



# Regional Technical Assistance Consultant's Report

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## Support for Implementation of the Second Governance and Anticorruption Action Plan (Financed by the Governance Cooperation Fund)

### Subproject: Support for the Establishment of An Independent Market Operator, PHI

- Supplementary Document—Transition to  
Independent Market Operator

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Asian Development Bank

**SUPPORT FOR IMPLEMENTATION OF THE SECOND GOVERNANCE AND ANTICORRUPTION  
ACTION PLAN**

**(SUBPROJECT) SUPPORT FOR THE ESTABLISHMENT OF AN  
INDEPENDENT MARKET OPERATOR, PHI**

**TA-6445 (REG)**

**IMO TRANSITION PLAN**

**Prepared for**

**Department of Energy and The Asian Development Bank**

**2012**



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## 1 INTRODUCTION

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### 1.1 Objective

- 1.1.1 The objective of this document is to identify and outline the actions required to transition from the existing structure to the recommended IMO structure. This document will form the basis for planning and preparation by an IMO Transition Board (“ITB”). This document will provide a guide for assessing the level of resourcing required and a realistic timeframe, including the identification of the significant milestones for this transition phase of the Project.
- 1.1.2 Refer paragraph 1.2 below for a description of the role of the ITB.
- 1.1.3 The primary transition objective is implementation of the IMO structure in accordance with the EPIRA as recommended. This means that the IMO Board is in place and the market operation functions are being performed within the organization. The achievement of that objective is to be championed by the ITB who will oversee and direct Phases 1, 2, and 3 activities to their conclusion.
- 1.1.4 Outsourcing the performance of all or any one or more components of the market operation functions is not a requirement of the EPIRA and is appropriately left to the permanent WESM governing body, the IMO Board, and the DOE, to consider. Creating the IMO Board structure creates a solid foundation for the strategic development of the WESM, including market operations. Once the IMO Board is established then the question whether the IMO functions should be outsourced becomes a matter at the discretion of the IMO Board to consider and, with the approval of the DOE, to implement.
- 1.1.5 The ITB activities will ensure all the preparatory work is done to enable the IMO Board to be implemented. This will require a broad range of tasks including consultation, amending corporate structures and WESM Rules, transferring assets and liabilities to the IMO Board, revising market manuals and protocols, and recruiting personnel to the independent and other bodies in the WESM.

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- 1.1.6 The WESM bodies that either need to be changed or created to achieve the IMO Board and its associated structures include the following:
- 1.1.6.1 PEM Board ceases and the independent IMO Board is formed:
  - 1.1.6.2 PEMC becomes part of the IMO Corporation:
  - 1.1.6.3 A Market Committee is established composed of stakeholders similar to current PEM Board and to whom the Rules Change and Technical Committees report:
  - 1.1.6.4 A Compliance Committee is established and it and the Audit Committee, Market Surveillance Committee, and Dispute Resolution Committee report to the IMO Board.
- 1.1.7 The WESM Rules will need to be amended to reflect the recommended IMO Board structure, including the establishment of new bodies, name changes to existing bodies where needed, the membership criteria of each, and changes in reporting lines and functions.
- 1.1.8 Other changes will be required to be undertaken through mechanisms other than the WESM Rules, such as the PEM Board and PEMC constitutional changes, and re-allocation of the assets and liabilities and their transfer to the IMO Board.
- 1.1.9 In addition personnel will need to be sought and secured as the transition will require recruitment, for example of members of the IMO Board.

**1.2 IMO TRANSITION BOARD (ITB)**

- 1.2.1 An IMO Transition Board (“ITB”) will be established to oversee and direct the performance and completion of Phases 1, 2, and 3 tasks.
- 1.2.2 The ITB is to be chaired by the DOE Secretary and be composed of members selected by a process agreed with the PEM Board.
- 1.2.3 The objective of this document is to provide sufficient guidance for the ITB to plan and assess the level of resourcing required and timeframe reasonably expected, including the identification of issues to address and significant milestones.



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1.2.4 The IMO Transition Board will have constraints on the order in which it conducts its activities. Some tasks cannot be performed until other tasks are completed. This will be due to either resource management or incremental sub-tasking. Although the transition tasks are numerous they can be ordered logically into only three phases:

1.2.4.1 **Phase 1** – introduction of and consultation on DOE policy on the selection of the recommended IMO structure:

1.2.4.2 **Phase 2** – establishment of the ITB and the Market Committee and infrastructure preparation and rules development and approval:

1.2.4.3 **Phase 3** – implementation including the DOE and participants' endorsement of the formation of the IMO through its member selection process:

1.2.5 The above categorization of Phases is used in this Report.

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## 2 PHASE 1 – INTRODUCTION OF AND CONSULTATION ON DOE POLICY ON THE SELECTION OF THE RECOMMENDED IMO STRUCTURE

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### 2.1 OVERVIEW

2.1.1 Four consultations take place, three in Phase 1 and one in Phase 3. The two outlined below in paragraphs 2.1.1.1 and 2.1.1.2 are to be conducted together in Phase 1 as they cover the same ground. The first consultation is the DOE policy, which will be completed before the next consultation is undertaken. They are as follows:

2.1.1.1 **Governance Policy Consultation** on the DOE policy directive amending the WESM governing body structure to become the recommended IMO structure. It is not required under section 30 of the EPIRA but is the normal DOE consultative process for implementation of any policy matter. This is a public consultation:

2.1.1.2 **Governance Policy Implementation Consultation** on the detail of the DOE policy directive amending the WESM governing body structure to become the recommended IMO structure. It is not required under section 30 of the EPIRA however the policy directive involves a significant change to the current structure so the detail (not the policy) of the change process should be consulted. The consultation is between the DOE and the electric power industry participants which is defined as any person or entity engaged in the generation, transmission, distribution, or supply of electricity:

2.1.1.3 **IMO Endorsement Consultation** for “endorsement” of the entity that will be the IMO. This is the IMO selection, even though it has not been yet formed. This is relevant to section 30 of the EPIRA. The consultation is between the DOE and all the electric power industry participants. Consultation is the means to obtaining the “joint endorsement” between the DOE and the electric power industry participants of the entity that will become the IMO:

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2.1.1.4 **Rules Change Consultation.** This consultation is not covered in this Report because the WESM Rules already specify the appropriate process for rules changes. It is recommended that the rules change process outlined in the WESM Rules is used for the transition amendments; these amendments will already be drafted under the ITB direction in Phase 2 and so the amendments should be able to be quickly assessed and processed through the WESM system.

## 2.2 GOVERNANCE AND IMO CONSULTATION

2.2.1 The public Governance Policy consultation by the DOE has taken place. The DOE policy will be announced once it has considered the matters arising from that process. The further matters herein apply on the assumption the DOE will decide to pursue the recommended structure.

2.2.2 The Governance Policy Implementation and the IMO Endorsement consultation subject matter is inherently connected. The objective of the Governance Policy Implementation consultation is that the DOE hears the views of the electric power industry participants regarding the details of the implementation of the proposed policy change to the governing body structure. The objective of the IMO Endorsement consultation is that the DOE and the electric power industry participants give their “joint endorsement” to selection of the entity that will be the IMO.

2.2.3 Although the change of the governing body structure is a condition precedent for the proposed IMO entity to exist, the condition precedent is a policy directive from the DOE and so will be implemented. The consultation will therefore focus on the details of the policy implementation for the IMO structure and also of the endorsement of the entity of the IMO that is to be selected and/or formed. The focus is on both the IMO structure details and the IMO entity selection so the consultation may be referred to as the **“IMO Consultation – Structure Detail and Entity”**.

2.2.4 The initial consultation has been conducted and focused on the following:

2.2.4.1 the implementation of governance policy involving the details of replacing the current PEM Board structure with the two-tiered governance structure (the IMO and the Market Committee):

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2.2.4.2 an endorsement of the selection of the independent entity that will be the IMO.

2.2.5 The “IMO Consultation – Structure Detail and Entity” included:

2.2.5.1 determine who the electric power industry participants are:

2.2.5.2 determine what is an “endorsement”:

2.2.5.3 prepare consultation material:

2.2.5.4 set up mechanism for submissions:

2.2.5.5 ascertain and comply with publishing requirements for consultation:

2.2.5.6 disseminate information on the WESM website:

2.2.5.7 meet electric power industry participants:

2.2.5.8 determine deadline for submissions:

2.2.5.9 DOE decision.

### **2.3 ELECTRIC POWER INDUSTRY PARTICIPANTS**

2.3.1 The EPIRA defines the electric power industry participants as any person or entity engaged in the generation, transmission, distribution, or supply of electricity.

2.3.2 DOE determined whom the electric power industry participants are and with whom they are required to consult. It is reasonable to consider that the PEM Board is, to some extent, representative of the electric power industry participants. If so, then a “partial” or full endorsement may be sought from the PEM Board. It is important to note that the endorsement sought is of the IMO entity and not the structure, which is a policy decision. In respect of the IMO entity, the PEM Board has first hand knowledge of the operational experience and expertise that will form a significant part of the entity. The fact that the PEM Board will not know the actual composition of the IMO Board members may be managed by separating the selection of the IMO from its formation.

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**2.4 MEANING OF “ENDORSEMENT”**

2.4.1 Section 30 of the EPIRA states:

*“... an independent entity shall be formed and the functions, assets and liabilities of the market operator shall be transferred to such entity with the joint endorsement of the DOE and the electric power industry participants.”*

2.4.2 The Joint Congressional Power Commission (JCPC) has construed “endorsement” in this context to mean obtaining the “blessing” of electric power industry participants. Refer to the discussion on this topic in Appendix 10 of Report 1.

2.4.3 DOE will determine the criteria as to what level of agreement or support is required to become a “blessing” from the electric power industry participants.

2.4.4 Another issue raised by the section 30 “endorsement” requirement is “what is it that is required to be endorsed”?

2.4.5 The following questions arise:

2.4.5.1 is it only the transfer of the functions, assets and liabilities to the independent entity which is endorsed or also the formation of the entity?

2.4.5.2 if it includes the formation of the entity then is the personnel also to be endorsed?

2.4.6 During the JCPC deliberations on the drafting of the EPIRA IRR, Senator Osmena refers to the independent market operator as “the entity jointly endorsed by the DOE and the electric power industry participants to assume the functions, assets, liabilities from the AGMO”. In other words the questions raised in paragraph 2.4.5 can be answered in the negative; the endorsement is not intended to be so particularized - it is intended as an endorsement of the entity generally. However, obviously, during the process of endorsement people’s thoughts and assessments will be attended by considerations about the entity that are particularized.

2.4.7 So, in summary, the endorsement sought is “do you endorse the IMO which is to be formed within the new IMO structure?” – to answer that question

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participants are free to consider any particulars they wish but cannot object on irrelevant or unreasonable grounds.

2.4.8 The intended affect of the endorsement is simply that the DOE and stakeholders are content having a particular entity as the independent market operator. It might be reasonably assumed that “contentment” is synonymous with a “level of confidence” in the entity. This confidence may be derived from an assessment of one or more of many numerous relevant factors such as:

2.4.8.1 experience and qualifications of the entity and/or of individuals in it:

2.4.8.2 perceived level of commitment of the entity:

2.4.8.3 satisfaction the entity can perform the functions of a market operator to a reasonable standard:

2.4.8.4 trust that the entity will act primarily in the interests of the WESM.

2.4.9 In terms of the recommended IMO structure and the selection of the proposed IMO, the participants will not know who are to be the members on the IMO Board or the various standing Committees but will know that:

2.4.9.1 the Board and standing Committees’ members will be independent and must meet prescriptive entry criteria so will be of a high caliber:

2.4.9.2 the market operation and monitoring and compliance functions will be performed by groups under the IMO Board who have over 6 years of actual market operating experience in the WESM and are known by the members:

2.4.9.3 the proposed two-tiered governance structure delivers meaningful member participation through the Market Committee processes so participants have an effective voice regarding the performance of IMO functions.

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2.4.10 The factors above provide a reasonable basis for a participant to endorse the IMO selection.

2.4.11 Interestingly, the first set of WESM Rules were finalized by a “joint endorsement” of the DOE and industry participants. This was not specified as a requirement under EPIRA. The signatures of 17 representatives formalized this endorsement on 28<sup>th</sup> June 2002. In this case an endorsement was achieved by way of signature under the following statement:

*NOW THEREFORE, we, the undersigned industry participants for and in behalf of the entities we represent, hereby endorse the WESM Rules promulgated by the Department of Energy.*

## **2.5 DOE DECISION**

2.5.1 DOE will determine the outcome of the IMO consultation based on the feedback it receives.

2.5.2 DOE will prepare and publish a summary of submissions and its responses with its decision.

2.5.3 If the DOE decision is that the IMO has been selected following consultation then a further endorsement will be required at a later date (perhaps at the end of Phase 2) to form the IMO and transfer the assets and liabilities to it. This may be achieved through the process of selection of the IMO members.

## **2.6 TIME ESTIMATE FOR PHASE 1**

2.6.1 The consultation for Governance and IMO changes is likely to be completed soon, that is by February 2012.

2.6.2 As indicated above, it is possible that further consultative meetings are to be held after the initial endorsement of IMO selection is achieved. These meetings would probably be in the nature of exploring further the details of the governance structure – matters that did not have to be resolved to achieve an endorsement. The above time estimate does not factor these further meetings into the schedule.





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### **3 PHASE 2 - ESTABLISHMENT OF THE ITB AND THE MARKET COMMITTEE AND INFRASTRUCTURE PREPARATION AND RULES DEVELOPMENT AND APPROVAL**

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#### **3.1 OVERVIEW**

- 3.1.1 Phase 2 involves performing and completing those activities required to prepare for Phase 3, the implementation of the IMO Board structure.
- 3.1.2 Phase 2 activity is formally commenced as soon as, and only if, an endorsement has been acquired through the Phase 1 consultation process. There will be Phase 2 tasks that can be undertaken before Phase 1 is complete. It will be possible to commence some Phase 2 tasks without predetermining or appearing to predetermine the endorsement.

#### **3.2 SUMMARY OF TASKS IN PHASE 2**

- 3.2.1 Phase 2 involves undergoing all preparation activities required to enable Phase 3 implementation to proceed with significant momentum. It is envisaged that completion of Phase 2 tasks will enable all the formal processes required under Phase 3 to be quickly deployed (such as the Rules Change process, the corporate by-law adjustments, the assets and liabilities transfer, the Manual and Protocol amendment processes, and recruitment processes). This will require those formal Phase 3 processes to have immediate access to the necessary preparatory materials, draft documentation, and directions that were prepared in Phase 2.
- 3.2.2 The tasks that need to be undertaken in Phase 2 can be summarized under the following heads:
- 3.2.2.1 Establishment of ITB and Market Committee.
  - 3.2.2.2 Legal: prepare for change of name (make decision whether to change names) and incorporation details and by-laws for PEM Board and PEMC to the IMO Board and IMO Management Corporation: Consider the extent that the Board can commit to debt/borrowing obligations.

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- 3.2.2.3 Legal: assess the power of the DOE to impose some or all of the new rules (instead of through the Rules Change Committee):
- 3.2.2.4 Legal: assess the most effective mechanism to outline the restrictions on the IMO Board's decision-making power, such as the power to consider, approve, select, and engage outsourced service providers:
- 3.2.2.5 Financial: prepare for transfer of assets and liabilities from the ITB to the IMO Board: Review tax implications for new structure:
- 3.2.2.6 Personnel: prepare criteria for selection of new governance members; establish remuneration mechanism, decision on tenure:
- 3.2.2.7 Protocols: review existing protocols and prepare amendments and new protocols as appropriate:
- 3.2.2.8 Rules development: prepare outline of the WESM rule changes required including name changes, new reporting lines and structures, and inclusion of indemnities for governance members. Include recommendation for a process to commence for consideration of improvements to existing rules such as optional shorter billing cycles and change from hourly dispatch to half or quarter hour dispatch:
- 3.2.2.9 Manuals amendment: review and prepare outline of required amendments:

### **3.3 ITB AND MC ESTABLISHMENT**

- 3.3.1 Section 30 EPIRA states an independent entity shall be **formed** and the functions, assets and liabilities of the market operator shall be transferred to such entity with the joint endorsement of the DOE and the electric power industry participants.
- 3.3.2 Following consultation that took place in December 2011, the **selection** of the IMO is to be confirmed through DOE Circular.

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- 3.3.3 The IMO will be a new entity composed of the current PEMC and an independent Board. Although selected, this new IMO entity will not be **formed** until the independent members of the IMO Board have been selected. The selection process will involve the DOE and the electric power industry participants (through the yet to be formed Market Committee). The process will ensure that the IMO is formed, and the functions, assets and liabilities of the AGMO transfer to the IMO, with the joint endorsement of the DOE and the electric power industry participants.
- 3.3.4 The independent entity, the IMO, will be the entity that comprises the current AGMO operations, PEMC, headed by an independent Board. However, this new entity will not be **formed** until all the preparatory steps have been taken. These preparatory steps may take up to two years.
- 3.3.5 Section 7(d)(i) of rule 9 of the irr states that the AGMO governing body shall cease to govern the operation of the WESM upon the **formation or selection** of an IMO.
- 3.3.6 Therefore, when the DOE issues its Circular confirming the **selection** of the IMO as being a new entity composed of the current PEMC and an independent Board, the AGMO will cease to govern the operation of the WESM.
- 3.3.7 The new IMO entity will not be formed until all preparatory steps have been taken for its formation. But, as will be confirmed by the DOE Circular that notifies the IMO has been selected, the AGMO will cease to govern the WESM. This situation will leave a gap between the AGMO ceasing to govern and the new IMO entity being formed.
- 3.3.8 The ITB will be the caretaker Board who will bridge the gap and also be responsible for ensuring, expeditiously, all preparatory steps for the formation of the IMO are taken.
- 3.3.9 EPIRA and the IRR do not contemplate a caretaker Board. However, the ITB is the vehicle that enables the intent of the EPIRA and the IRR to be carried through. The ITB concept does not conflict with the provisions of
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EPIRA or IRR, but merely enables their provisions to be implemented. The process has been consulted and contains check and balance. At the same time the ITB is formed, a new entity, the Market Committee will also be established that represents market participants. The MC will have significant input into the selection of the IMO Board members and will have agreed this selection process and IMO Board member criteria. The IMO will not be able to be formed until the Market Committee has taken part in this selection process. When the IMO Board members are selected the IMO will be formed and the significant involvement of the MC in the selection process will represent the endorsement of the electric power industry participants.

- 3.3.10 The selection of the IMO Board members by the DOE and the Market Committee (the soon to be created representative body for the electric power industry participants) will be their joint endorsement of the formation of the IMO and the transfer of functions, assets and liabilities to it.

### **3.4 LEGAL**

- 3.4.1 Prepare documentation for corporate changes. Consider the ownership structure to ensure there are no surprises with tax, salary cap, and governance implications. Consider necessity and mechanism for managing the requirement in sections 6 and 8 of the RE Act for the PEMC to perform certain tasks and assume certain responsibilities. Consider whether it is more effective or efficient to retain the names PEM Board and PEMC by amending the by-laws than changing the RE Act references.
- 3.4.2 Consider the extent that the IMO Board should be able to commit to debt/borrowing obligations and insert the necessary powers in the by-laws and constitution.
- 3.4.3 Consider and prepare the legal basis for the transfer of assets and liabilities from the autonomous group market operator (AGMO) to the IMO Board.
- 3.4.4 Consider the appropriate level of, and mechanism to effect, limitation on liability and indemnity applicable for the Board and Committee members.

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- 3.4.5 Assess the power of the DOE to impose some or all of the new rules (instead of through the Rules Change Committee) in the event that the formal rules change process becomes obstructive:
- 3.4.6 Assess the most effective mechanism to outline the restrictions on the IMO Board's decision-making power. This includes the power to consider, approve, select, and engage outsourced service providers, which becomes an issue if it is accepted that a decision to engage a concessionaire is a policy decision for the Doe to make.

**3.5 FINANCIAL**

- 3.5.1 Confirm the exact nature and ownership of the assets and liabilities of the AGMO. Ascertain the assets and liabilities that should be transferred to the IMO Board, regardless of whether those assets and liabilities currently reside with the AGMO. For example this may take into account the desirability to financially prepare the IMO Board to be able to obtain new software for reasons such as to upgrade the existing software and/or hardware, link with SO systems, or enable the integration of open access and renewable energy obligations.
- 3.5.2 Develop mechanism for the smooth transfer of the said assets and liabilities to the IMO. Co-ordinate with Philippine legal adviser.
- 3.5.3 Ensure the AGMO holds, immediately prior to transfer, all the assets and liabilities determined that should be transferred to the IMO Board. This may include any debt loading required to transfer debt or assets (eg MMS hardware and software/license) from other agencies' books or to provide sufficient resource for the IMO to function, which also may remove debt from the Government's books.
- 3.5.4 Determine required documents for the transfer of assets and liabilities to the IMO.
- 3.5.5 Review mechanism for Committee member payments and also for IMO performance incentives to the operations arm of the IMO (the Board is not party to performance incentives and remains independent of the operations arm). The payment structure should accommodate possibility of foreign

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expert secondments to assist either as a member of the Board or a Committee or otherwise as an adviser.

- 3.5.6 Confirm tax break is still applicable under section 30 of the Tax Code. If not then establish the most efficient mechanism under which the IMO Board should operate.
- 3.5.7 Decide the desirability, level, and mechanisms for the IMO Board to incur debt obligations and/or have access to contingency funds (similar to PJM) for unexpected or unbudgeted operational needs.

### **3.6 PERSONNEL**

- 3.6.1 ITB to establish criteria for selection of new governance members, establish remuneration mechanism.
- 3.6.2 ITB to finalize the consultation process for selection of replacement IMO Board members after the initial selection.
- 3.6.3 Feed into the Rules development process to enshrine the definition of “independent” so far as it relates to the IMO Board members. Note that the EPIRA refers to the IMO as an independent entity but does not itself define the term.

### **3.7 PROTOCOLS**

- 3.7.1 DOE to determine the appropriate protocols that should be amended or put in place to align with the IMO Board structure.
- 3.7.2 Protocols should be in place between the ERC and MAG and ECO and the Compliance Committee, IMO management and SO and also metering service providers.

### **3.8 RULES**

- 3.8.1 The ITB will decide on the process it will rely on to amend the rules in preparation for an IMO Board structure. The ITB may decide to use the WESM Rules Change process outlined in the rules or the DOE may impose initial pre-ITB rule changes under its own powers.

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- 3.8.2 Rule amendments will not be made until Phase 3. The alternative is to make the rule change during Phase 2 but ensuring an adequate lead in time is provided before it is effective.
- 3.8.3 The amendments should be drafted in draft final form to enable the Rules Change Committee to understand clearly the intent of each draft proposed rule and to process it with minimal changes.
- 3.8.4 Most of the rule changes are to Chapter 1 (governance) of the WESM Rules (including insertion of new Compliance Committee, Audit Committee, and Market Committee), also significant changes will be required in Chapter 5 (market information and confidentiality), Chapter 7 (enforcement and also dispute resolution), and Chapter 8 Rule Change. Refer to the paragraphs at the end of this document that deal specifically with rule changes.
- 3.8.5 The whole of the WESM Rules will need also to undergo a general sweep to align terminologies and concepts with the IMO Board structure.
- 3.8.6 Decide, coordinating with the Legal input, the extent of the limitation on liability and indemnity applicable for the Board and Committee members.
- 3.8.7 A mechanism must be considered to incentivize IMO properly, for example for the market operation functions to be immune from penalty but to suffer instead a reduction in bonus payment. This will ensure that penalties work to incentivize compliance and are not simply passed through to end consumers.
- 3.8.8 Decide Compliance Committee restrictions: it will decide whether to accept ECO recommendations about breach and also decide what recommendation it will make regarding penalty in each case. No appeal is necessary as there is not one currently and ERC is the appropriate quasi-judicial body to rehear matters finally determined under the IMO processes.
- 3.8.9 Consideration may be made here to also propose draft rules arising from the Project recommendations that do not relate to the IMO but are provided for improved efficiency in the market. This refers specifically to 2 changes which are (1) a change to the prudential requirements to allow participants to settle earlier than the current 1 month cycle thereby reducing that

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participants prudential requirement; and (2) a reduction of the dispatch window from one hour to half or quarter hourly to enhance efficiency.

### **3.9 MANUALS**

3.9.1 The WESM Manuals will need to be created for new committees and existing ones reviewed and any appropriate amendments drafted for processing through the system.

### **3.10 IMO BOARD COMMITTEE MANUAL**

3.10.1 The key elements of the IMO Board Manual is to be drafted. The President of the IMO Management sits on the Board but does not chair it and likely will be a non-voting member. The IMO Board relationships with the various Committees are to be set out here.

### **3.11 MARKET COMMITTEE MANUAL**

3.11.1 The key elements of the Market Committee Manual are to be drafted. The membership shall mirror the existing PEM Board except that TRANSCO is replaced (or added with) with the concessionaire SO. Its relationship with the various standing Committees and the Board are to be set out as well as with the Rules Change and Technical Committees.

### **3.12 COMPLIANCE COMMITTEE MANUAL**

3.12.1 The key elements of the Compliance Committee Manual are to be drafted. ECO recommends whether a breach has occurred (but not penalty) and reports to the Compliance Committee. The Compliance Committee reviews ECO's recommendation on breach and makes its own recommendation on breach and penalty to the Board. The Compliance Committee may decide not to pursue investigations on grounds. The Compliance Committee is principally a filter for the Board and essentially most compliance related decisions are left with the full Board.

### **3.13 AUDIT COMMITTEE MANUAL**

3.13.1 The key elements of the Audit Committee Manual are to be drafted. Ensure there is a clear delineation of responsibility for software change approvals and the role this Committee has for it.



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**3.14 BOARD TO CONSIDER**

- 3.14.1 The DOE may recommend matters for the IMO Board to consider such as the outsourcing of IMO functions.
- 3.14.2 The IMO Board will also consult with the DOE if it is considering the potential for outsourcing component functions by way of one or more Service Agreements. Any final decision to outsource component functions of the market operation (i.e. not a concession) must be agreed, in principle, between the DOE and the IMO Board. Where outsourcing is only of component functions then, once the DOE has agreed in principle with it, the IMO Board will make the decision regarding the person who will provide those services and enter into and manage any contract regarding those services. Where outsourcing is in the nature of a concession (that is being in the nature of a monopoly of State controlled functions by such terms as - the outsourcing agreement is longer than 10 years and the functions are the whole of the market operator functions) the DOE will have the power to decide the policy and approve any Concessionaire engagement.
- 3.14.3 The IMO Board should consider alternative funding options, for example agreeing a tariff with industry to replace or supplement the current fee-setting mechanism. Alternatively, the financial support for the Market Committee processes could be left to be self-managed by the industry and supported by an industry tariff. In this way the market operator would not need to include this in its fee application to the ERC.

**3.15 SCOPE OF IMO FEES CHARGE**

- 3.15.1 As referred above the IMO Board might consider alternative funding options, for example to agree a tariff with industry to replace or supplement the current fee-setting mechanism.
- 3.15.2 As an alternative to that approach, the options for including a tariff structure could be canvassed during the Phase 1 consultation rather than waiting until the IMO structure is in place for the IMO Board to consider. Altering the fee/tariff structure may have a better chance of being realized if there is an agreed approach by participants at the pre-implementation stage rather than after the IMO structure is already in place.

- 3.15.3 One possible option is that full or partial financial support for the Market Committee processes is borne directly by the industry and supported by an agreed industry tariff, perhaps collected by the IMO. In this way the market operator would not include this cost in its fee application to the ERC. As, discussed in paragraph 3.15.8, this would also further enshrine and highlight the independence of the performance of the IMO functions.
- 3.15.4 Section 30 of the EPIRA requires that the cost of administering and operating the WESM be recovered by the market operator through a charge imposed to all market members, provided that such charge is filed with and approved by the ERC.
- 3.15.5 The proviso (“provided that”) written in the EPIRA cited above is not clearly expressed because it relates to a mandatory provision (“shall be recovered”). It is ambiguous to say a person “shall do something provided that ...”. One sensible interpretation of the provision is to read the term “shall be recovered” as not indicating a requirement to ‘recover’ but, rather, a power to ‘recover’; and that this power is not exerciseable until a pre-condition has been met. In other words the market operator is being given a power to recover its costs by imposing a charge on all market members but that the market operator can only exercise this power if the ERC approves the charge.
- 3.15.6 If that is the correct interpretation then it is key to know the scope of the market operator’s power to ‘recover’. The scope is defined by the charge that the market operator can recover. This charge is limited to the cost of administering and operating the WESM.
- 3.15.7 If the cost of running the Market Committee processes is a cost of administering and operating the WESM then that cost can only be recovered by the market operator after obtaining ERC approval.
- 3.15.8 The Market Committee purpose is to provide advice and support to the IMO. To enable it to do that the Market Committee has its own Committees to provide it with support and advice. Its purpose is neither to administer nor operate the WESM. This is proper because the IMO must independently administer and operate the WESM. This is the critical element that removes the Market Committee processes from the IMO

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administrative and operational processes. If that is the case then the costs of the Market Committee and the various Committees that report to it are not costs of administering or operating the WESM. This also aligns with the wording of EPIRA, which, in section 30, refers to the function of “administering the market” but does not cover in its definition those functions of the Market Committee and its supporting Committees.

- 3.15.9 Under this analysis, then, the cost of the Market Committee processes is not a cost of administering and operating the WESM and so the cost may be recovered by the market operator through a process other than that outlined in section 30 requiring ERC approval. This interpretation, however, is a little strained and lies somewhere on the edge of reasonableness.

### **3.16 TIME ESTIMATE FOR PHASE 2**

- 3.16.1 The Phase 2 tasks may be undertaken simultaneously by various IMO Transition Board members and/or seconded members and contractors.
- 3.16.2 Many of the Phase 2 tasks can be completed quite quickly. The more complex tasks are the Legal structuring plan for the IMO and the Rules Change summary preparation (including Manuals) and protocols. Depending on available resources, but assuming one person is tasked, then latter may take 30 days, and the formal drafting perhaps 90 business days. Finalizing the proposed model for structuring of the IMO may take longer as it is a complex issue. The matter may involve several external parties with long gaps between communications. It may take up to 1 year to finally settle on a structure and prepare for it.
- 3.16.3 It is estimated, therefore, that Phase 2 tasks could take 120 business days but that is an optimistic estimate and may take longer. A conservative estimate may be 1 year.

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**4 PHASE 3 - IMPLEMENTATION**

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**4.1 OVERVIEW**

4.1.1 Phase 3 involves the implementation of the IMO Board structure. Many Phase 3 tasks may be commenced before Phase 2 is completed provided the tasks are undertaken after the completion of the relevant prerequisite Phase 2 sub-tasks.

**4.2 SUMMARY OF TASKS IN PHASE 3**

4.2.1 The tasks that need to be undertaken in Phase 3 can be summarized under the following heads:

4.2.1.1 Legal: change of name and incorporation details for the PEM Board and PEMC to the IMO Board and IMO Management Corporation:

4.2.1.2 Financial: transfer of assets and liabilities from the AGMO to the IMO Board:

4.2.1.3 Personnel: select new governance members:

4.2.1.4 Personnel: there may be current independent members on other committees who could fill some of the positions in the new IMO Board and the Compliance Committee. The other committees may just rollover with their existing members. The key position is the Chair of the IMO Board.

4.2.1.5 Protocols: amend existing protocols and finalize new protocols as appropriate:

4.2.1.6 Rules change: initiate the WESM Rules Change process or other process as determined by the DOE:

4.2.1.7 Manuals amendment: initiate the changes required to WESM Manuals:

4.2.1.8 IMO Board structure starts: In place and at least filled to a quorum are the IMO Board, the Market Monitoring Panel (or MSC if it retains its current name), and the Compliance and

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Audit Committees. In place and effective are the WESM Rules and Market Manuals as amended and the protocols between the IMO and the ERC, SO and metering service providers.

**4.3 TIME ESTIMATE FOR PHASE 3**

- 4.3.1 The Phase 3 tasks will be undertaken by IMO Transition Board members, PEMC staff, and any seconded consultants or engaged external expertise. By the time Phase 3 commences the preparation has largely been completed under Phase 2 that will provide a significant momentum for the implementation to proceed.
- 4.3.2 The tasks that will take the longest period to complete are the corporate restructuring, rules changes, and the personnel selection.
- 4.3.3 It is estimated that Phase 3 tasks could take 120 business days, depending on resources available and on the quality of the applicants for the Board and Committee positions received on the initial position notifications. That is a conservative estimate and may take longer. A conservative estimate may be 1 year.

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**5 OVERVIEW OF RULES, MANUALS, AND PROTOCOLS CHANGES**

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- 5.1 The implementation of the IMO requires amendments to current WESM Rules, Manuals, and Protocols.
- 5.2 These amendments are to be made during the transition period under the IMO Transition Board (the “ITB”).
- 5.3 The following includes the tasks that need to be undertaken during the ITB transition period:
- 5.3.1 Finalize key decisions regarding the details of the IMO structure to ensure all new and amended requirements and functions and powers are appropriately reflected in the WESM Rules:
  - 5.3.2 Prepare draft of the WESM rule changes required including name changes, new reporting lines and structures, and inclusion of indemnities for governance members:
  - 5.3.3 Review existing Protocols and prepare amendments and new protocols as appropriate:
  - 5.3.4 Review and prepare outline of required amendments to Manuals and drafting of new Manuals for the Market Committee and the Compliance Committee.

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**6 PROCESS**

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- 6.1 The DOE, through the ITB, will determine the appropriate formal process to amend the Rules, Manuals, and Protocols in preparation for the IMO.
- 6.2 The DOE will assess the appropriate mechanism to implement the rule changes.
- 6.3 The WESM Rules amendments will be put into force during the ITB phase and will provide an adequate lead in time for effectivity.

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**7 CHAPTER 1 INTRODUCTION**

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**Chapter 1**

Consider inserting an entrenchment provision for Chapter one rules. Such a provision will prevent Chapter one changes without intensive consultation and unanimous approval of the IMO.

**Rule 1.1 Scope of Chapter 1**

Insert Compliance Committee

Insert Responsibilities of the Market Committee

Amend PEM Board to IMO Board

Amend Market Operator by amending its definition (this will remedy its use throughout)

**Rule 1.4 Governance of the Market**

1.4.1 PEM Board

1.4.2 Composition of PEM Board

1.4.2.1 - 1.4.2.6

1.4.3 Appointment of the PEM Board

1.4.3.2

1.4.4 Voting rights to include President right to vote but not in tie.

1.4.4.4: Delete

Rule 1.4.6 Formation of Committees paragraph (d) reference to Rules Change Committee change to Market Committee:

Rule 1.6 Market Surveillance Committee, 1.6.2 review responsibilities and paragraph (d) transfer of role to Compliance Committee:

Rule 1.7 Technical Committee



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1.7.1 Appointed by Market Committee with some independent members on it

1.7.2 include responsibility to Market Committee:

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**8**      **CHAPTER 2 REGISTRATION**

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**9**      **CHAPTER 3 THE MARKET**

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**10**    **CHAPTER 4 METERING**

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**11 CHAPTER 5 MARKET INFORMATION AND CONFIDENTIALITY**

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**Rule 5.3 Confidentiality**

5.3.2 Exceptions: to include standing committees:

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**12 CHAPTER 6 INTERVENTION AND MARKET SUSPENSION**

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General: Consider whether Market Committee should be engaged when there are decisions made regarding intervention and market suspension for example in rule 6.2.3 regarding the Administered Price Cap

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**13 CHAPTER 7 ENFORCEMENT AND DISPUTES**

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**Rule 7.2 Enforcement:**

include Compliance Committee reference where appropriate

remove ECO decision re breach,

remove MSC involvement at rule 7.2.4.3,

Board decision on penalty to be inserted:

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**14 CHAPTER 8 RULES CHANGE PROCESS**

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**Rule 8.2 Rules Change Committee**

review of rules to include Market Committee in the process

revision of rules 8.2.1 to 8.2.6 and 8.2.9:

**Rule 8.3 (Referral of matters to RCC)**

8.3.1 review who receives rule change proposal:

**Rule 8.4 (Consideration of proposal)**

General: Review roles to insert Market Committee in process

8.4.7 Insert Market Committee as the maker of recommendation to Board:

**Rule 8.5 (Consideration of proposal)**

8.5.1 to 8.5.3.2 to include Market Committee process:

**Rule 8.6 Approval by DOE**

8.6.4 and 8.6.5 review to include Market Committee:

**Rule 8.7 Indemnity:**

General, include Market Committee as appropriate



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**15 CHAPTER 9 INTERPRETATION**

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**Additions**

**Alterations**

**Deletions**

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**16**    **CHAPTER 10 TRANSITORY PROVISIONS**

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12.1

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**17 CHAPTER 11 GLOSSARY**

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**Compliance Committee**

**IMO**

**IMO Board**

**IMO Operations** (by amending the definition of **'Market Operator'**)

**Market Committee**

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**18 GENERAL ISSUES FOR CONSIDERATION**

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18.1 Consideration should be made regarding associated IMO issues such as:

18.1.1 The appropriate extent of the limitation on liability and indemnity applicable for the Board and Committee members:

18.1.2 The appropriate mechanism to effectively incentivize the IMO.

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**19 APPENDIX 1 TIMELINE PHASES**

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**TIMELINES**

**FOR**

**PHASES 2 AND 3**

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**19.1 TIME ESTIMATE**

- 19.1.1 The optimistic timeline to transition from the WESM being governed under the present structure to the IMO structure would need to assume there are sufficient resources available at all times during the phases, is no unscheduled delay, and no issues take longer than expected. If that were the case then it may be reasonable to estimate 120 business days for Phase 2 completion and 120 business days for Phase 3.
- 19.1.2 However, it is unlikely that the optimistic timeline will be realistic given the complexity of the changes and tasks needed to be completed and the sensitivity to them. Not to mention the significant pressures it will put on resources at DOE and PEMC who are stretched already. In the circumstances we recommend setting a realistic target that doubles the optimistic estimate. This will then set the timeframe to just under two years from the time the ITB is established.

**19.2 TIMELINE PHASE 2 - MARCH 2012 TO FEBRUARY 2013**

<b>INFRASTRUCTURE PREPARATION AND RULES DEVELOPMENT</b>		<b>2012</b>	<b>M</b>	<b>A</b>	<b>M</b>	<b>J</b>	<b>J</b>	<b>A</b>	<b>S</b>	<b>O</b>	<b>N</b>	<b>D</b>	<b>J</b>	<b>F</b>	<b>2013</b>
	<b>240 Business Days</b>		<b>PHASE 2</b>												
Prepare corporate changes including name and bylaws															
Review legal requirements - Finalise ownership model to be used															
Prepare transfer assets and liabilities															
Prepare membership criteria															
Prepare HR for engagement programme															
Identify and summarize rule changes needed															
Detail drafting of rule changes															
Drafting of Manual amendments															
Drafting of Compliance Committee Manual provisions															
Drafting of Audit Committee Manual provisions															
Drafting of protocol changes															

**19.3 TIMELINE PHASE 3 - MARCH 2013 TO FEBRUARY 2014**

<b>IMPLEMENTATION</b>		<b>2013</b>	<b>M</b>	<b>A</b>	<b>M</b>	<b>J</b>	<b>J</b>	<b>A</b>	<b>S</b>	<b>O</b>	<b>N</b>	<b>D</b>	<b>J</b>	<b>F</b>	<b>2014</b>
	<b>240 Business Days</b>		<b>PHASE 3</b>												
<b>Implement corporate changes</b>															
<b>Initiate Member selection process</b>															
<b>Member selection and engagement</b>															
<b>Transfer assets and liabilities</b>															
<b>Finalize and approve rule amendment</b>															
<b>Finalize and approve Manuals</b>															
<b>Finalize and approve protocols</b>															
<b>IMO Board replaces ITB</b>															