NEW YORK INDEPENDENT SYSTEM OPERATOR

Annual Report on Governance
to Federal Energy Regulatory Commission

In its "Order Accepting Proposed Revisions to Independent System Operator Agreement" (Sept. 13, 2004, Docket No. ER04-1024-000) the Commission accepted the NYISO's proposal with regard to the participation of Demand Response Providers (DRPs) and Distributed Generators (DGs) in its shared governance structure. In the Order, FERC also required the NYISO to monitor the effect of the proposed changes on voting and governance and to report annually on its findings. Since the FERC Order was issued, DRPs and DGs have neither been admitted to, nor rejected from, participation in NYISO governance. To date, there is only one application pending from a potential member in these stakeholder groups. Therefore, the NYISO has no findings to report on the impact of the participation of DRPs and DGs in its governance structure.

At this time, however, the NYISO has operated with essentially the same governance regime for five years and an assessment of its governance in the light of this experience should prove instructive. This assessment will focus on some issues that have risen to prominence since the formation of ISOs and RTOs in this country, including: whether the various forms of ISO/RTO governance can support fair and efficient markets; whether the competing interests of market participants can be represented effectively and balanced fairly; and, particularly, whether the costs of operating an ISO or an RTO can be managed effectively through its governance process.

<u>The Shared Governance Process</u> The NYISO's basic governance structure and processes remain substantially unchanged since the organization's inception in 1999. It operates with a shared governance -- that is, an independent 10 member Board of Directors and a Management Committee comprised of all market participants share decision-making authority in almost every aspect of the NYISO's management and operations. The shared governance concept and implementation resulted from early adverse FERC governance decisions and FERC/ISO mediated settlement discussions. The essential features of the NYISO governance are:

Three decision-making market participant committees comprised of five sector groups of roughly equal size. Each sector is ostensibly populated by stakeholders with similar market interests and concerns.

Generally a "1/N" scheme or "one entity/one vote" voting scheme within the market participant sectors

A 58% passage threshold for the Management Committee to propose tariff amendments to the Board of Directors and for any of the decisional committees to take other actions. The hope was that this threshold would strike a balance between requiring a reasonable degree of consensus for enacting changes and creating gridlock in the decisional committees.

Board concurrence for amendments filed under section 205 of the Federal Power Act

An internal appeals process in which the NYISO Board of Directors serves as an internal, quasi-judicial arbiter of disputes over actions by the Committees with the power, where appropriate, to issue stays.

The underlying objectives of this seemingly cumbersome governance structure were relatively straightforward. The structure of the market participant committees, and the voting rules, were crafted to strike a balance among the various economic interests in the NYISO administered markets. The composition of the independent Board, and its relationship to the market participant committees, were designed to foster an internal system of checks and balances.

The Results The NYISO's budgetary process is unique in that its budget is prepared by its market participants, with the help of its management and staff. The budget goes through the normal participant committee process, until it is approved by the participants and then forwarded to the independent Board. In this way, the folks who pay the bills formulate the budget, providing for maximum critical scrutiny by the very people who must ultimately bear its cost. Although the independent Board has the final say on all financial matters, including the budget, in five years the Board has made only one minor adjustment to the annual budget; an adjustment that was accepted by the market participants. The NYISO operates with the smallest annual budget, on a revenue requirements basis, of all ISOs and RTOs in the Country.

Certainly the central consideration in ISO administered wholesale markets is to assure the very competitiveness of those markets. The NYISO's shared governance contributes constructively to this effort. Tariff changes ordinarily require concurrence of the Management Committee and the Board of Directors. The sectoral representation of all market participants, large and small, in the stakeholder committees was designed to achieve a balance of interests. The independence of the Board and its strict adherence to a rigorous Code of Conduct provides assurance that it will not knowingly tilt towards any individual economic interest.

A review of the voting history of the Management Committee and Board actions related to market participant decisions since 2000 indicates that these underlying objectives have basically been achieved. One quantitative measure shows that positions supported by suppliers (the Generator Owners sector and others) prevailed in 49 out of 90 votes over the past five years. Another indicator is that over 100 filings have been made pursuant to Section 205.

Beyond budgetary matters, the Board has shown admirable restraint on all market design and governance issues by not substituting its judgment for that of the market participants except when clearly necessary. Out of 20 appeals to the Board of Management Committee decisions, the Board has overturned the Management Committee only twice.

The effectiveness of the NYISO governance is evident in the state of the New York market. It is an active and liquid market which has matured steadily to reflect the direction of the Commission and the desires of its market participants. As a practical matter, the NYISO's process for addressing market issues mandates an extensive exchange of information and ideas among its major constituents: customers, market participants, staff and Board. The voting threshold and the 205 filing requirements have created a corporate culture of consensus building and compromise.

For the foregoing reasons, we believe that the NYISO's governance structure should be continued and there is no need for the Commission to intervene in the process at this time.

April 25, 2005