

Memorandum

To: ISO Board of Governors

From: Nancy Saracino, Vice President, General Counsel and Corporate Secretary

Date: March 17, 2010

Re: *Decision on Updating Corporate Documents and Policies*

This memorandum requires Board action.

EXECUTIVE SUMMARY

Over nearly twelve years of operation, the governance structure of the California Independent System Operator has changed significantly. The initial Board of Governors, which consisted of stakeholder representatives, was converted by statute to an independent Board appointed by the Governor of California. Then, following litigation with the Federal Energy Regulatory Commission, the process for selecting Board members was revised. Finally, the entity that the Legislature originally charged with overseeing the ISO, the Electricity Oversight Board (EOB), has been defunded and disbanded.

While the laws have changed and the ISO has matured as an organization, eight key corporate documents have remained largely untouched since their original development. Many contain vestiges of the ISO's original stakeholder board or assume an active EOB. Accordingly, Management is recommending changes to these corporate documents to ensure that they reflect changes in law, as well as the current activities of the ISO and best practices for corporations.

MOTION

Moved, that the ISO Board of Governors approves the amendments to the documents listed below, as presented with the memorandum dated March 17, 2010:

- *Amended & Restated Bylaws*
- *Open Meeting Policy*
- *Information Availability Policy*
- *Board Selection Criteria*
- *Governors Code of Conduct*
- *Employees Code of Conduct and Ethical Principles*
- *Corporate Governance Principles*
- *Compliance Program Policy*

The revisions to the Employees Code of Conduct and Ethical Principles will be effective May 1, 2010.

DISCUSSION AND ANALYSIS

1. Bylaws

Management is recommending amendments to the ISO's bylaws, which have been unchanged since April 2001, in order to comply with current law and corporate practices. The most significant proposed revisions are:

- revising the statement of corporate purposes to reflect the ISO's full scope of responsibilities under AB 1890,
- updating provisions about selection of Governors and their terms of office. The bylaws currently reflect the state law on Board selection as of January 2001 (AB5X), but not the subsequent changes from October 2001 (SB47). The bylaws should be amended to conform to the current statutory requirements.
- deleting provisions that require action by a state oversight authority. Several provisions, including the appointment of a Chair and state advisory representatives, and also provisions about amending the bylaws themselves, assume a functioning Electricity Oversight Board and are based on the prior governance structure for the ISO. Because the EOB no longer exists, these provisions are being deleted. Although the bylaws currently specify that some of these amendments require approval from the EOB, the Corporations Code allows the ISO to amend these bylaws where the EOB is unable to act.
- Eliminate a separate committee to administer Alternative Dispute Resolution (ADR). The Board has not had a separate ADR committee for many years, with this function being assigned to the Audit Committee. This function will remain assigned to the Audit Committee under its charter, pending a proposal to the Board for a tariff amendment that would – consistent with the practices of other ISOs and RTOs – relieve the Board of this responsibility and place it under Management's supervision.

2. Open Meeting Policy

The ISO's Open Meeting Policy, which governs the Board's open meeting practices, has remained unchanged since its adoption in 1998. As a corporation, the ISO is not subject to the Bagley-Keene Open Meetings Act that requires state boards and commissions to hold open meetings. However, in 2003, the state legislature enacted a statute that requires the ISO to provide public notice of and access to its meetings. Specifically, section 345.5 of the California Public Utilities Code requires that the ISO:

[m]aintain open meeting standards and meeting notice requirements consistent with the general policies of the Bagley-Keene Open Meetings Act . . . and affording the public the greatest possible access, consistent with other duties of the corporation.

The statute recognizes that the policy in place meets this standard, and also prohibits the ISO from amending the policy in ways that would make it “less consistent” with the Bagley-Keene Act than the policy in effect in 2002.

Management is recommending revisions to the Open Meeting Policy to:

- modify the introductory language that summarizes the purpose of the policy, which is now out of date, to reflect the requirements of the governing statute;
- supplement the provision stating members of the public are not required to register their names in order to attend an open meeting by adding an exception for compliance with facility security requirements;
- delete the prohibition against conducting an emergency meeting in executive session by teleconference to allow such meetings to occur when needed and only where the ISO would otherwise have the authority under the Open Meeting Policy to conduct an executive session meeting; and
- delete a footnote that describes expectations about the meetings of the Market Surveillance Committee – in particular, that the MSC would meet mainly in executive session – because these expectations have turned out to be erroneous. The MSC is still subject to the Open Meeting Policy and complies with its requirements.

These proposed amendments clarify and correct the policy but do not make it any “less consistent” with the Bagley-Keene Open Meetings Act than the policy in effect in 2002.

3. Information Availability Policy

The Information Availability Policy is subject to the same state statute as the Open Meeting Policy. It requires the ISO to “provide public access to records consistent with the general policies of the California Public Records Act . . . and affording the public the greatest possible access, consistent with the other duties of the corporation.” Public Utilities Code §345.5(b)(4). The statute recognizes that the currently effective policy complies with this requirement, and also prohibits the ISO from amending the policy in a way that would make it “less consistent with the California Public Records Act.”

Management is recommending revisions to the Information Availability Policy to:

- modify the “statement of policy” regarding public access to information, which is now out of date, to match the requirements of the governing statute;

- add an exemption from disclosure for personnel information to match the exemption in the California Public Records Act;
- delete a provision that creates a right of appeal to the Electricity Oversight Board of any decision to deny disclosure of information;
- delete appendices that purported to summarize tariff provisions on confidentiality, which were out of date, with a link to the currently effective tariff; and
- delete a provision regarding fees for subpoenaed records, as these fees are governed by statute.

These proposed amendments clarify and correct the policy but do not make it any “less consistent” with the California Public Records Act.

4. Board Selection Criteria

The Board adopted selection criteria for new Governors in 2005 as part of resolving a governance dispute between the ISO, the State of California and FERC. The ISO filed the selection criteria with FERC, which issued a declaratory order approving the criteria as sufficient to meet the independence requirements found in FERC’s key orders on the subject – Orders No. 888 and 2000. The ISO made minor revisions to these criteria in 2006.

The recommended revisions center on the conflict of interest restrictions. The provision includes an overly-broad prohibition of investments in any company in the electricity business anywhere in the United States. This broad prohibition is not required under FERC’s rules, and Management recommends that it be modified to prohibit investments in California ISO market participants and their affiliates. This change would also be consistent with state rules, which have been incorporated into the document as well.

Along the same lines, the currently-effective version prohibits employment affiliations with any company in the electricity business anywhere in the United States. This restriction should be modified to electricity companies that do business within the Western Electricity Coordinating Council.

Management also proposes to allow a candidate who holds prohibited investments or a prohibited employment relationship to agree to resolve those issues after being selected for office. As the document is worded now, it prohibits the search firm from considering candidates who have prohibited financial investments or relationships. This too is unnecessarily restrictive.

5. Employees Code of Conduct and Ethical Principles

The Employees Code of Conduct and Ethical Principles currently consists of two separate documents – a narrative statement of ethical principles drafted in 2007, plus a legalistic and code of rules from startup, with some duplication between the two. Management is proposing to combine the two documents and simplify the rules. In particular, the Management proposes to rewrite the rules regarding investments (to adopt the federal regulation that governs employees

of RTOs and links to the independence requirements for ISOs and RTOs), and gifts (to add specificity), as well as to update or eliminate obsolete references.

In addition, Management proposes to move material about some of the legal requirements that apply to the ISO to a new document – a Guide to the Employees Code of Conduct and Ethical Principles. The Guide will be the responsibility of Management, so that it can be updated as legal requirements change. The Guide will also include explanations of the rules in the employees code, using clearer language than the legalistic document that exists now.

Under the proposed revisions, the employees code will no longer apply to contractors. The issue of contractors compliance with corporate policies, including the code of conduct, is now addressed through the Compliance Program Policy.

To allow adequate time to roll out the new code and the Guide to ISO employees, Management recommends that the new employees code become effective May 1, 2010, and that the existing code remain effective until then.

6. Governors Code of Conduct

As with the Employees Code of Conduct and Ethical Principles, Management recommends revising the Governors Code of Conduct to replace the current legalistic style with much clearer language. Management also recommends substantive changes to reflect applicable legal requirements about independence of the Board. The current version, which has not been amended since 1999, contemplates a stakeholder Board and permits investments and engagement with market entities that are prohibited under the federal and state laws. Management is proposing new rules about conflicts of interest and investments that are consistent with the legal requirements for board independence.

7. Corporate Governance Principles

The Corporate Governance Principles, which were adopted in 2005 and amended in 2006, describe the framework for governance of the ISO. It summarizes the roles and responsibilities of both the Board and Management, and sets expectations for Governors' conduct and procedures for Board meetings.

Management is proposing amendments to

- align the document with the proposed revisions to the bylaws as well as other changes to corporate governance that have occurred since 2006. These changes include the elimination of certain committees and, more recently, direct oversight of market monitoring as required by FERC Order No. 719;
- add an introductory section to clarify the purpose of the document and its relationship with other corporate documents; and

- reorganize the sections of the document to focus more clearly on the Board of Governors, its responsibilities, procedures and expectations for Governors.

8. Compliance Program Policy

Finally, the ISO's Compliance Program Policy, which was adopted in January 2007, sets the policy and requirements for the ISO's compliance program. Management is recommending revisions to ensure that this policy is consistent with corporate best practices and reflects the experience that Management has gained in three years of administering the compliance program.

The most significant change is to add an emphasis that goes beyond legal compliance to focus on doing business ethically and with integrity. This enhancement will bring the ISO's compliance policy in line with best practices for corporations that are subject to Sarbanes-Oxley.

Management also recommends revisions to

- require Management to periodically assess risk of non-compliance with laws and regulations;
- require that contractors comply with corporate policies to the extent practicable;
- refine requirements related to reporting violations to authorities so that the ISO is required to report only actual violations of the law;
- make employees accountable for reading and understanding the code of conduct; and
- refine the responsibilities of the Compliance and Ethics Committee consistent with the emphasis on ethical conduct.

CONCLUSION

Management recommends that the Board approve the proposed revisions to ensure that the documents align with the current corporate structure, law and best practices.