

TO: NAESB Board of Directors
Jim Buccigross
Rae McQuade

FROM: Jay Costan *Jmc*

DATE: July 14, 2002

SUBJECT: Review of Proposed Quadrant Procedures for the Wholesale Electric
Quadrant

This will set forth my opinion on whether the proposed Quadrant Procedures recently adopted for the Wholesale Electric Quadrant ("WEQ") meet the test of being "not inconsistent with the Certificate and Bylaws of NAESB" and, thus, are eligible for acceptance by the NAESB Board of Directors.

As explained below, I conclude that the proposed WEQ Quadrant Procedures meet the applicable test, provided that they are interpreted and applied in such a way as not to exclude any entity with a legitimate business interest in the wholesale electric sector from joining a Segment and Sub-segment of the WEQ and running for a seat on the Board of Directors or Executive Committee from such Segment and Sub-segment. Because of the way in which the WEQ Formation Group has identified particular Sub-segments, there is a real danger that "service providers" and transmission organizations (*i.e.*, RTOs, RROs, ISOs, IMO and the like) might be excluded from the WEQ, unless the proposed Quadrant Procedures are interpreted and applied in an inclusive way, as required by NAESB's Certificate and Bylaws.

A. Background

After a series of meetings over the last four months, the WEQ Formation Group adopted proposed Quadrant Procedures at its July 9-10 meeting in Wilmington, Delaware. Because of the large number of participants in the WEQ Formation Group and the contentiousness of the debate at times, the proposed Quadrant Procedures (attached as Exhibit A) are more in the nature of an outline than a detailed road map for governance of the WEQ.

Unlike the Quadrant Procedures developed by the other Quadrants of NAESB, the WEQ Procedures are quite explicit in dividing each Segment into Sub-segments and designating the number of seats on the Board and Executive Committee that are allotted to each Sub-segment. There are no "at large" seats in any of the Segments. In response to "inclusivity" concerns raised at the July 9-10 meeting, the consensus expressed by the WEQ Formation Group was that the Sub-segments are intended to be

inclusive. In other words, any entity with a legitimate business interest in the wholesale electric sector should be able to joint at least one Segment and Sub-segment through a process of self-selection and be considered for seats on the Board and Executive Committee from that Segment and Sub-segment.

In addition to the designation of Segments and Sub-segments, the proposed Quadrant Procedures include seven "Procedural Elements," which cover various issues relating to participation in the WEQ. For example, one of these Procedural Elements (Item No. 2) describes a "sunrise" requirement with respect to the continuing effect of the designation of Sub-segments. It requires that the "Sub-segments may be revisited at any time, but no later than three years." It also states that "changes to sub-segments require 75% affirmative from within the segment." Another of the Procedural Elements (Item No. 4) states that "all WEQ participants will pay a fixed annual payment," which is intended to cover the expected budget for administering the standards development process. Finally, Item No. 7 acknowledges that the vote taken on approval of the proposed Quadrant Procedures at the WEQ formation meeting was meant to approve such procedures as a package, and that "no changes of any kind can be made to this agreement without prior agreement of parties."

One of the objectives relating to formation of the WEQ is to allow the Quadrant to be up and running and to hold elections so that it can select Board and EC members for the various Segments before NAESB's September 23, 2002 Annual Meeting and Board Meeting.

B. Analysis

Despite the "bare bones" nature of the proposed WEQ Quadrant Procedures, the procedures are sufficient to meet the minimum requirements of the Certificate and Bylaws. All that is required is that the initial Quadrant Procedures designate (i) the number of Segments within the Quadrant, (ii) the definition of each Segment, and (iii) the number of seats on the Board and EC for the Quadrant and each Segment. The WEQ's proposed procedures satisfy these minimum requirements.

In addition, although the "Procedural Elements" are presented in a fairly sketchy fashion, they are sufficiently intelligible and non-specific as to be susceptible to an interpretation that is not inconsistent with the Certificate and Bylaws. For example, the requirement in Item No. 4 for the fixed annual payment does not suggest that the payment would be any different from, or in lieu of, NAESB's annual dues. Similarly, the statement in Item No. 7 that the procedures cannot be changed without prior agreement of the parties is susceptible to the interpretation that the restriction on changes is limited to modifications prior to consideration by the NAESB Board for acceptance. Once the Quadrant Procedures are accepted, they can be changed by a vote of the voting membership of the WEQ (dues paying members per Article 1, Section 1.1 of the Bylaws) or as otherwise provided through actions by the Voting Members of the WEQ.

What is problematical about the proposed WEQ Procedures is the degree to which the Quadrant determined to define Sub-segments and allocate seats on the Board and the Executive Committee among such Sub-segments. Because there are no designated "at large" seats, all persons or entities with a legitimate business in the wholesale electric sector must be able to identify themselves with one or more of the Sub-segments. Because the Sub-segments are defined in a very shorthand fashion, without any "catch-all" provision for other interested parties, the WEQ's approach raises concerns about compliance with NAESB's objective to promote broad-based membership.

Specifically, the definition of the Sub-segments implicates at least two provisions of NAESB's governance documents:

1. Article IV, Section 1 of the Certificate, which states that "the requirements for becoming a member of NAESB shall facilitate to the greatest extent possible a wide-based membership consistent with NAESB's fiscal requirements . . ."
2. Article 2, Section 2.2 of the Bylaws, which sets forth certain guiding principles of NAESB, including the principle of "Inclusivity", which requires that "all interested parties have the opportunity to participate in the activities of the standards organization and to join NAESB. All participants should be identified and associated with a Segment and Quadrant."

In practical terms, the combined effect of these provisions is that any person or firm with a legitimate business interest in a given Quadrant should be permitted to join at least one Segment of that Quadrant.

Two obvious candidates for membership in the WEQ are not specifically identified in the designation of Sub-segments: (i) "service providers," who happen to have their own Segments in each of the other Quadrants of NAESB; and (ii) transmission organizations like RTOs, RROs, ISOs, and IMOs. If the proposed WEQ Procedures were interpreted to exclude either of these possible candidates from membership in the WEQ, the procedures would not be consistent with the NAESB Certificate and Bylaws.

On one level, the lack of specific mention of service providers and transmission organizations is troubling, particularly in light of the apparent specificity of the Sub-segment designations. On the other hand, the WEQ Formation Group was of the view that no one was intended to be excluded from voting membership in the WEQ.

To dispel any ambiguity, in order for the proposed WEQ Quadrant Procedures to pass muster under the NAESB Certificate and Bylaws, they must be interpreted and applied in such a way that service providers and transmission organizations be able to join at least one Segment and Sub-segment, and run for seats on the Board and Executive Committee from such Sub-segment. Because transmission organizations, by their very nature, appear to be aligned with the Transmission Segment, the proposed

WEQ Procedures must be interpreted and applied to recognize a legitimate business interest by RTOs, RROs, ISOs, and IMO in the Transmission Segment.¹

Service Providers, on the other hand, are somewhat different. For the other Quadrants of NAESB, the Service Provider Segments are populated by a variety of different service firms and vendors, including consulting firms, software development firms, law firms, dispute resolution organizations, metering firms and accounting/audit firms. Since the WEQ has determined not to create a separate service provider Segment, and since service providers generally can be viewed as having a legitimate business interest in each of the Segments of the WEQ, they must be given a broad set of choices for membership. Accordingly, in order to pass muster, the proposed WEQ Procedures must be interpreted and applied to recognize a legitimate business interest by service providers in any of the Segments or Sub-segments designated in the WEQ Quadrant Procedures. Provided that the WEQ Quadrant Procedures are interpreted and applied as outlined above as to transmission organizations and service providers, I am of the opinion that they are not inconsistent with the NAESB Certificate and Bylaws.

While the above interpretation parallels the consensus view expressed at the WEQ formation meeting that it was the intent of the proposed WEQ Quadrant Procedures that no firm with a legitimate business interest in the wholesale electric sector be excluded from membership in a Segment of the WEQ, the WEQ is free to clarify or modify its Quadrant Procedures to address in more specific detail the specific Segment(s) and Sub-segment(s) in which transmission organizations and service providers can be Voting Members. Once the Board accepts the proposed Quadrant Procedures, the governance of the WEQ will be vested in the Voting Members of the Quadrant. Given the bare-bones character of the proposed Quadrant Procedures, modifications and additions to the Procedures by the Voting Members would be expected to make them more understandable and serviceable for the Quadrant.

To take account of the opinion expressed above, and, at the same time, recognizing the inherent right of the WEQ to clarify or modify its Quadrant Procedures, I have prepared a resolution for consideration by the Board that makes acceptance of the proposed Quadrant Procedures for the WEQ contingent on the following conditions:

- (1) that on or before August 30, 2002, the Voting Members of the Wholesale Electric Quadrant may amend or clarify the Quadrant Procedures with respect to specific Segments or Sub-segments for which service providers and transmission organizations will qualify for membership; or
- (2) absent such clarification or modification, the proposed Quadrant Procedures will be interpreted and applied so that "service providers" will

¹ The lack of specific mention of transmission organizations in the designation of Sub-segments is puzzling. This is particularly true given the fact that transmission organizations have actively participated in WEQ formation and, indeed, at one point were advocating creation of a separate transmission organization Segment. The failure of that effort in no way detracts from transmission organizations' legitimate business interest in the WEQ.

be viewed as having a legitimate business interest in any of the Segments or Sub-segments of the WEQ designated in the proposed Quadrant Procedures, and transmission organizations will be viewed as having a legitimate business interest in the Transmission Segment.

The August 30, 2002 clarification/modification date was selected because of the need to conduct WEQ elections in anticipation of the September 23, 2002 Board meeting. If changes are made to the Quadrant Procedures by August 30, the NAESB office will still have sufficient time to conduct elections before the Board meeting.

Attachment



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TO: NAESB Members and Interested Industry Participants
FROM: Rae McQuade, Executive Director
RE: Wholesale Electric Quadrant Formation Decisions
DATE: July 9 and 10, 2002

The below Caucus report was adopted by the Wholesale Electric Quadrant Formation Group on July 9 by a vote of 73 to 3 in the room and with all participants on the phone in agreement, excepting item 3 of the procedural elements. Item 3 was adopted through a separate vote taken on July 10, with a vote of 64 to 2 in the room and 1 in opposition on the phone.

IOU Definition: An investor owned entity who has substantial business interest in owning and/or operating any two of the following three asset categories -
 -- generation, transmission, distribution.

SEGMENT	SUB-SEGMENT	# of SEATS¹
Generation:	Muni/Coop	1
	Fed/State/Provincial	1
	IOU	2
	Merchant	2
Transmission:	Muni/Coop	1
	Fed/State/Provincial	1
	IOU	2
	ITC	2
Distribution/LSE:	Muni/Coop	2
	IOU	2
	Competitive Retailer (not available to muni/coop, IOU or IOU affiliates)	1
	Other	1
	(not available to muni/coop, IOU or IOU affiliates)	
Marketers/brokers	Muni/Coop	1
	Fed/State/provincial	1
	Not IOU affiliated	2
	IOU Affiliated	2
End user	End Use (also in another segment)	1
	Regulator	1
	Residential/Commercial	1
	Large Industrial (not in other segments)	2
	End Use (Self Generation)	1

¹ The number of seats refers to the number of seats the sub-segment holds on the Board and on the EC.



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Procedural Elements:

1. Entities may participate in multiple segments within WEQ.
2. "Sunrise." Sub-segment principles will continue. Sub-segments may be revisited at any time, but no later than three years. Changes to sub-segments require 75% affirmative from with segment, subject to other minimum participation and deadline requirements.
3. RTO/ISO/IMO participation. All RTOs/ISOs and comparable Canadian entities are strongly encouraged to participate in the standards drafting process from conception through drafting to the ratification stage. Furthermore, a Technical Advisory Council comprising those jurisdictionally-approved entities will be formed to provide technical support and counsel to the NAESB Board and EC. The Council will have the obligation to provide a technical assessment, evaluation and recommendation to the EC on all standards relevant to the grid system and RTO market operations. Furthermore, the Council has an affirmative obligation to apprise the EC of a given standard's feasibility.
4. Fixed Annual Payment. All WEQ participants will pay a fixed annual payment. Annual payment should provide for required budget to administer the process to develop standards. Exceptions must be approved by the NAESB Board.
5. Sub-segment population. NAESB WEQ will establish minimum number for populating sub-segments within a segment, including a deadline for such population.
6. Consultants. Contract consultants may be considered as an option for standards drafting, contingent on identification of need and availability of sufficient funding.
7. Final comprehensive affirmation. This vote will reflect only the elements of this settlement. No changes of any kind can be made to this agreement without prior agreement of parties.

The below motion was approved on July 10, with a vote of 71 to 2 of the room, and 1 in opposition on the phone.

Approve and forward the package to the Board for initial WEQ quadrant procedures for the formation of the WEQ, including the above amended motion regarding RTO participation [item 3 of the procedural elements]. Should the Board not approve the initial quadrant procedures, it is requested to respond in writing to the WEQ formation group with its reasons for denying the initial quadrant procedures.



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Prior Preliminary Agreements Reached

Segments Identified (5/9/02):

- Transmission
- Generation
- Marketers/Brokers
- Distribution/Load Serving Entities
- End Users

Segment Definitions (5/9/02 and 5/29-30):

- **Transmission:** Any entity engaged in the activity of owning, operating or controlling bulk electric transmission facilities in North America.
- **Generation:** Any entity engaged in the activity of owning and/or operating wholesale electric generation facilities in North America.
- **Marketers/Brokers:** Any entity engaged in the activity of buying and selling wholesale electric power in North America on a physical or financial basis.
- **Distribution/Load Serving Entities:** Any entity engaged in the activity of electric power sales and/or delivery to end use customers in North America, or any entity designated to represent a distribution utility.
- **End Users:** Any entity in North America that is an end use consumer of electricity, engages in electricity regulation, or represents customer interests, or any entity designated to represent an end user.

Segment Seats (6/21/02):

For the Wholesale Electric Quadrant representation, there should be 6 seats per segment for the Board of Directors and 6 seats per segment for the Executive Committee.