



Regional Technical Assistance Consultant's Report

Project Number: 41251
January 2012

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

- Activity Completion Report Executive
Summary

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This consultant's report does not necessarily reflect the views of ADB or the Government concerned, and ADB and the Government cannot be held liable for its contents. (For project preparatory technical assistance: All the views expressed herein may not be incorporated into the proposed project's design.)

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)

FINAL REPORT

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

Prepared for ADB

31 January 2012

Prepared by; TA Consultants

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TABLE OF CONTENTS

SECTIONS

INTRODUCTION	1
1.1 Background	1
1.2 Objective and Scope	1
1.3 Methodology and Approach	3
RECOMMENDATIONS	4
1.4 Recommendations for Implementation of IMO and Governance Structure	4
1.5 Recommendations for Selection of ITB and IMO	5
KEY ISSUES AND RISKS IN FUTURE	7
1.6 Introduction	7
1.7 Consultation Feedback	7
1.8 JCPC	8
1.9 ITB	8
1.10 Fees for IMO	8
1.11 Market Committee Representation	9
1.12 IMO Isolation	9
CONCLUSIONS AND RECOMMENDATIONS	10
1.13 Project Impact	10
1.14 Further Recommendations	10
APPENDIX 1 IMO STRUCTURE	11
APPENDIX 2 SELECTION OF ITB AND IMO	12

1.1 Background

1. The “Electric Power Industry Reform Act of 2001” (EPIRA) mandated the Department of Energy (DOE) to establish the Wholesale Electricity Spot Market (WESM). As part of the preparatory work to implement the WESM and to initiate its commercial operation, the Philippine Electricity Market Corporation (PEMC), which is the Autonomous Group Market Operator (AGMO), was created to manage, govern and administer the WESM. The PEMC’s Articles of Incorporation and By-Laws was endorsed and filed by the DOE with the Securities and Exchange Commission (SEC). PEMC has been constituted as a non-stock, nonprofit corporation which main task is to undertake the preparatory work and initial operation of the Wholesale Electricity Spot Market (WESM).
2. In accordance with the provision under the EPIRA, the IRR, and the WESM Rules, the PEMC Board was formed with equitable representation of the electric power industry.
3. In 2009, three years after commencement of the commercial operation of WESM, the DOE deemed it appropriate to move towards the appointment of the Independent Market Operator (IMO) in accordance with EPIRA. The DOE recognized the tremendous task involved to undertake to implement and appointment an IMO, and sought ADB's Technical Assistance to help the Government put in place an adequate and efficient market mechanism and an effective governance structure prior to the transition of AGMO to IMO.
4. It was recognized, in the Background and Rationale Paper that preceded and supported this TA, that the power sector restructuring in the Philippines had passed the point of no return, and that the new power sector structure had created some uncertainties in terms of governance. These risks, it was considered, would be best overcome by accelerating the pace of reform and establishing clear authority and accountability among stakeholders. The Paper stated that key gaps in the reform process remained, which would reduce the effectiveness of the new governance structure; that one particular area required immediate attention to ensure transition of WESM operations from the current DOE driven PEMC to an independent market operator (IMO) without further delay. This was recognized to be crucial for the good governance of the power sector and the success of the power sector restructuring process.
5. Consequently, DOE and PEMC requested ADB's technical assistance that initiated this subproject: Ta-6445 (Reg) - Support For The Establishment Of An Independent Market Operator, Phi.
6. Initially the view was held, as reflected in the initial ToR, that an IMO would be put in place by an international tendering process. However, this view was modified soon after the project team began its review and analysis of the power industry legislative landscape. The project team proposed that an independent market operator should not report to a stakeholdered Board and recommended a different tack to that reflected in the initial ToR.

1.2 Objective and Scope

7. The impact of the project is improved governance of the restructured power sector in the Philippines.

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8. The expected outcome is reduced price manipulation risks and enhanced competition in a transparent and fair manner. The TA aimed to achieve the outcome through development of an implementation plan for the selection and appointment of the Independent Market Operator.
 9. The main outputs of the TA were expressed as:
 - i. Independent market operator (IMO) structure designed:
 - ii. Selection process, guidelines and procedures for the appointment of the IMO prepared:
 - iii. Technical specifications prepared for the bidding of the IMO to the prospective bidders.
 10. The proposed TA was designed to assist DOE and PEMC to implement Rule 9 Section 6 (a) of the EPIRA's Implementing Rules and Regulations (IRR), which states that "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: Provided, That the IMO shall be financially and technically capable, with proven experience and expertise of not less than two (2) years as a leading independent market operator of similar or larger size electricity market".
 11. Initially, the activities under the project included the following:
 - i. Develop independent market operator (IMO) structure and identify the terms of contract
 - ii. Establish proper ownership of assets and liabilities of the autonomous group market operator (AGMO) and develop mechanism for the smooth transfer of the said assets and liabilities to the IMO.
 - iii. Develop selection process, guidelines and procedures for the appointment of the IMO
 - iv. Develop the performance indicators and performance contract of the IMO and a set of monitoring strategies.
 - v. Design approach and instrumentalities to be used by the DOE and PEMC during the stakeholders' consultation and endorsement for the tendering of the IMO.
 - vi. Develop program and documentation for the promotion of the IMO to the prospective bidders.
 12. After the project team consulted with ADB a few months into the project the focus of TA activities shifted from tendering for an IMO to the restructuring of the WESM Governance structure, including the splitting of the present AGMO structure into a two-tiered governance structure with a purely independent IMO and a stakeholdered Market Committee providing advice to it. New tasks were then designed under the project, which included the following:
 - i. Assist the DOE during public consultations on the formation of the IMO, as necessary:

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- ii. Assist the DOE in finalizing the action plan and timeline for the formation of the IMO:
 - iii. Develop the necessary documents for the formation of the IMO such as the Transition Plan from AGMO to IMO:
 - iv. Develop the necessary processes, guidelines, procedures, and other related documents for the formation of the WESM governing body:
 - v. Identify and recommend WESM Rules changes necessary to implement the formation of the IMO:
 - vi. Such other tasks as maybe directed by the DOE.
13. The focus of the project team shifted then to refinement and detailing of its recommendations for a two-tiered governance structure and to formulating a transition plan including providing advice and documentation for possible consultations, rule changes, transition, and implementation.

1.3 Methodology and Approach

14. Initially the project was divided into 7 activities: IMO structure, IMO services, technical specifications, pricing, tender process, and transition.
15. The project team applied a 3-phase approach to each activity. Phase 1 entailed problem definition including gathering information, analyzing data, identifying issues, and seeking feedback. Phase 2 entailed option analysis including identifying options, assessing alternatives, and seeking feedback. Phase 3 included incorporating feedback and finalizing the report including recommendations.
16. The project team applied the methodology to the first five of the stated activities, which would pave the way for the last two activities (tender process and transition). However, before the last two activities were completed the project team were compelled by its review and analysis to approach ADB with a recommendation for a revised ToR to align the required outputs with the findings of the project team.
17. Consequently the project team ToR was amended to encapsulate its interim recommendation on the way forward and next steps based on its initial findings. It recommended that the WESM move to a two-tiered governance structure comprising the IMO (composed of an independent Board and the PEMC who had, by that time, been the market operator of WESM for over 4 years), and a stakeholdered Market Committee. The recommendation was based on the project team's interpretation of EPIRA and comparison with structures of other electricity markets (Australia, New Zealand and the ISOs and RTOs of North America). The objective for the recommendation was to ensure that the IMO was independent and did not report to a stakeholdered board, in line with the EPIRA and associated IRR and the markets the project team surveyed.

1.4 Recommendations for Implementation of IMO and Governance Structure

18. The project team recommended implementation of an IMO and the appropriate governance structure as follows:
 - a. That an IMO Board:
 - i. be selected as the independent Board that oversees its market operations arm, the current PEMC (independent means non-stakeholdered and non-government):
 - ii. be formed:
 - iii. comprises the IMO management President and 4 (if the President has voting rights) or 5 (if the President is a non-voting member) elected members all of whom are independent:
 - b. That an Audit Committee and a Compliance Committee and Market Surveillance Committee report to the IMO Board:
 - c. That an interim Board is established, the IMO Transition Board (ITB), to replace the current AGMO PEM Board, to manage an orderly transition from the non-independent AGMO Board to the independent IMO Board:
 - d. That the existing non-independent AGMO PEM Board members transfer to a stakeholdered Market Committee:
 - e. That the Market Committee functions include:
 - i. recommends rule changes to the IMO Board:
 - ii. in other ways provides advice and guidance to the IMO Board:
 - f. That the Rules Change Committee and the Technical Committee report to the Market Committee:
 - g. That the membership, reporting lines, functions, powers, and duties of these and associated bodies outlined in this report are reflected in the WESM Rules, Manuals, Protocols, and associated documents:
 - h. That the IMO Transition Board (ITB) prepares for the implementation of an IMO within two years of its establishment to manage an orderly transition to the IMO with tasks including finalising the rules changes, selection of IMO Board members, forming the IMO, and ensuring the allocation of all appropriate assets and liabilities such that those are transferred to the IMO Board immediately upon its formation to enable the IMO to effectively govern the WESM:
 - i. That the recommended two-tiered governance structure and the transition proposal toward it be consulted by the DOE.
19. The two-tiered governance structure for the IMO is represented diagrammically in Appendix 1.

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20. The basis for the above recommendations in respect of the two-tiered governance structure can be referred to in the following reports that are included as a supplement this Report:
 - a. Supplementary Report 1 IMO and Governance Structure, which includes the analysis of the legislation and the recommended structure and compares foreign market structures:
 - b. Supplementary Report 2 IMO Services and Assurance, which provides a basis for future monitoring activity in respect of IMO performance:
 - c. Supplementary Report 3 Technical Specifications, which provides the current operational details of the current PEMC and contributed to the project team's recommendation that PEMC has the required technical capability as required under Section 6 (a) of Rule 9 of the IRR:
 - d. Supplementary Report 4 Pricing Analysis, which supports the project team's recommendation that PEMC has the required financial capability as required under Section 6 (a) of Rule 9 of the IRR.
 21. The basis and support for the above recommendations in respect of the ITB can be referred to in the following document that is included as a supplement this Report:
 - a. Supplementary Working Document Transition Plan.
 22. Support for the above recommendations in respect of the consultations can be referred to in the Supplementary Document Transition Plan and in the following documents and consultation mini-packs that are included as a supplement this Report:
 - a. Supplementary Document Mini-Pack DOE and ERC Roles in WESM:
 - b. Supplementary Document Mini-Pack IMO Asset and Liability Transfer:
 - c. Supplementary Document Mini-Pack IMO Compliance Committee Process:
 - d. Supplementary Document Mini-Pack IMO IMO Board Selection Process:
 - e. Supplementary Document Mini-Pack IMO Penalty Immunity:
 - f. Supplementary Document Mini-Pack IMO Selection Process:
 - g. Supplementary Document Mini-Pack Market Comparisons:
 - h. Supplementary Document Mini-Pack Rule Change Process:
 - i. Supplementary Document Mini-Pack Rules, Manuals, and Protocols Changes:
 - j. Supplementary Document Speech and Circulars:
 - k. Supplementary Document Consultation Material Primer.

1.5 Recommendations for Selection of ITB and IMO

23. The project team recommended the options for selection of the ITB and IMO members as shown in Appendix 2. Each recommended selection process provides inputs from the market participants and the DOE.

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24. The skill-set of the members is mixed, covering the areas of academe, economics, finance or commerce, law, and technical. It may cover areas of experience such as electric regulatory affairs, electric utility management, corporate finance, bulk power systems, power pool operations, public policy, consumer advocacy, environmental affairs, business management, law, the performance of markets and information systems.
 25. The members must demonstrate high standards of ethics, integrity, and professionalism, independence, sound judgment, and meaningful experience in the relevant skill-set sought. In addition, the members must be committed to representing the long-term interests of the WESM. They must have an inquisitive and objective perspective, practical wisdom and mature judgment. The Board will therefore represent a range of experience at policy-making levels in business, education, and technology.
 26. The Academe qualification requires a person from a high academic position such as faculty head. The faculty disciplines will be related to commerce or science.
 27. The Economist qualification requires a person with experience in senior management positions in markets and have a background in the disciplines of econometrics and macro-economics. The person will hold a doctorate degree in economics.
 28. The Finance/Commerce qualification requires a person with experience in a senior management position in a commercial field, preferably with a significant finance-related component. The person will be a member of a public corporation Board or head a professional institution that represent a Commerce-related discipline (for example a Chamber of Commerce).
 29. The Law qualification requires a person who is a senior partner in a medium to large law firm or held a position as a judge in an appellate Court.
 30. The Technical qualification requires a person who has a reputation for excellence in a discipline of engineering and has in-depth knowledge and understanding of an energy related field. The person must carry strong credentials for sound strategic thinking and evidence their abilities with proven experience in senior management roles.
 31. The Nomination Committee will reassess the qualifications of a director, including the director's past contributions to the Board and the director's attendance and contributions at Board and Committee meetings, prior to recommending a director for reelection to another term.
 32. The Board and its Committees have the right at any time to retain independent outside accounting, financial, legal or other advisers, and the IMO shall provide appropriate funding, as determined by the Board or any Committee, to compensate such independent outside advisers, as well as to cover the ordinary administrative expenses incurred by the Board and its Committees in carrying out their duties.

1.6 Introduction

33. The recommendations outlined above, although gaining significant support, initiated rigorous debate. Out of the consultation process several common themes emerged in respect of the concerns expressed. The DOE consultation process was, as expected, conducted in an inclusive and transparent manner. The details, including consultation process, summary of meetings, and responses, are maintained for public viewing on its website.

1.7 Consultation Feedback

34. Perhaps the most common concern expressed during consultation of the proposed IMO structure was what processes would be in place to ensure an independent Board is selected. Given the manner in which this issue was consistent expressed, it could be interpreted as guarded support for an independent Board but with doubts expressed as to the likelihood of its successful execution.
35. In order to mitigate the risk of corrupting the 'independence' of the IMO, as the consultation process revealed was uppermost in people's minds, our recommendations include criteria around the qualifications and experience requirements for the Board members, but further prescriptions and refinements will be made by the ITB during the transition phase.
36. Comments were received during the consultation regarding whether an 'independent' Board could be achieved still by having stakeholders in it. Several views were expressed that the independent Board should have stakeholders in it .
37. We agree that so-called independent Boards do exist with stakeholders within it. We disagree that such a structure is appropriate in the case of WESM. We made the point that the Market Committee will exist as the second tier of the governance structure and will provide advice to the Board so the Board should always be well informed about market issues through the lines of communication open between the two entities. It is our view that two-tiered mechanism will achieve a greater level of self governance within WESM and will assist greatly to progress the reforms in accordance with EPIRA. It puts the stakeholders in the driver's seat in respect of market development and rule change processes and leaves the integrity functions and the task of governing the market to the IMO, of which Board will provide independent and highly qualified strategic consideration to the issues confronting WESM.
38. Many other matters were raised during consultation, mostly involving detail that does not impact directly on matters of principle. These will be largely left to be ironed out over the course of the transition phase of the restructure. For instance whether the President of PEMC has a voting right on the Board will be settled during the transition phase and will itself determine whether the Board will consist of 4 or 5 independent members. We recommend a non-voting President in a 6-member Board, with the other 5 members being independent. This will also impact the members' term. If there are 5 independent members then each member will serve a 5-year term. Initially the IMO Board will have staggered membership between 1 and 5 years, so that each year only one member position is up for selection.
39. Concerns were also raised about the establishment of the ITB. Some consultation commenters considered that the ITB should be composed of stakeholders. We consider it important that the ITB composition reflects the principles that support our

recommendation for an independent IMO Board. We recommended that the ITB does not have stakeholders within it. To mitigate the concerns expressed we provided a supporting recommendation on ITB selection, which provides a process that reflects the wishes of both the DOE and the market stakeholders in terms of membership. This in turn will assure an endorsement is achieved between DOE and the market participants on the composition of the ITB. A similar process is recommended for the selection of the IMO Board members with the same result for endorsement, which may also be interpreted as fulfilling the requirement by EPIRA for endorsement of the IMO formation and transfer of functions, assets, and liabilities..

1.8 JCPC

40. At this point in the closing stages of the project the concepts are well developed and largely agreed. At the time this TA will end, however, the DOE will still need to pass the concepts through the JCPC for its views and it will be seeking JCPC's approval to proceed.

1.9 ITB

41. We have provided recommendations on the composition and tasks of the ITB.
42. If the JCPC approves the concepts, then the next phase of implementation can be effected. This will mean that the necessary bye-laws and rules changes are put in place and the ITB be formed using an agreed selection process. Our recommended process is outlined in Appendix 2. If this occurs then the stakeholders on the PEM Board will concurrently form the Market Committee and the basic two-tiered governance structure will begin to take form.
43. The ITB will then be charged with managing the transition to the IMO. It will have two years to complete all the preparatory tasks.
44. The biggest intellectual and legal challenge for the ITB could be settling the legal structure and personality that the IMO will take. The IMO will be non-profit and non-stock as is the current AGMO but, unlike the AGMO, its members will be independent. The appropriate ownership model is by no means clear right now and its resolution will be a highly challenging legal exercise. What is clear are a set of principles about what is sought to achieve through the ownership model and what is clearly sought to avoid. For instance the model should not create a potential to impose additional pressures on the independence of the IMO members than is absolutely necessary. In other words the ownership model should not itself create bias toward either the government or market participants.
45. Another significant challenge will be completing the rule amendments to prepare for the changes that need to take place. Work has been done on this but the ITB will need to establish a working group to complete the drafting and processing.

1.10 Fees for IMO

46. The IMO will be subject to the rules, of course, and so will be exposed to the penalty regime under WESM. This raises several interesting issues. The IMO is non-profit and if it receives a penalty the payment may just be passed through to consumers.
47. The IMO operations arm will be accountable to its IMO Board and, if it is not performing adequately, might even escalate to the DOE. This may happen if the Market Committee has a grievance regarding operations performance and is unhappy with the

response from the market operations arm of the IMO or the IMO Board. But day to day accountability of the operations arm is to the IMO Board.

48. Penalties imposed against the market operations arm will usually be considered normal business under WESM. It might be worth consideration having a bonus system attach to the IMO performance that is exposed to the penalty regime. This may provide a better incentive for IMO compliance. The object of the compliance is to make the imposition of any form of penalty work as an incentive for compliance.

1.11 Market Committee Representation

49. The Market Committee will be the representative voice of the electric power industry participants.
50. It will be important that Luzon, Visayas, and Mindanao (when it enters the market) are also represented adequately on the Market Committee. This point is made here merely as a highlight and does not signal a likely risk of not occurring.

1.12 IMO Isolation

51. Under the proposed two-tiered governance structure lies an inherent risk to effective governance if the IMO Board becomes isolated from the market. The Board members are independent and their normal professional spheres of activity outside of the IMO Boardroom are unlikely to encompass the market sector. This may create a natural barrier to effective engagement with industry. Although this may not in fact happen, it is a natural phenomenon and can be mitigated if not eradicated completely.
52. It will be absolutely crucial to the success of the IMO structure that the Board is accessible to the market. It will be crucial that meaning engagements occur at frequent intervals between the Board and the Market Committee.
53. The success of WESM's two-tiered governance structure hinges greatly on the level of meaning engagement between the IMO Board and the Market Committee. The ITB will need to formulate mitigation strategies that foster good communication channels between the two entities. This must include regular health checks of the level of meaningful engagement between market and the IMO. One method may be to establish a Governance Assessment Committee or at least establish regular meetings between the chairs of each entity to discuss governance issues.

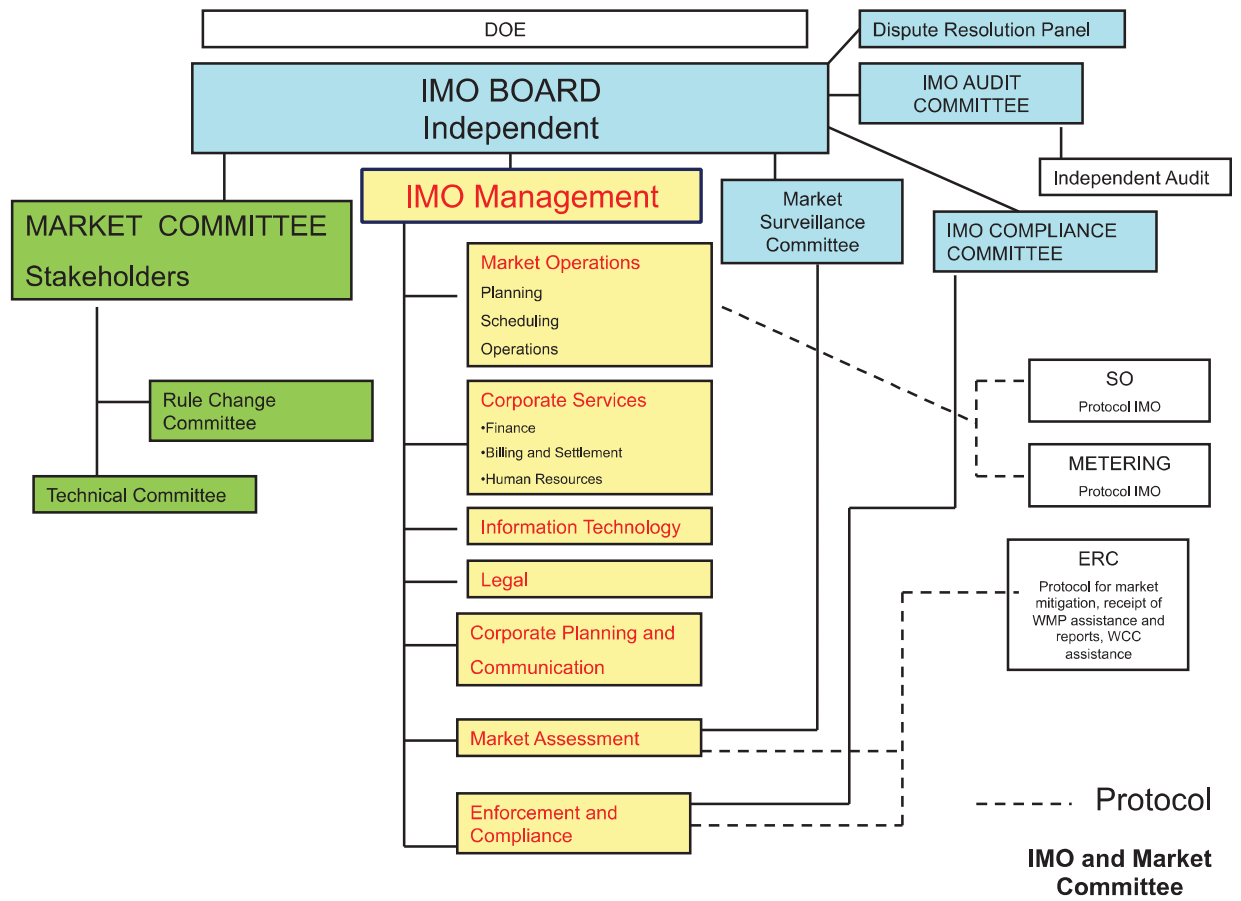
1.13 Project Impact

54. At the time of writing, as the project is nearing its final stage, it appears the recommendations have a reasonably high probability of been carried through to completion. If the JCPC lends its support, which may be known before the end of March 2012, then this probability will strengthen.
55. The project process and outputs have the potential to significantly progress the EPIRA reforms. Many of the solutions to the issues confronted by the project team have often been principle driven, which carries the attendant risk of creating silos of opposition and support, and various shades between. However, in this TA subproject, the project team found its associations with PEMC, DOE, and stakeholders largely positive which contributed often to cross-interest palatable principle-based solutions.
56. It will for for that reason, if the recommendations are effected, that those recommendations have taken a life of their own. Other than promoting an independent WESM governing body, a significant achievement of the project will be if the recommendations continue to be pushed and achieved after the TA subproject has ended.

1.14 Further Recommendations

57. Although the project did not focus on operational matters per se, it did observe several issues that, although not directly connected with the IMO structure, may adversely impact on the ITB and IMO at a time when they will be most sensitive and vulnerable to criticism. For this reason these observations are noted here.
58. For the reasons that the WESM will be under particularly close scrutiny during the IMO transition phasing and there are pressing market development matters competing for priority, the project team raises two matters which, if left unanswered for too long, could adversely impact the consistent progress of WESM to date:
 - a. Billing and Settlements: to reduce the billing cycle and thereby reducing prudential requirements and barriers to entry:
 - b. Dispatch: to step-wise reduce the 1 hour dispatch window in order for the market to trend toward real time dispatch.

APPENDIX 1 IMO STRUCTURE



SELECTION OF IMO and ITB

IMO SELECTION

OPTION 1 4 INDEPENDENT MEMBERS

ASSUMPTIONS:

NO STAKEHOLDER MEMBERS

THE 4 INDEPENDENT DIRECTORS ARE MEMBERS

IMO MEMBER TERM IS 4 YEARS (INITIALLY TERM IS STAGGERED)

PRESIDENT IS VOTING MEMBER

NOMINATION COMMITTEE

Each year Nomination Committee membership alters depending who is choosing slate (DOE, MC, IMO)

When MC chooses slate or approves from slate its chair will alternate between its representative sectors

PROCESS

Each year one IMO member finishes term and a replacement member is elected by the IMO

The IMO member who is finishing his or her term does not vote for the new member, so 3 IMO members vote at each member election

Year 1 Academic: slate from DOE from which MC approves 2 candidates from which one is selected by IMO

Year 2 Economist: slate from IMO from which MC approves 2 candidates from which one is selected by IMO

Year 3 Lawyer: slate from IMO which DOE approves 2 candidates from which one is selected by IMO

Year 4 Technical: slate from MC which DOE approves 2 candidates from which one is selected by IMO

PRESIDENT

President is selected by the 4 independent IMO members

President does not vote in IMO member election

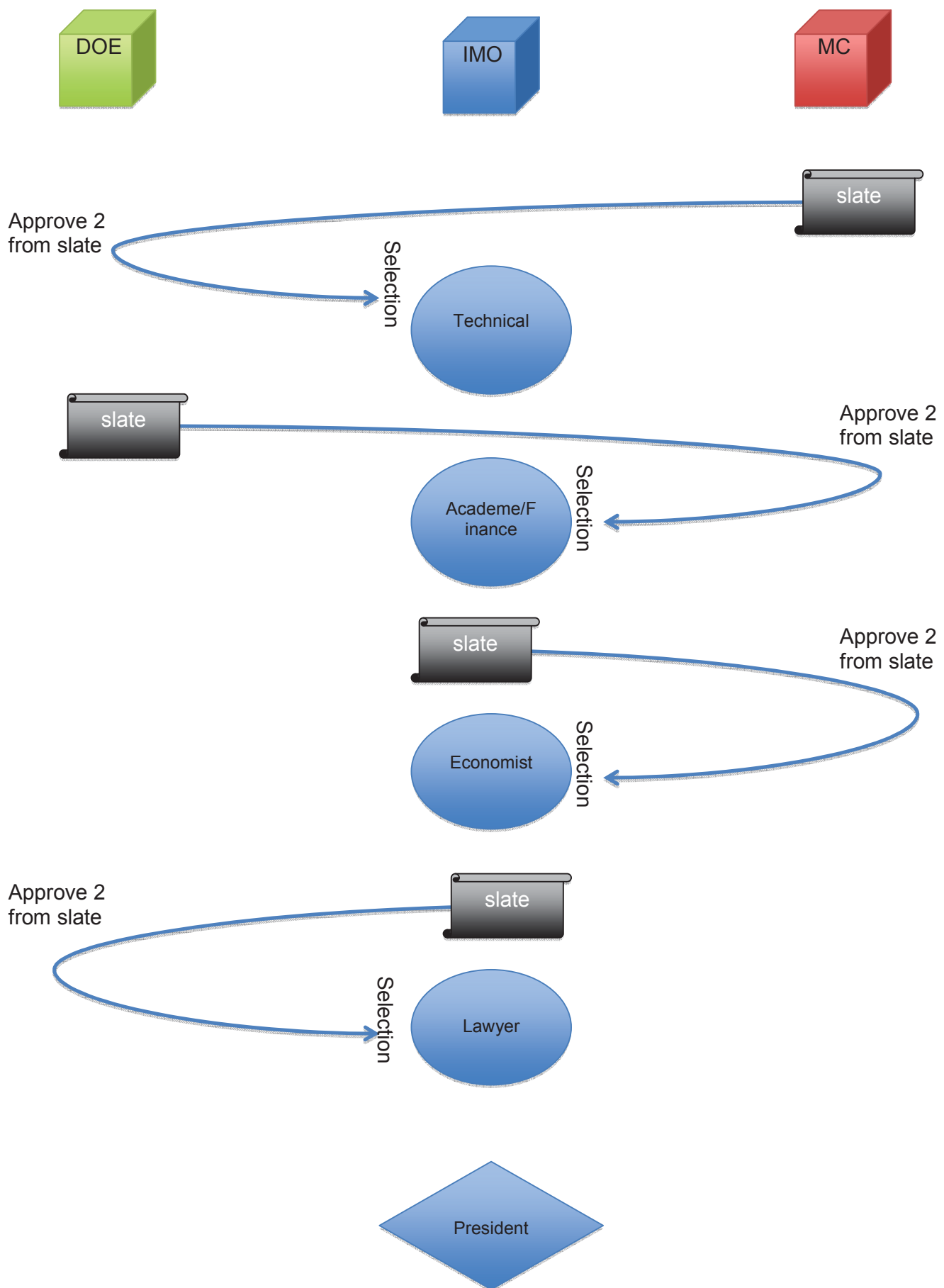
INITIAL SELECTION OF IMO

Same process as diagram except:

Lawyer slate is provided by the DOE from which one is elected by ITB

Economist slate is provided by the ITB from which MC approves 2 candidates from which one is elected by ITB

ITB elects the Academic and the Technical from 2 candidates for each position which were approved by MC and DOE from a slate provided by DOE and MC respectively



IMO SELECTION

OPTION 2 5 INDEPENDENT MEMBERS

ASSUMPTIONS:

NO STAKEHOLDER MEMBERS

THE 5 INDEPENDENT DIRECTORS ARE MEMBERS

IMO MEMBER TERM IS 5 YEARS (INITIALLY TERM IS STAGGERED)

PRESIDENT IS NON-VOTING MEMBER

NOMINATION COMMITTEE

Each year Nomination Committee membership alters depending who is choosing slate (DOE, MC, IMO)

When MC chooses slate or approves from slate its chair will alternate between its representative sectors

PROCESS

Each year one IMO member finishes term and a replacement member is elected by the IMO

The IMO member who is finishing his or her term does not vote for the new member, so 4 IMO members vote at each member election with Chair having casting vote

Year 1 Academic: slate from MC from which DOE approves 2 candidates from which one is selected by IMO

Year 2 Economist: slate from DOE from which MC approves 2 candidates from which one is selected by IMO

Year 3 Finance: slate from DOE from which MC approves 2 candidates from which one is selected by IMO

Year 4 Lawyer: slate from IMO from which DOE approves 2 candidates from which one is selected by IMO

Year 5 Technical: slate from MC from which DOE approves 2 candidates from which one is selected by IMO

PRESIDENT

President is selected by the 5 independent IMO members

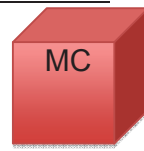
INITIAL SELECTION OF IMO

Same process as diagram except:

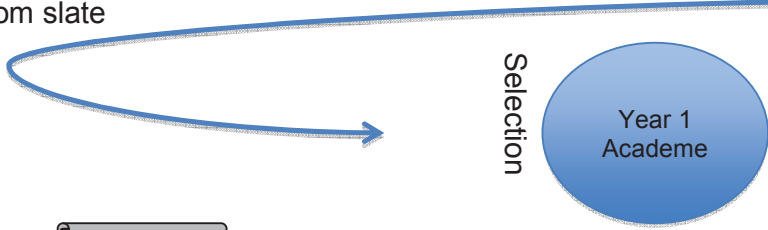
Lawyer slate is provided by the DOE from which one is selected by ITB

Economist slate is provided by the ITB from which MC approves 2 candidates from which one is selected by ITB

ITB selects the Academic, Finance, and the Technical from 2 candidates for each position which were approved by DOE, MC, DOE from a slate provided by MC, DOE, MC respectively



Approve 2 from slate



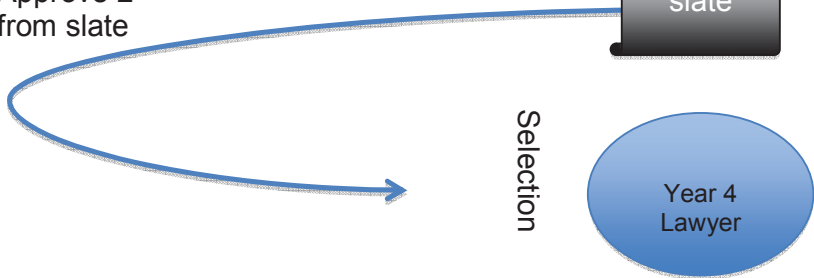
Approve 2 from slate



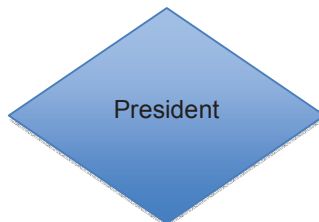
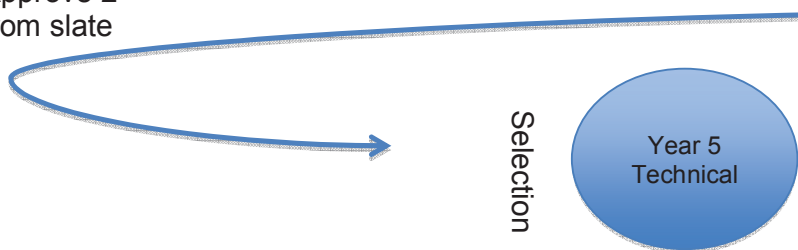
Approve 2 from slate



Approve 2 from slate



Approve 2 from slate



ITB SELECTION

OPTION

ASSUMPTIONS:

NO STAKEHOLDER MEMBERS

ITB MAXIMUM 5 INDEPENDENT DIRECTOR MEMBERS

QUORUM 3 INDEPENDENT DIRECTORS PLUS DOE AND PRESIDENT

ITB MINIMUM 5 MEMBERS (INCLUDING DOE AND PRESIDENT)

PRESIDENT IS NON-VOTING MEMBER

EACH ITB MEMBER SERVES THE FULL TERM OF THE ITB

MARKET COMMITTEE WILL BE ESTABLISHED CONCURRENTLY WITH

ITB ESTABLISHMENT

NOMINATION COMMITTEE

Nomination Committee comprises PEM BOARD components (DOE, PEMB, and PEMB Stakeholders)

Nomination Committee membership alters depending who is choosing slate (DOE, PEMB Stakeholders, PEMB)

When PEMB Stakeholders choose slate or approves from slate its chair will alternate between its representative sectors

If slate has less than four realistic candidates the approver may request bigger slate

ITB steps in shoes of PEMB when Market Committee (MC) is created and MC steps in shoes of PEMB Stakeholders

SELECTION PROCESS

Academic: selected by PEMB

Economist: slate from DOE from which PEMB Stakeholders approve 2 candidates from which one is selected by PEMB

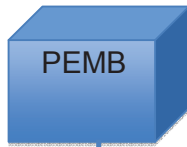
Finance: slate from PEMB Stakeholders from which DOE approves 2 candidates from which one is selected by PEMB

Lawyer: selected by DOE

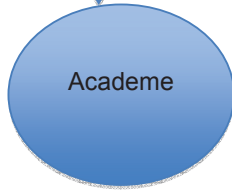
Technical: selected by PEMB Stakeholders

PRESIDENT

President selected by ITB using current cycle



Selection

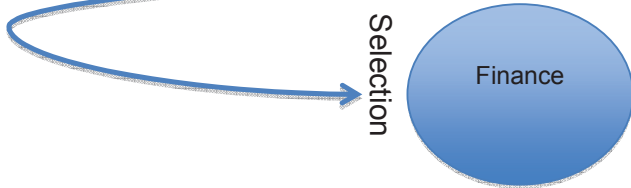


Approve 2 from slate



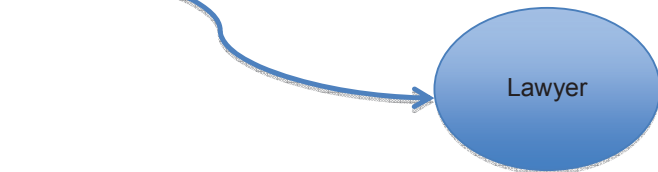
Selection

Approve 2 from slate

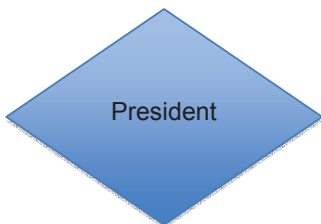
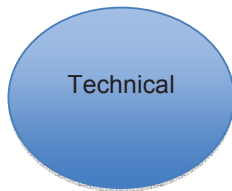


Selection

Selection



Selection



Project Authority

- **ADB Project TA-6445 (REG)**
- TA was result of agreement between DOE and ADB to:
 - Undertake a study to implement the IMO
 - Implement the IMO
- **Project commenced February 2010**
 - Project team: Alasdair Macdonald, Carlo Borlaza, Richard Penn, Bennett Parton

Summary of Recommendations

- IMO is independent of stakeholders and arm's length from the government
- A Market Committee, composed of stakeholders, to be established
- Creation of IMO Transition Board
 - Stakeholder-free composed of, at the very least, 3 independent members, the PEMC President, and DOE Secretary
 - Chaired by the DOE Secretary
 - To oversee the orderly transition to the IMO Board when all necessary preparatory steps are completed.

EPIRA R.A. 9136

Section 30 ...

Not later than one (1) year after the implementation of the wholesale electricity spot market, 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.

EPIRA R.A. 9136

Section 30 ...

*Not later than one (1) year after the implementation of the wholesale electricity spot market, 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.*

“independent entity”

- This is the IMO

EPIRA R.A. 9136

Section 30 ...

*Not later than one (1) year after the implementation of the wholesale electricity spot market, 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.*

“INDEPENDENT”

- WHAT IS MEANING OF *INDEPENDENT*?
 - guidance
 - section 45 EPIRA
 - Section 2(j) EPIRA
 - JCPC deliberations
 - *WESM Rule 1.4.2.7*

EPIRA R.A. 9136

Section 30 ...

*Not later than one (1) year after the implementation of the wholesale electricity spot market, 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.*

“formed”

- Chairman Sen Cayetano stated that the JCPC would interpret the word “form” liberally and does not mean it has to be organized and established
- The IRR refers to “formation or selection”, in the case of the proposed IMO it has been selected but not yet formed

EPIRA R.A. 9136

Section 30 ...

*Not later than one (1) year after the implementation of the wholesale electricity spot market, 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.*

" market operator "

- This is the AGMO
 - from whom the *functions, assets and liabilities* are *transferred* to the IMO

"AGMO"

- This is the PEM Board and PEMC together

Rule 9 of the IRR

- Provides the details of the AGMO
- Under sections 7(a) and (b) the AGMO governing body comprises stakeholder and independent members chaired by the DOE Secretary
- Its functions include governing the operation of the WESM

Rule 9 of the IRR ... *cont*

- Section 7(d) provides that the AGMO governing body governs the operation of the WESM until the formation or the selection of the IMO
- Section 7(e) requires the AGMO governing body to transfer its functions, assets and liabilities to the IMO

Rule 9 of the IRR ... *cont*

- Section 7(d) provides that the AGMO governing body governs the operation of the WESM until the formation or the selection of the **IMO**
- Section 7(e) requires the AGMO governing body to transfer its functions, assets and liabilities to the **IMO**

IMO

- Other than the requirement to be independent
 - Rule 9 Section 6(a) of the IRR
 - IMO required to
 - Be financially and technically capable
 - Have proven experience and expertise of not less than 2 years as a leading market operator of similar or larger size electricity market

EPIRA R.A. 9136

Section 30 ...

*Not later than one (1) year after the implementation of the wholesale electricity spot market, 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.*

"joint endorsement"

- That the independent entity is jointly endorsed means it has the blessing of the DOE and the electric power industry participants.
 - Refer JCPC deliberations

Project Guidance

- The Project Team guided by:
 - The Legislative Context (Primary)
 - EPIRA and the IRR set the Direction
 - The International Context (Secondary)
 - Provides level of confidence in Direction

ISO and IMO Governance Structures

Comparison of other Markets

	Independent Board *	For Profit	Rule Change Process	Budget / Fee's / Monitoring
New England ISO	Yes	No	Members Vote on Rule Changes, outcome not binding to the Board	Budget is set by NE-ISO and Fee's recovered via a FERC governed Tariff. Internal Market Monitoring and External
New York ISO	Yes	No	Members - Management Committee (MC) votes on Rules 58% required for pass to go to Board	Budget is set by NYISO and Fee's recovered via a FERC governed Tariff. MC works with NYISO on Budget Internal Market Monitoring and External
PJM ISO	Yes	No	Members Committee – provides advice to the Board and recommendations to the Board.	Budget is set by PJM and Fee's recovered via a FERC governed Tariff. Monitoring Undertaken by an outsourced company Monitoring Analytics
MISO ISO	Yes	No	Advisory Committee made up of members can provide advice to the Board on Rule changes	Budget is set by MISO and Fee's recovered via a FERC governed Tariff. Internal Market Monitoring and External

	Independent Board *	For Profit	Rule Change Process	Budget / Fee's
ERCOT ISO	No - mix of Independents plus Participants	No	Members - Technical Advisory Committee (TAC) makes recommendations to the Board. PUCT has final approval, Sunset Commission (2010) recommended greater independence so Board is charged with developing a new representative Advisory Committee structure	Budget is set by ERCOT Public Utilities Commission (PUCT) approves fees PUCT has Market Oversight
CAL ISO	Yes	No	Committees struck as required to provide advice to the Board	Budget is set by CALISO and Fee's recovered via a FERC governed Tariff. Internal and External Monitoring
Ontario IESO	Yes	No	Members Technical Panel Recommends Rule Changes to Board, Vote recorded	Budget set by IESO Approved by Ontario Energy Board Market Surveillance Panel Reports to the OEB (Regulator)
Alberta AESO	Yes	No	Consultation by AESO with Members	Reviewed by Alberta Utilities Commission (AUC) if complaints. The Monitoring Authority is a separate not for profit providing input to the AUC

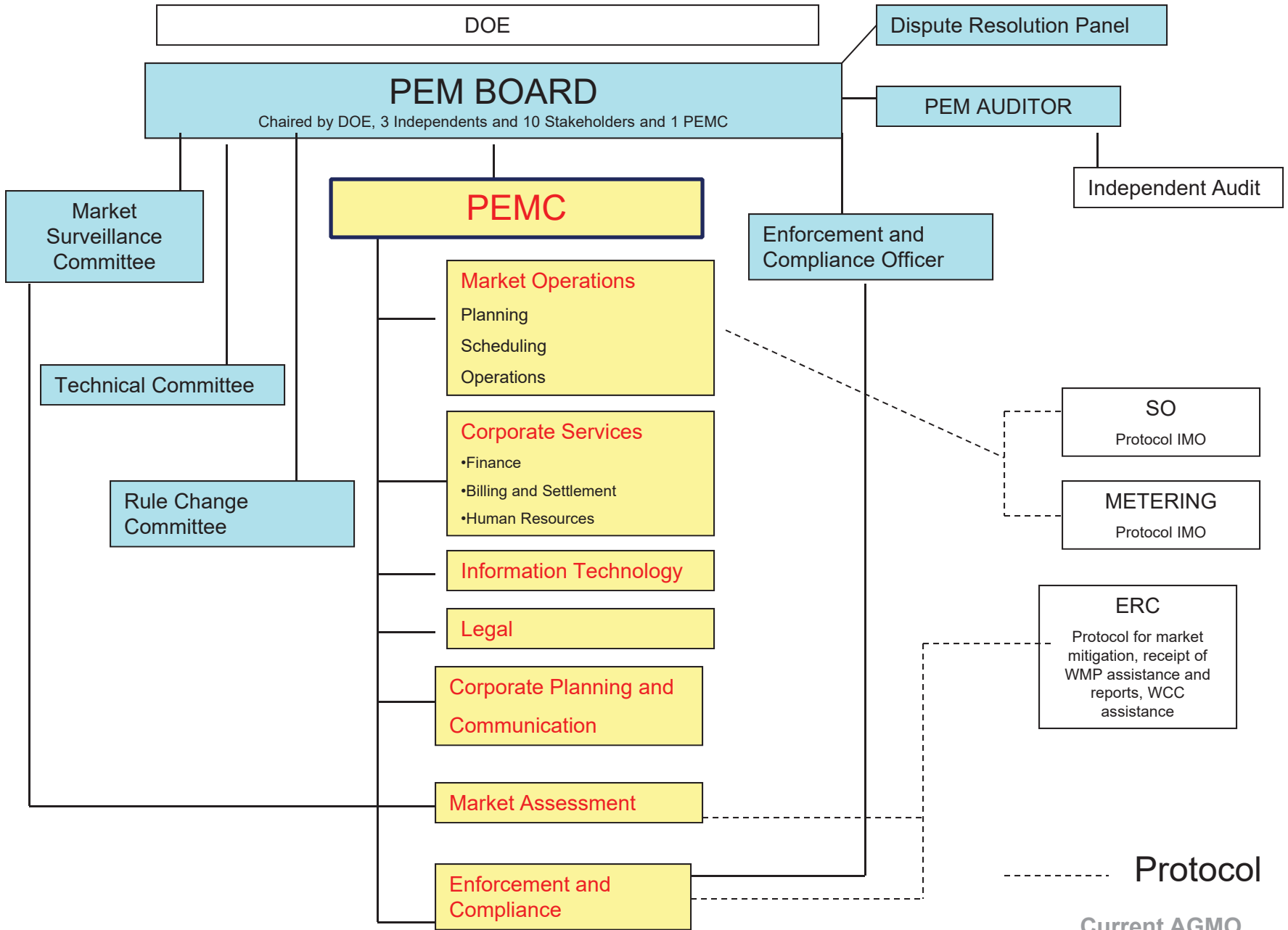
	Independent Board *	For Profit	Rule Change Process	Budget / Fee's
Singapore EMC	Yes – Independent of Stakeholders	Yes, joint venture between Gov't and Software supplier	Members Rule Committee (RCP) recommends Rule Changes to the Board	Fees Approved by Energy Market Authority (Gov't Agency) Market Surveillance Compliance Panel Reports to the EMC and the EMA (Regulator)
Australia (AEMO)	Stakeholders plus Government Majority of Board is Independent	No	Rules set by AEMC (Gov't Agency), CEO on the Board but not to be Chair, AER conduct monitoring and enforcement	Set by member agreed Tariff. Market Monitoring reporting to a constituent of the Australian Competition Commission
Western Australia IMO	Yes	No	Members Market Advisory Committee (MAC) recommends Rule Changes to the Board	Set by the IMO and approved by the State Minister for Energy The Economic Regulation Authority a separate Gov't Organisation monitors the Market
New Zealand	Yes	No, outsourced to service providers	Ad Hoc Working Groups reporting to the Board	Collected by the Gov't of New Zealand

Summary of Comparison

- By far the vast majority of Market Operators (10 of 12) have an Independent Board and a not for Profit Structure (11 of 12)
- Those that have Stakeholders on the Board (2 of 12) have their Market Integrity Functions (Market Surveillance and Compliance) reporting to a different entity with the ability to effect change if issues are found

Present WESM Structure

- Stakeholder Board:
 - Has Market Integrity Functions
 - (Compliance, Surveillance, Audit) Reporting to the Board and
 - Governs operations
 - Of Market Operator (PEMC)



----- Protocol

Current AGMO Structure

Proposed WESM Structure

- Independent Board:
 - Having Market Integrity Functions Reporting to the Board and
 - Governing the operation of the Market Operator (IMO)
- Stakeholders providing guidance and advice

DOE

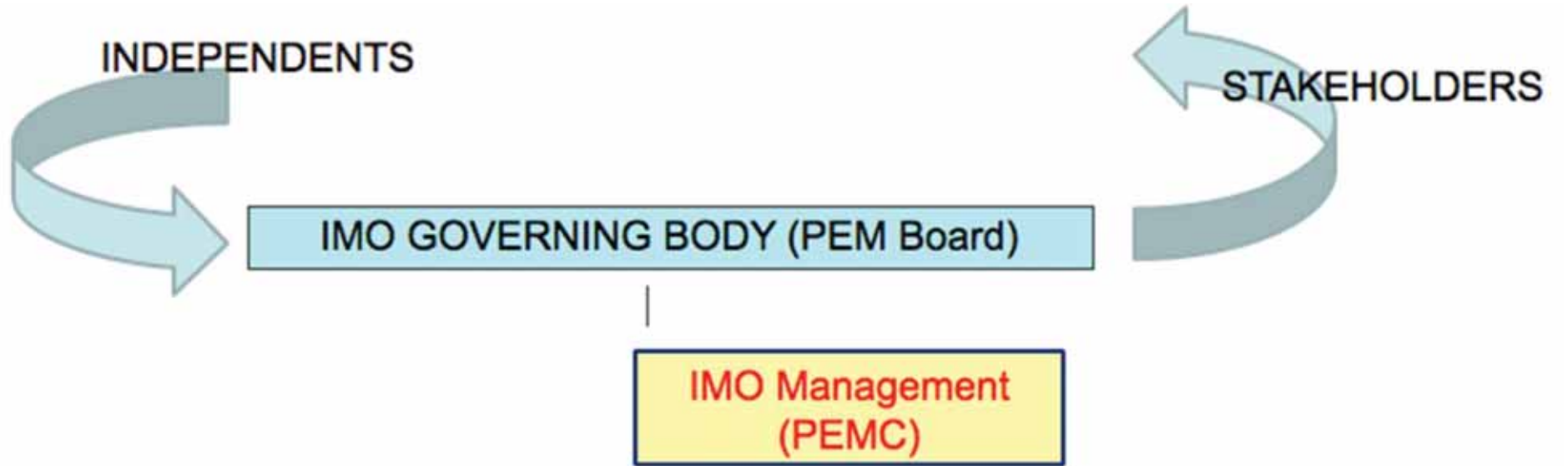
IMO BOARD
5 independent members

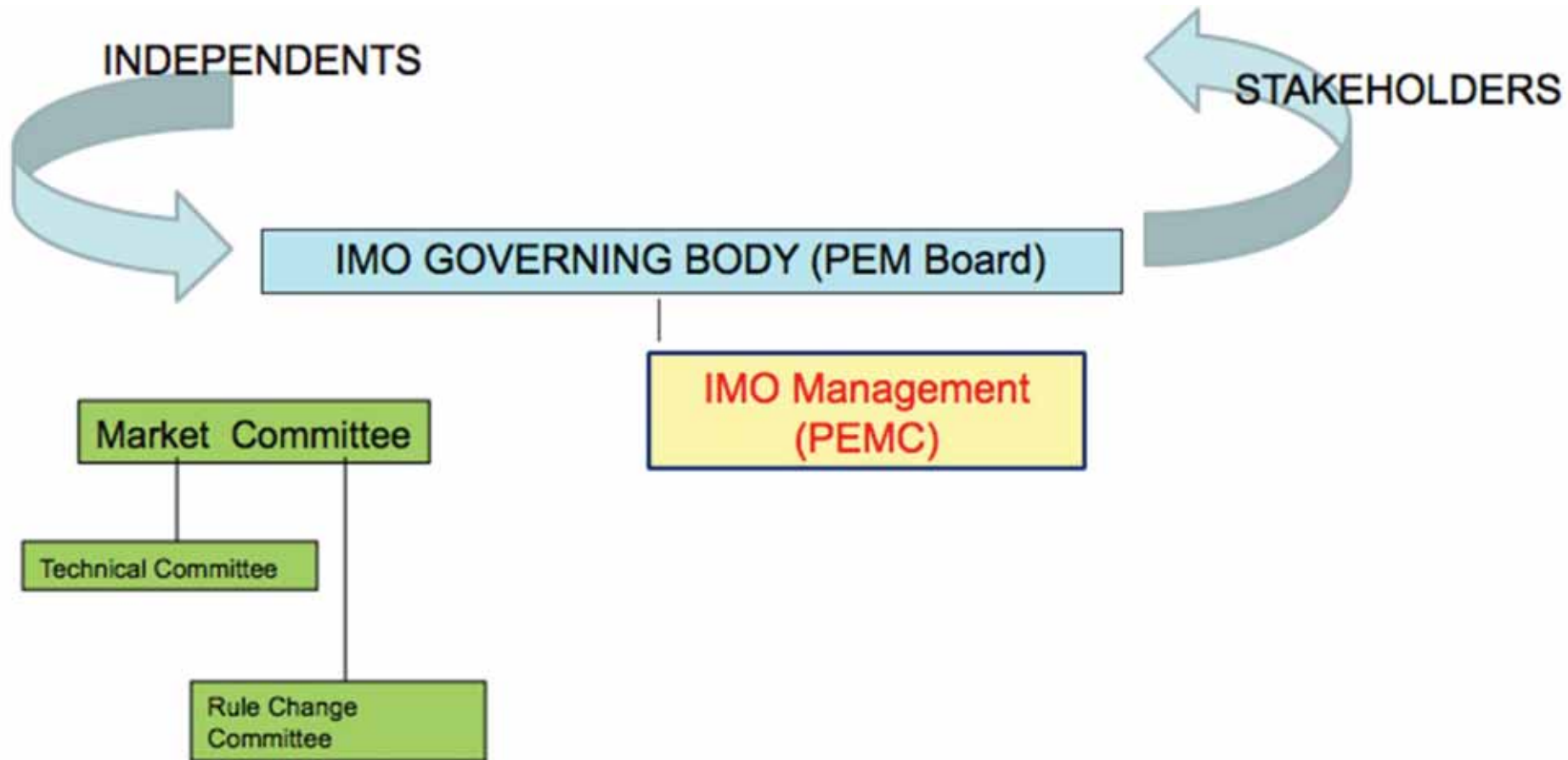
Market Oversight Reports to the Board

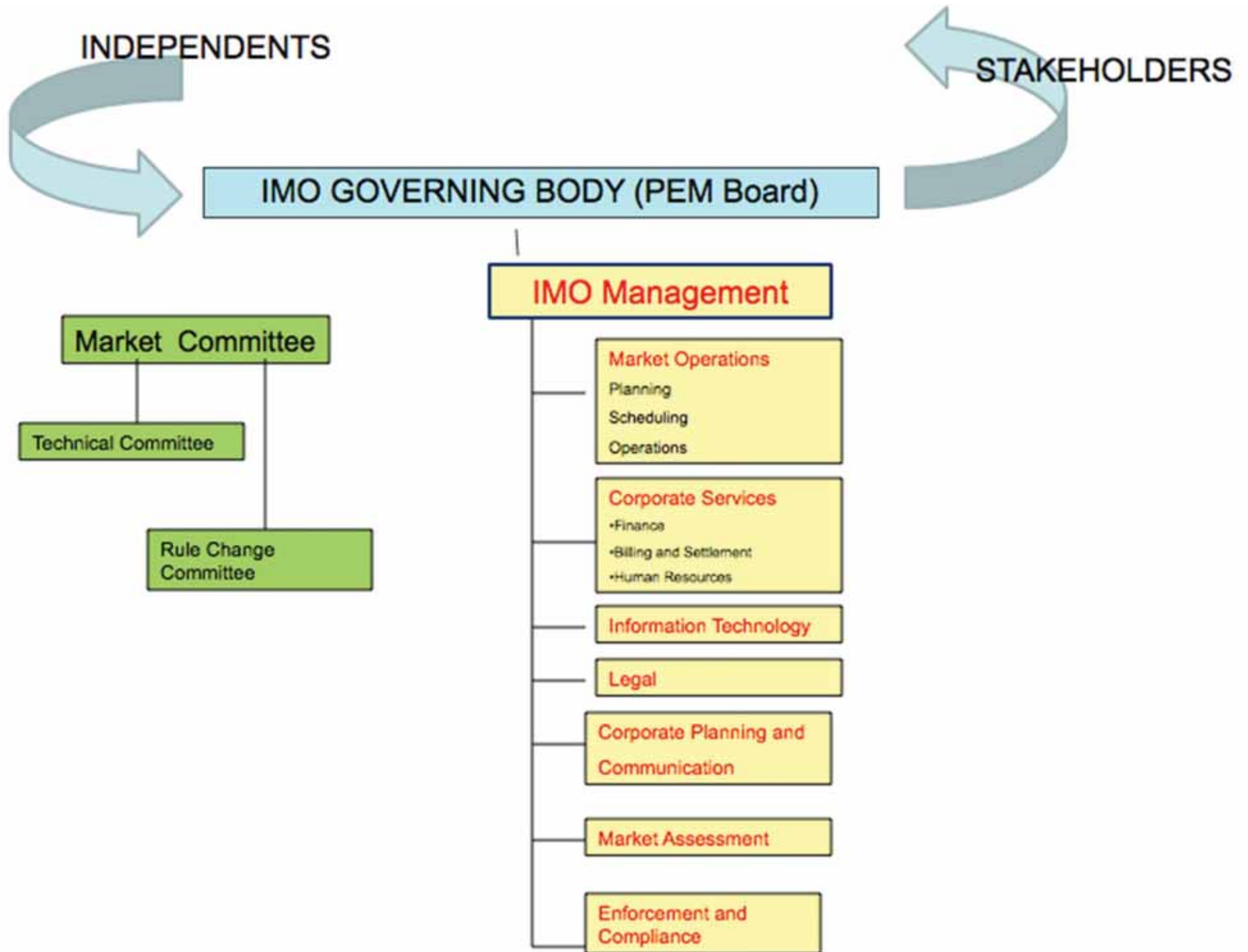
IMO
Management and Staff

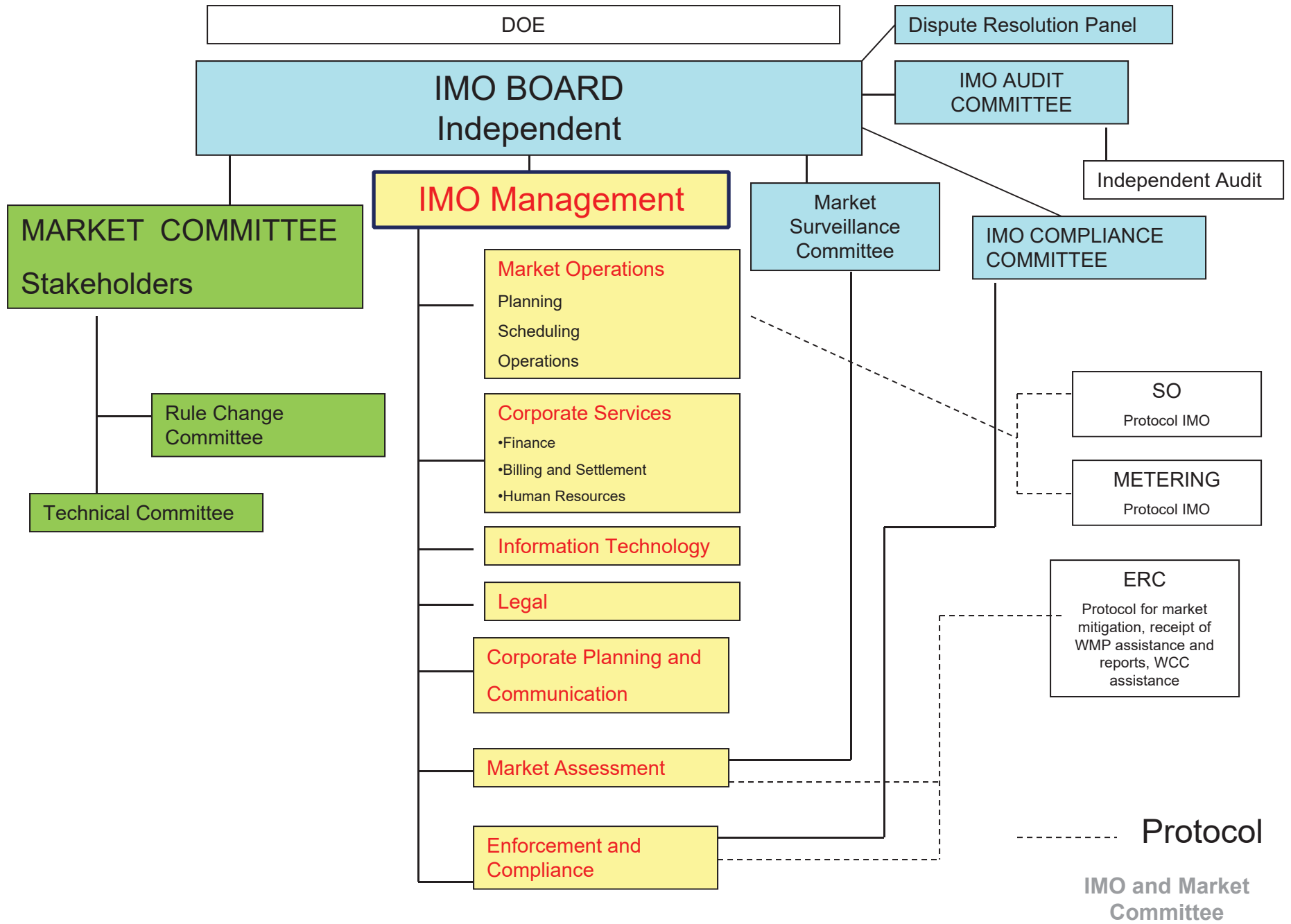
Market Participants provide Advice and Guidance to IMO Board

The simple Concept
The Independent Market Operator





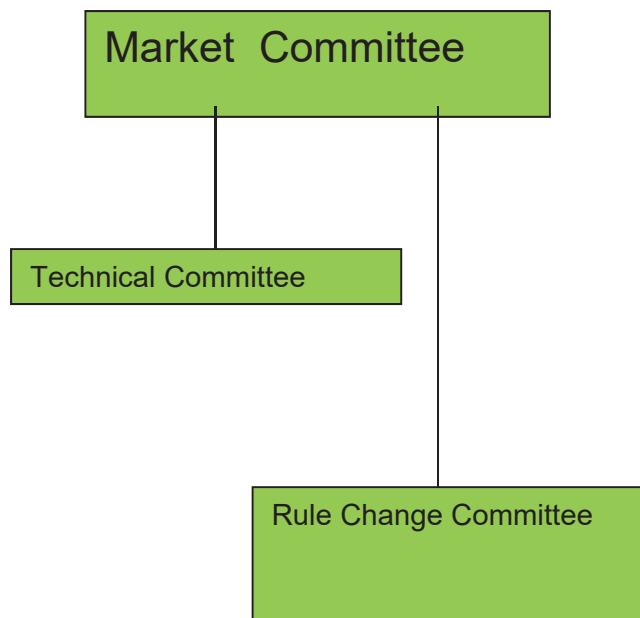




Committee Structure

Stakeholder Committees

Market Committee (NEW)



Purpose: Responsible to provide Stakeholder input into Board Decisions

- Provide Advice to IMO Board via Regular Meetings
- Provide a slate of potential Independent candidates to the Board alternatively will select from a slate provided to it
- Receive Recommended Rule Changes
- Recommend Rules changes to the Board
- Review Advice of other Committees
- IMO Budget Review

Composition:

One (1) *Member representing the Market Operator;*

One (1) *Member representing Transmission Service Provider;*

Four (4) *Members from Distribution Utilities, provided that:*

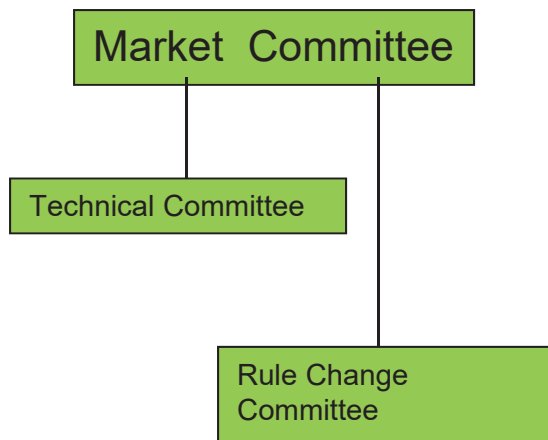
Two (2) *are from Electric Cooperatives; and*

Two (2) *are from by Distribution Utilities*

One (1) *Member from Customers, including but not limited to Suppliers;*

Four (4) *Members from Generation Companies*

Rules Change Committee
(Established)



Purpose: Responsible for reviewing proposed Rule changes and provide advice to the Markets Committee on these changes

- Provide advice whether proposed Rule Changes warrant further study
- Provide Advice to Market Committee via Regular Meetings
- Recommend Rules changes
- Can create special Working Groups with expertise to review proposed Rule Changes

Composition:

One (1) *Member representing the IMO (Chair);*

One (1) *Member representing Transmission Service Provider;*

Four (4) *Members from Distribution Utilities, provided that:*

Two (2) *are from Electric Cooperatives; and*

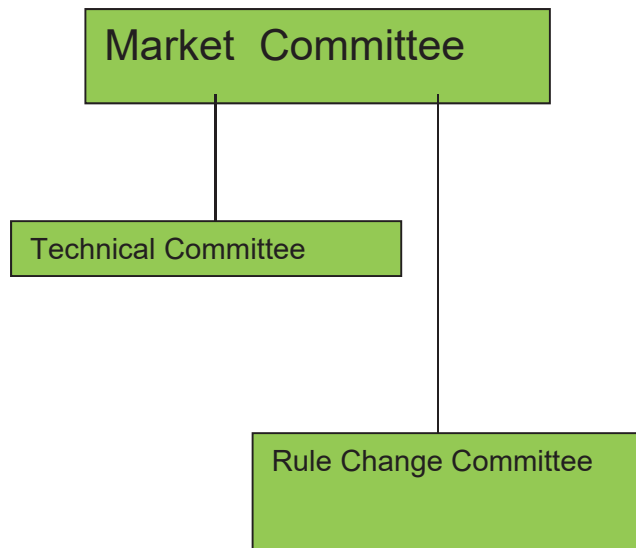
Two (2) *are from by Distribution Utilities*

One (1) *Member from Customers, including but not limited to Suppliers;*

Four (4) *Members from Generation Companies*

Four (4) *Independents*

Technical Committee (Established)



Purpose: Responsible for reviewing the technical performance of the MMS and other related systems and for recommending upgrades/changes

- Monitor Technical Matters related to the WESM
- Provide Technical Reports to MC
- Provide Technical Expertise to MC on
 - IT
 - Metering
- Provide advise if requested to RC
- Provide Technical advice to the IMO
- Create Special Working Groups if required.

Composition:

One (1) *Member representing the Market Operator;*

One (1) *Member representing Transmission Service Provider;*

Four (4) *Members from Distribution Utilities, provided that:*

Two (2) *are from Electric Cooperatives; and*

Two (2) *are from by Distribution Utilities*

One (1) *Member from Customers, including but not limited to Suppliers;*

Four (4) *Members from Generation Companies*

Four (4) *Independents*

Board Structure

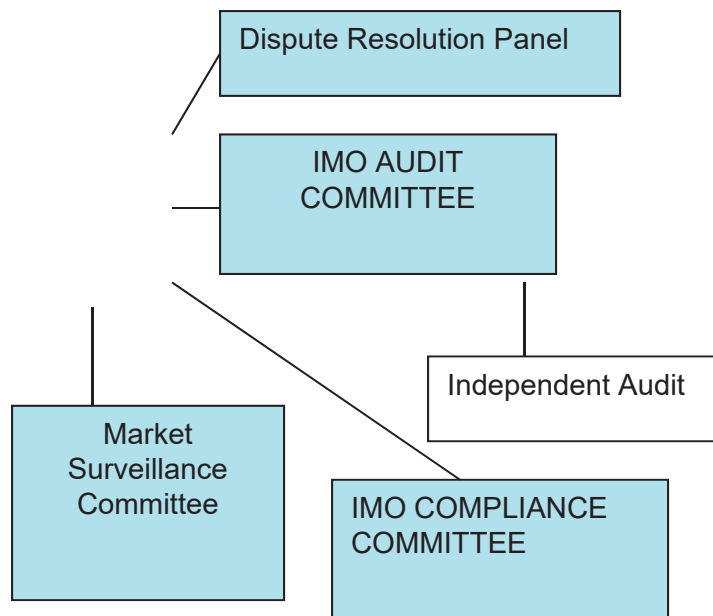
BOARD MEMBERSHIP

- Prescriptive member qualifications
- 6 member Board
- IMO President on Board
- Independent from Stakeholders
- Arms length from Government

Committee Structure

Independent Committees
Reporting to the IMO Board
For Market Oversight

IMO Market Surveillance Committee (Established)



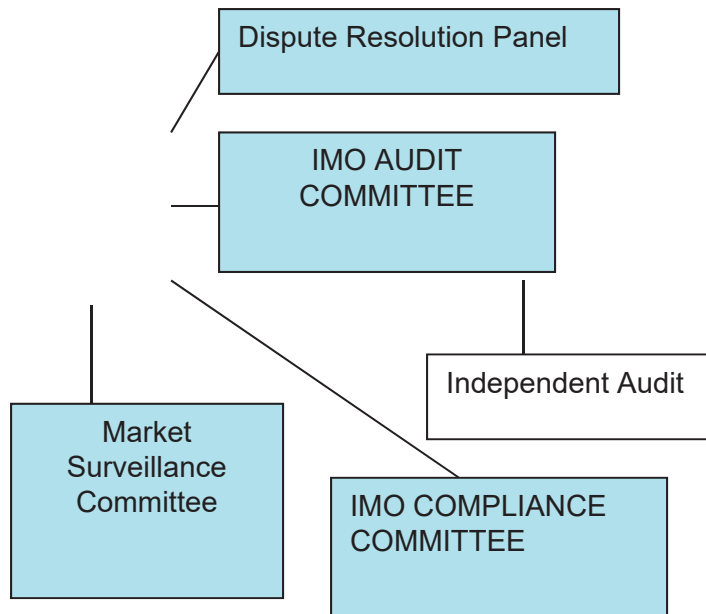
Purpose: Responsible to provide Independent Advice on Participant Behaviours and anti-competitive behaviour

- Provide Advice to IMO Board via Regular Meetings
- Provide Advice on Participant Behaviour
- Provide Advice on Anti-Competitive Behaviour
- Review Advice of other Committees
- Matters Concerning the Spot Market that should be submitted to IMO Board, ERC and DOE
- Recommend Rules changes to the Board to create correct market incentives and / or enhance the ability to meet the WESM objectives

Composition:

Four (4) Members are Independent appointed by the IMO Board

IMO Compliance Committee (Established)



Purpose: Responsible to provide Independent Advice on Breaches of the Market Rules

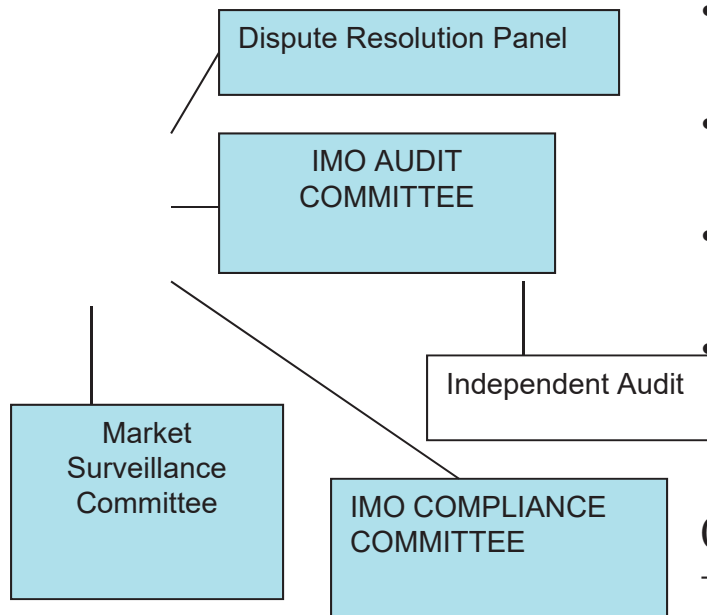
- Provide Advice to IMO Board on Sanctions against the System Operator, Market Operator and Participants
- Review Participant Behaviour against the WESM Rules
- Provide a Mechanism to promote Compliance with the Rules
- Recommend Rules changes to the Board to create correct market incentives and / or enhance to ability to meet the WESM compliance objectives

Composition:

Three (3) Independent Members consisting of:

- One (1) lawyer
- Two experts in Electrical Generation and or other affiliated fields

IMO Audit Committee / IMO Auditor (Established)



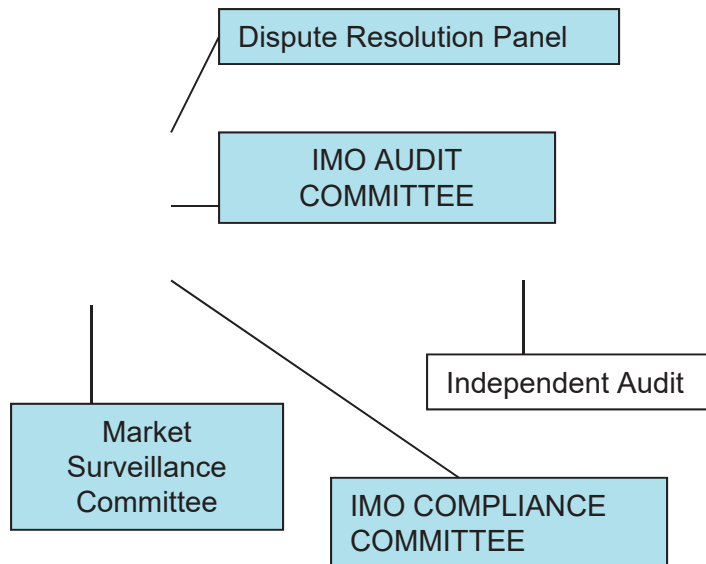
Purpose: Responsible to Conduct Annual Audits of the Market Operator and Provide advice to the IMO Board

- Provide Advice to IMO Board via Regular Meetings
- Conduct Annual Audits on the Market Operator and Settlement Systems
- Test new software being provided by the IMO to participants
- Review IMO Procedures and Manuals at the direction of the Board
- Recommend Rules changes to the Board due to Audit, test, check or other review
- Review Advice of other Committees

Composition:

The Market Auditor is appointed by the IMO Board and is Independent

IMO Dispute Resolution Panel (Established)



Purpose: Responsible to provide a Dispute Resolution mechanism for members of WESM

- Resolve participant disputes about payments
- Resolve participant disputes about Final Statements
- Resolve participant disputes about Contracts between parties wrt application of WESM Rules
- Resolve participant disputes about non-compliance with the WESM Rules

Composition:

All members of the Panel are Independent and approved by the Board – an outsourced function

Conclusion

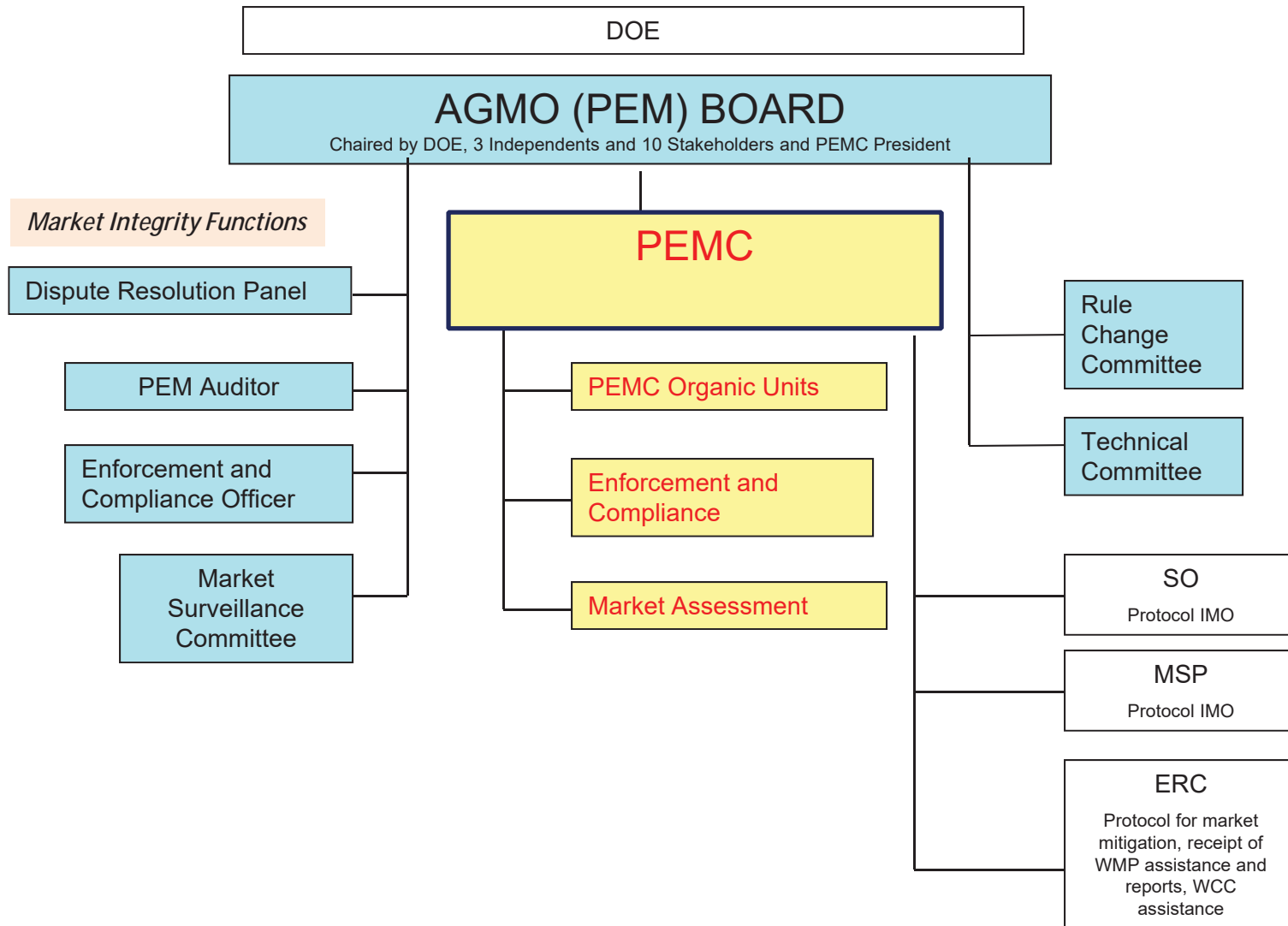
- This is the Structure recommended by the Project Team
- This Structure provides:
 - *A strong and purely independent market system to ensure consumer protection and enhance the competitive operation of the electricity market and promote investor confidence*
 - *a dual governance role of both an Independent Board and a separate Market Participant function*

Transition Plan

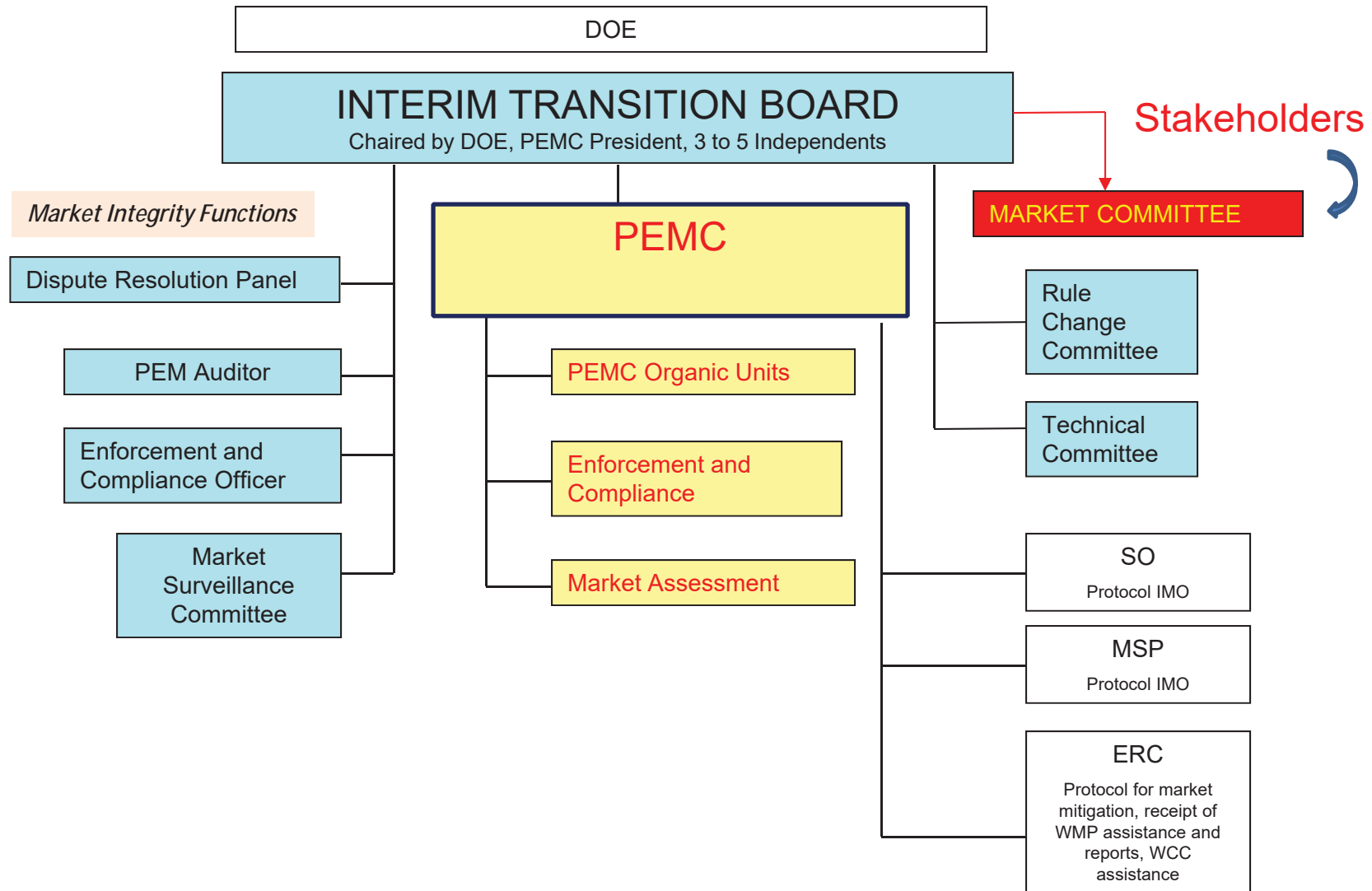
- Creation of the Interim Transition Board, which mandates include:
 - Prepare criteria for selection of new governance members; establish corporate structure: establish remuneration mechanism, decision on tenure
 - Review existing protocols and prepare amendments and new protocols as appropriate
 - WESM Rules development and changes
 - Manuals enhancements and amendments

Transition to IMO

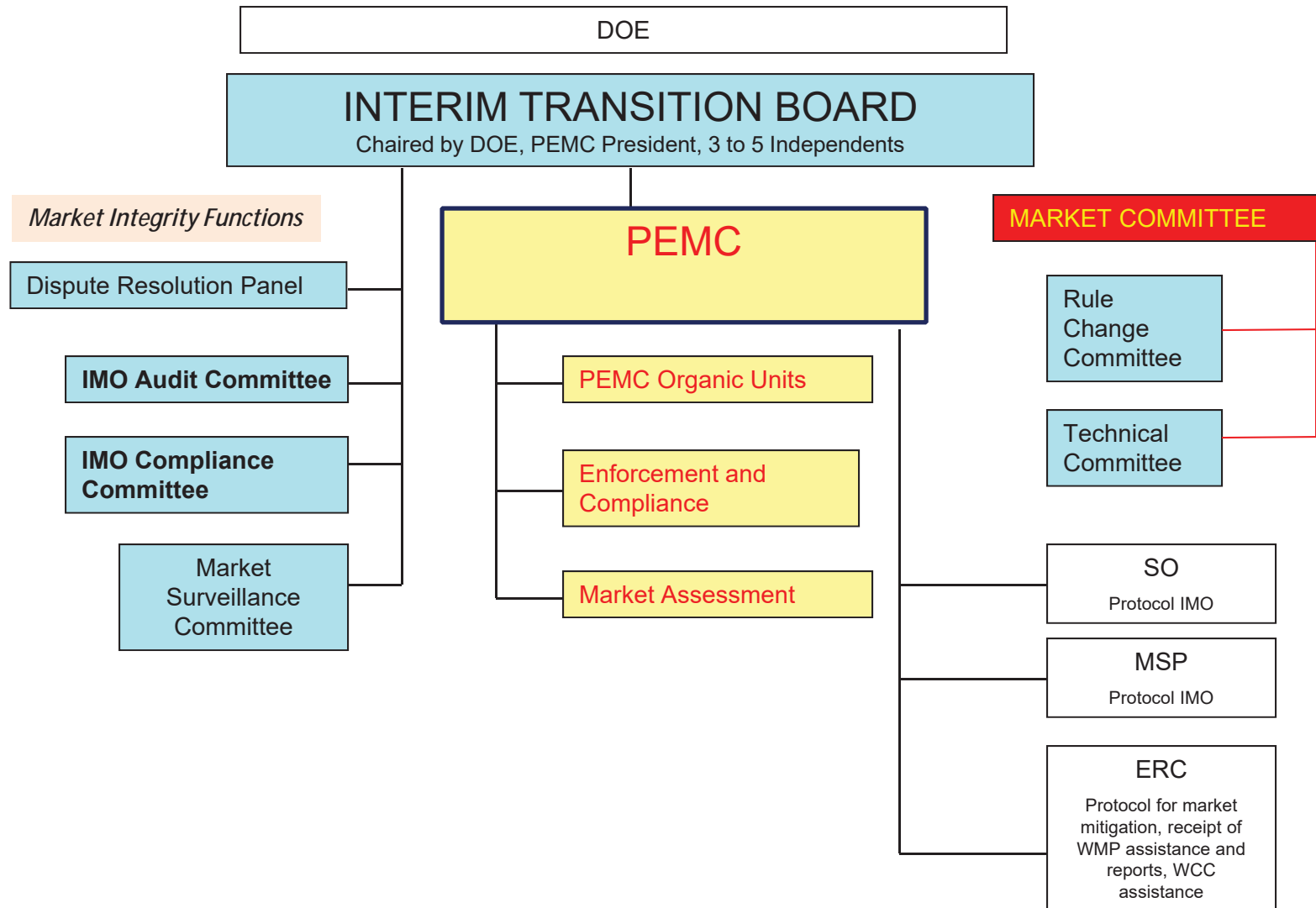
- The following provides a pictorial outline of the transition from the current AGMO PEM Board through the ITB to the final IMO structure

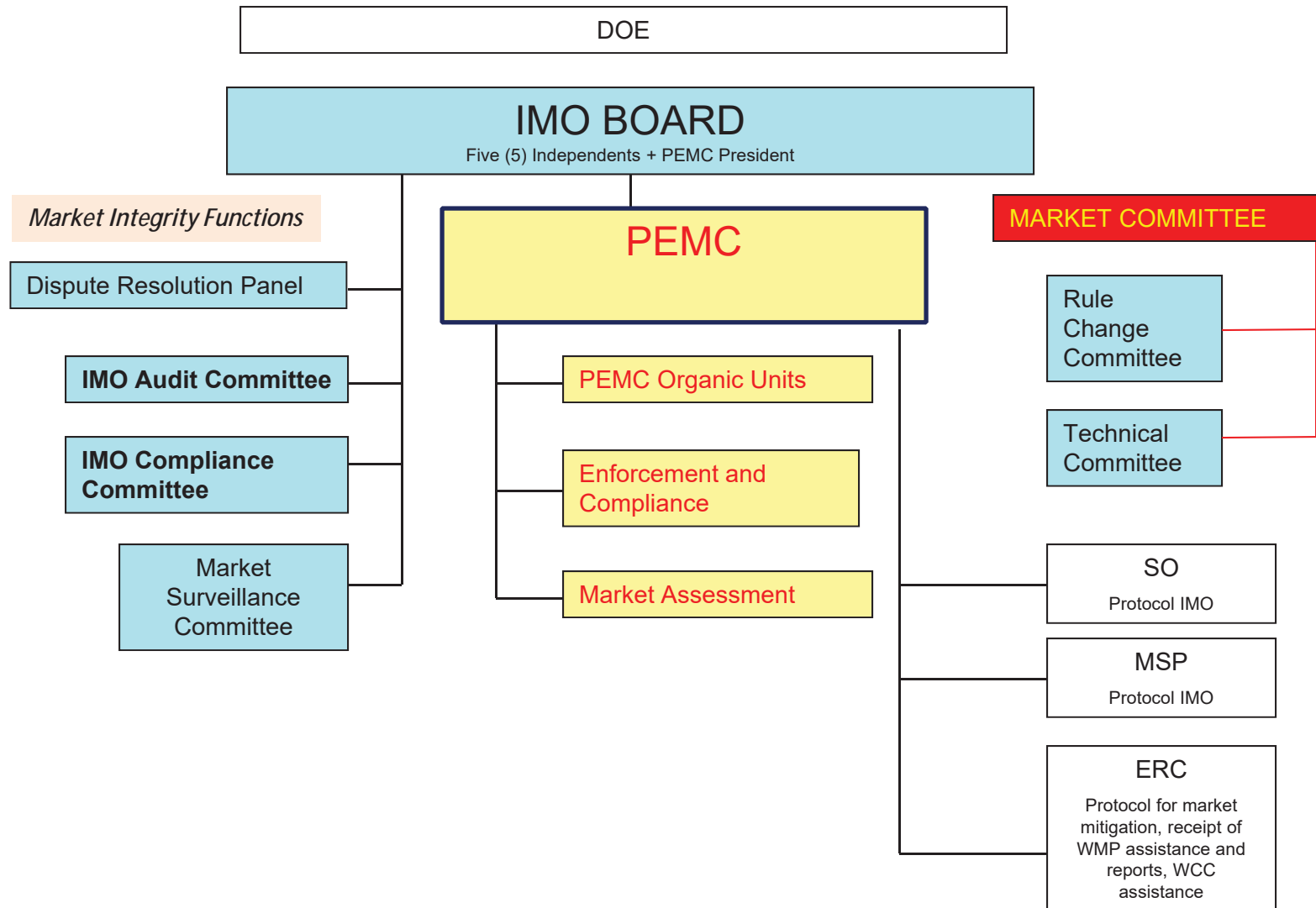


Current AGMO Structure



ITB and Market Committee



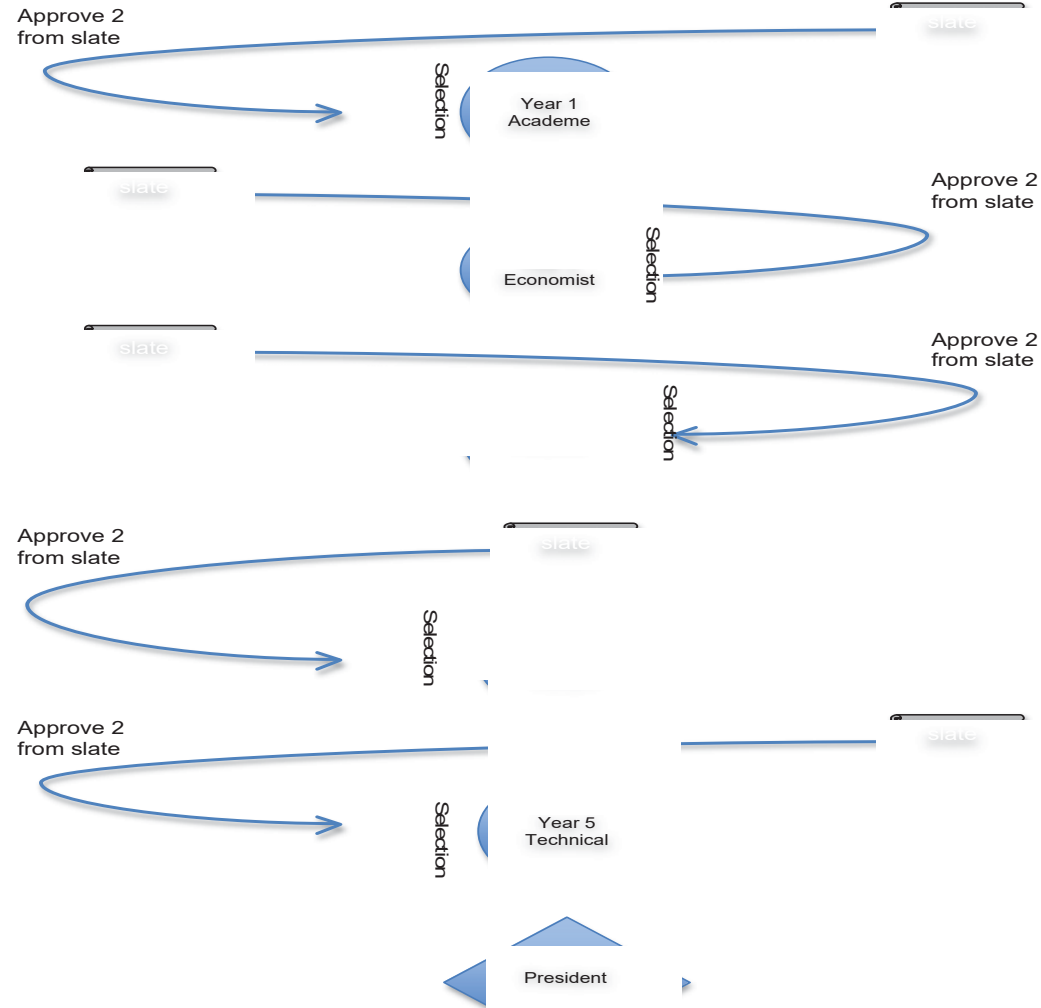
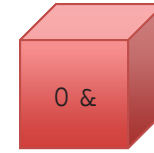
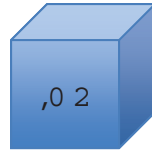
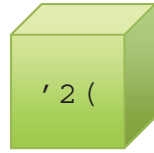


IMO SELECTION

5 INDEPENDENT MEMBERS

ASSUMPTIONS:

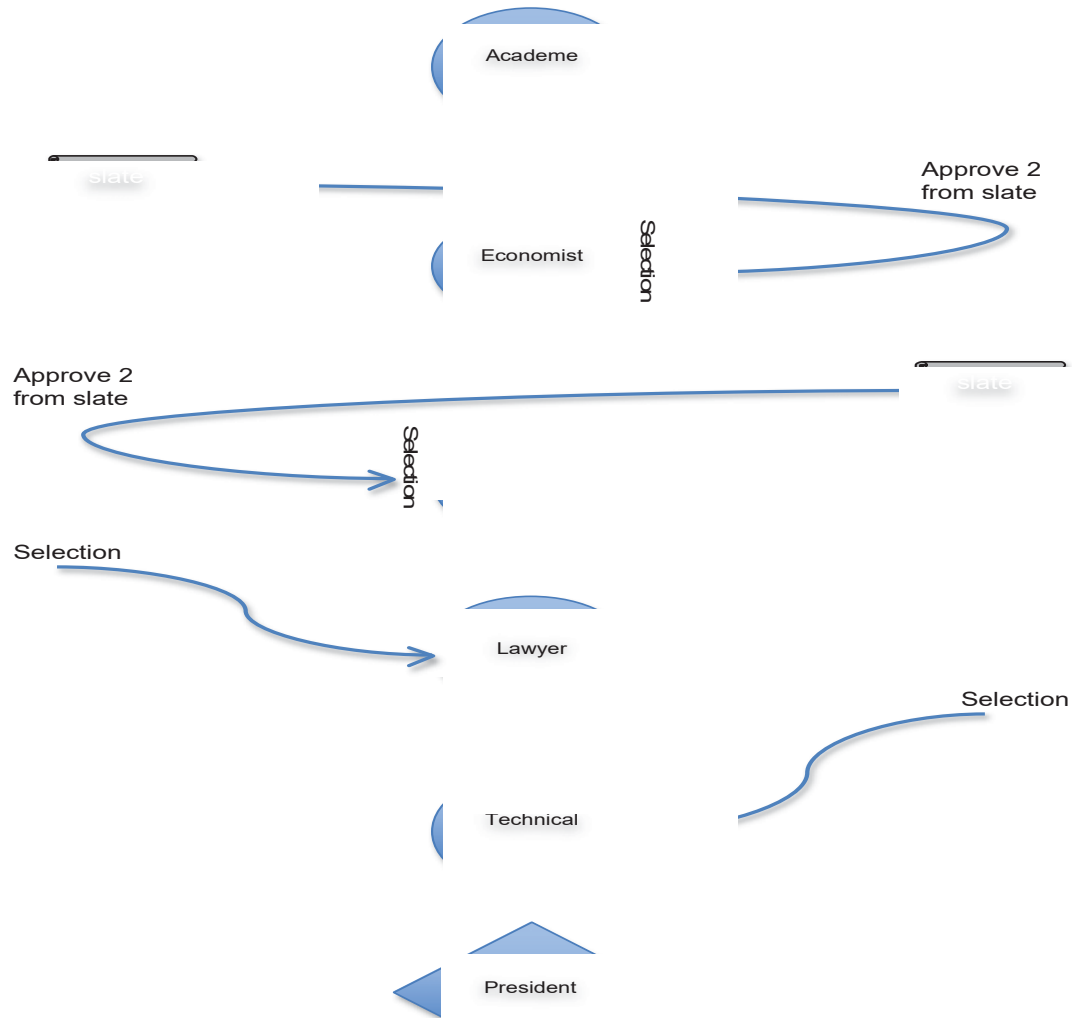
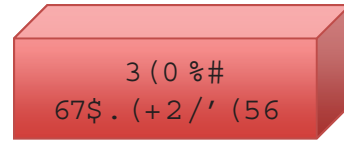
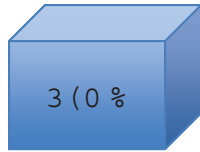
- NO STAKEHOLDER MEMBERS
- THE 5 INDEPENDENT DIRECTORS ARE MEMBERS
- IMO MEMBER TERM IS 5 YEARS (INITIALLY TERM IS STAGGERED)
- PRESIDENT IS NON-VOTING MEMBER



ITB SELECTION

ASSUMPTIONS

- NO STAKEHOLDER MEMBERS
- ITB MAXIMUM 5 INDEPENDENT DIRECTOR MEMBERS
- QUORUM 3 INDEPENDENT DIRECTORS PLUS DOE AND PRESIDENT
- ITB MINIMUM 5 MEMBERS (INCLUDING DOE AND PRESIDENT)
- PRESIDENT IS NON-VOTING MEMBER
- EACH ITB MEMBER SERVES THE FULL TERM OF THE ITB
- MARKET COMMITTEE WILL BE ESTABLISHED CONCURRENTLY WITH ITB ESTABLISHMENT



THE END