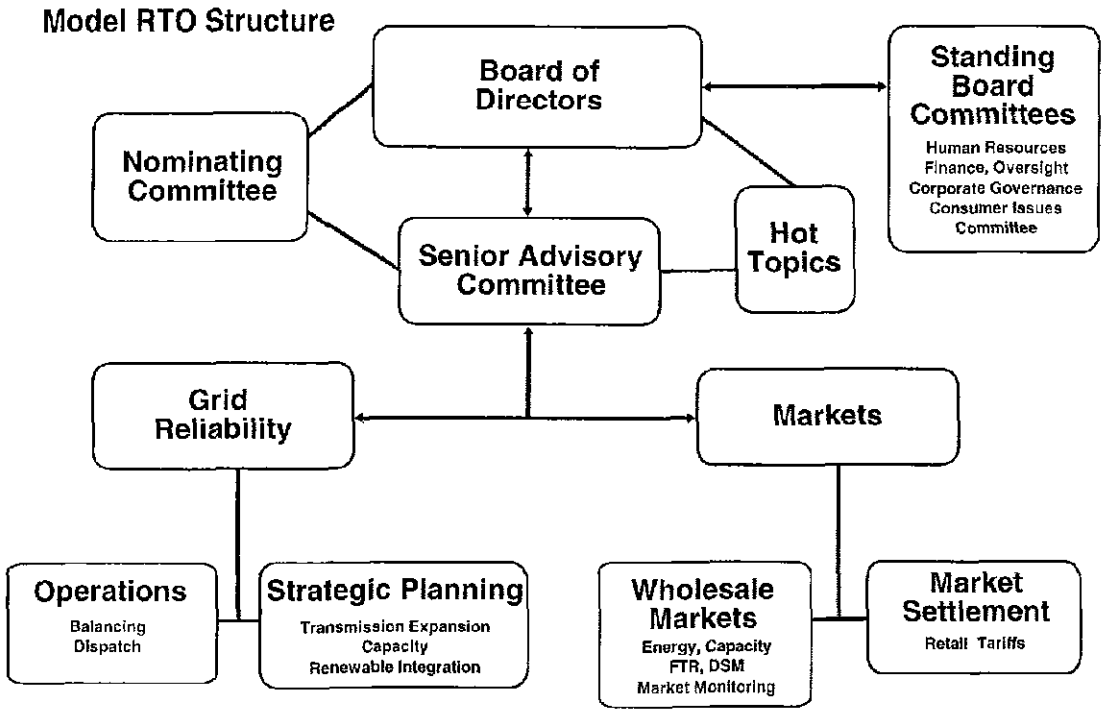
Finally, it is important to remember that the interests and priorities of the public consumer advocates differ from one another depending upon the circumstances of each state. For this reason, consumer advocates are not always able to speak with one voice,[44] and the funding should not be established 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.

[44] 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

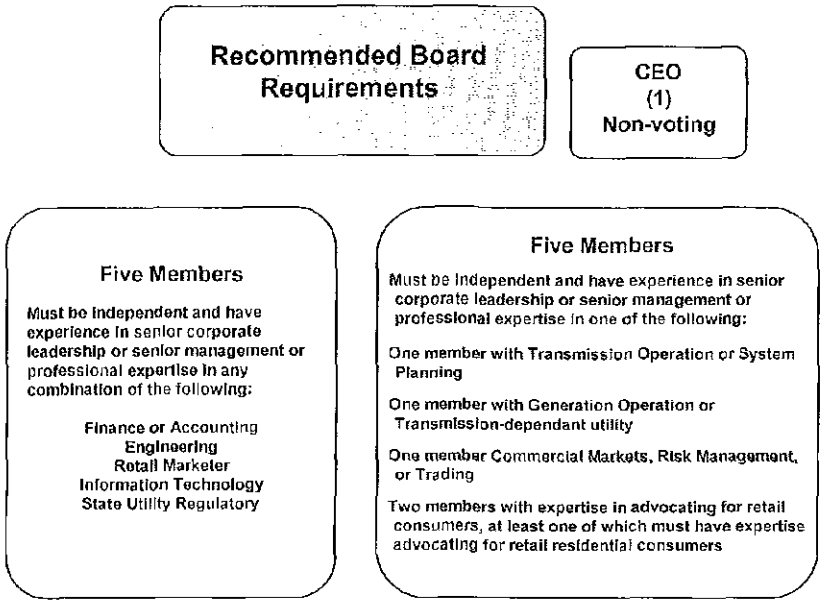
Senior Management experience expertise in any combination of the following areas, Finance or Accounting, Engineering, State Utility Regulation, Information Technology, and Retail Markets.

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



2. 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.

3. 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 is 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:[45]

- ✓ Transmission Owners;
- ✓ Generation/Suppliers;[46]
- ✓ 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.

4. 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 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

[45] Two sectors pay the costs for the services provided by the other two sectors.

[46] 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.

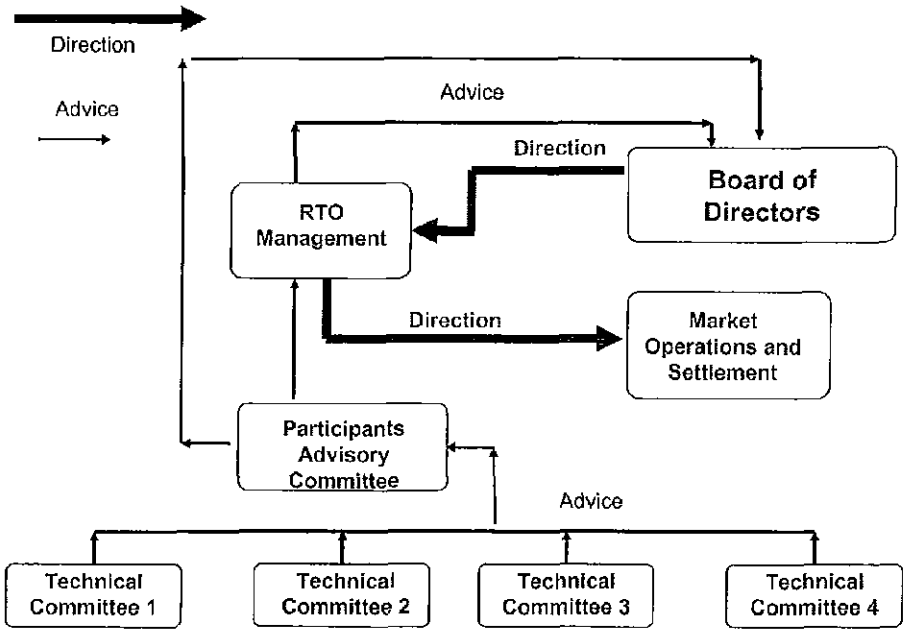
IV. CONCLUSION

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.