

Briefing on Cost Allocation Guiding Principles

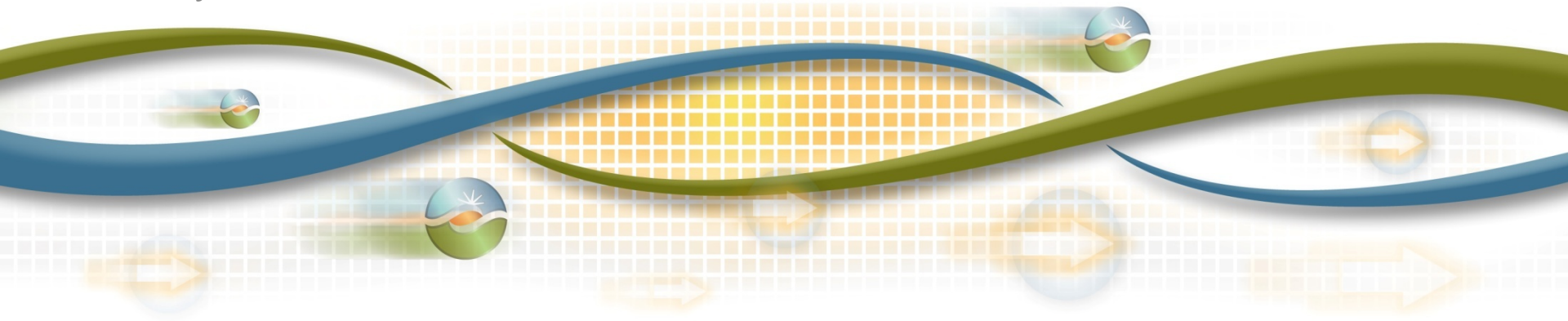
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Board of Governors Meeting

General Session

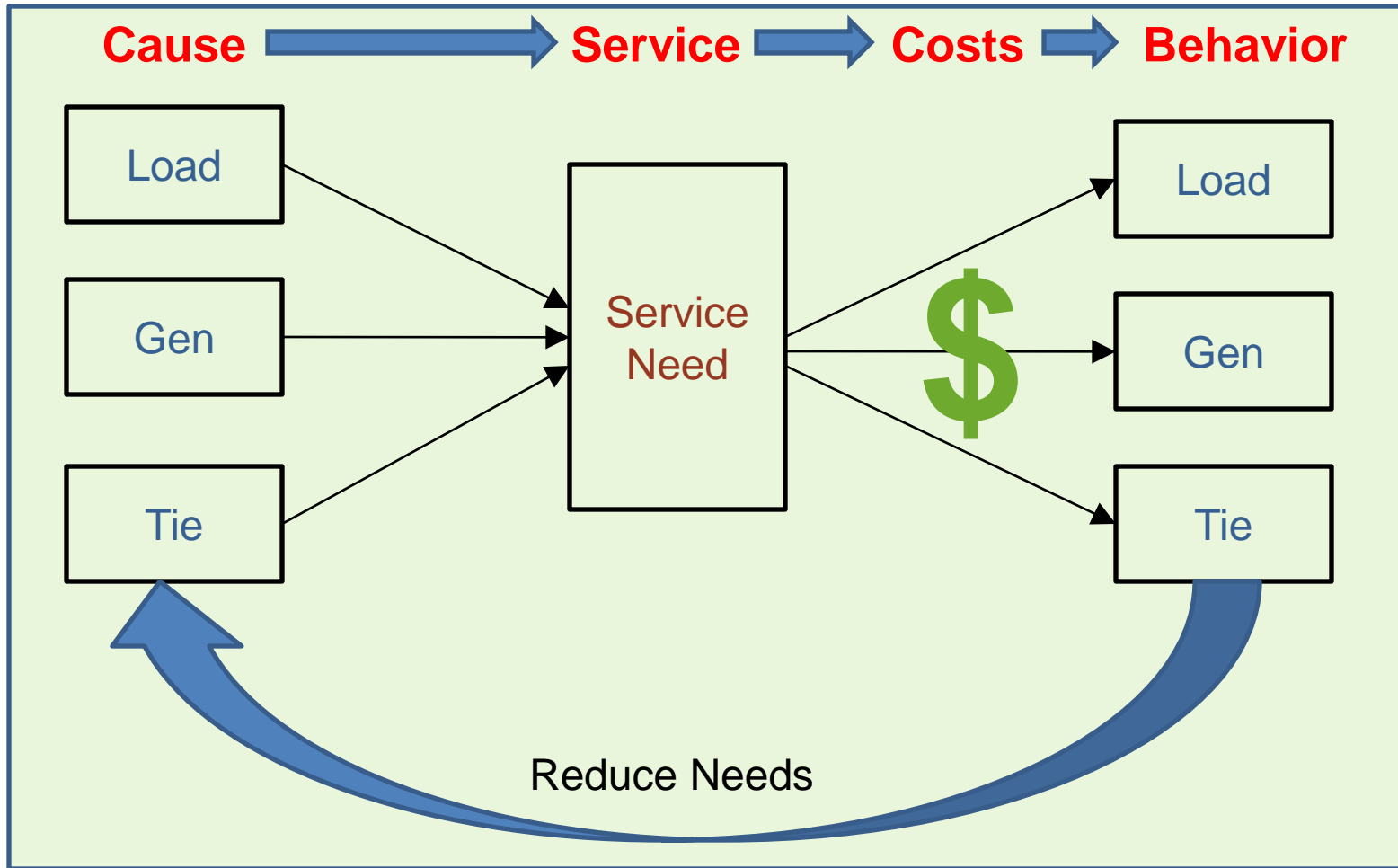
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Industry changes warrant reexamining traditional methods for allocating ISO market costs.

- Under existing paradigm, many costs allocated to load
- Changes to the generation fleet, are increasing the costs of balancing supply and demand
- New market products highlight the need for consistent cost allocation principles
- FERC directives reinforce the regulatory requirement to allocate costs consistent with cost causation principles

Allocation of costs based on causation will incentivize behavior to reduce costs.



The cost allocation guiding principles consist of seven elements.

- 1. Causation:** Costs will be charged to resources that benefit from the service being procured or to resources that drive the procurement decision.
- 2. Comparable treatment:** Market participants with similarly situated resources should receive similar allocation of costs and not be unduly discriminated against.

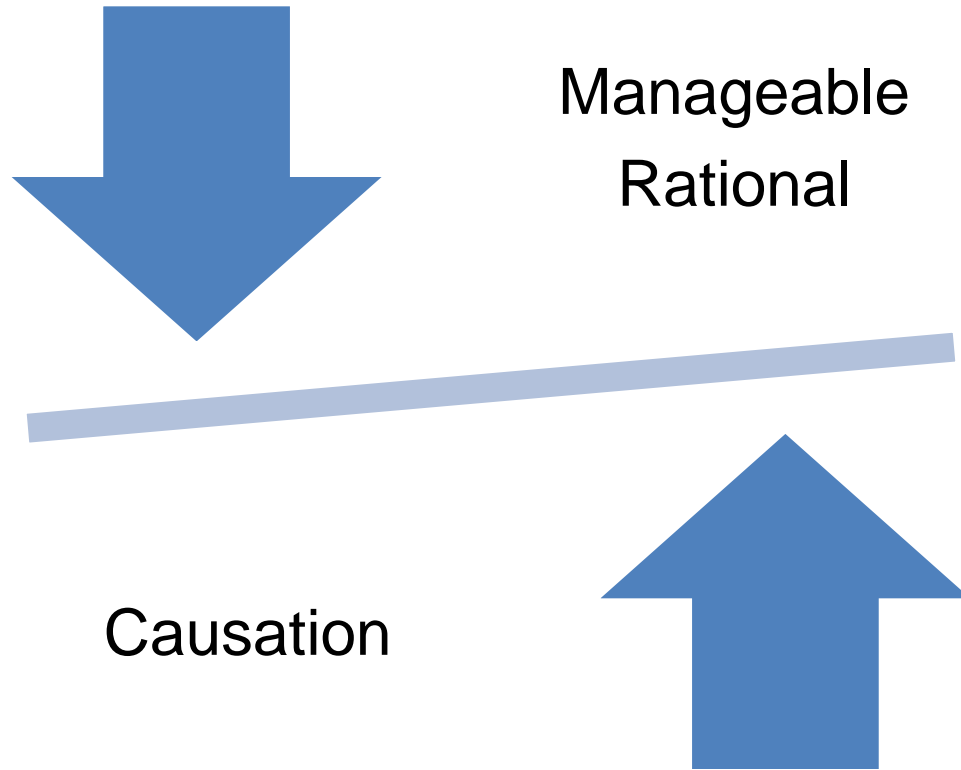
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- 3. Accurate price signals:** The cost allocation design supports the economically efficient achievement of state and federal policy goals by providing accurate price signals from the ISO market.
- 4. Incentivize behavior:** Cost allocation design should provide appropriate incentives for market participants to take action to reduce costs.

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5. **Manageable:** Market participants should have the ability to manage exposure to the cost allocation.
6. **Synchronized:** Cost allocation is aligned with the timing and quantity of the service procured.
7. **Rational:** Implementation costs and complexity should not exceed the benefits that are intended to be achieved by allocating costs.

Applying principles may create inherent tensions that will also require proper balancing.



Management intends to apply guiding principles to new and existing market products.

- Guiding principles are being applied to cost allocation rules for the flexible ramping product.
- Process will provide further opportunity to refine and improve the guiding principles.
- Comprehensive review of cost allocation for all ISO market products is planned to commence in late 2012.