

# Memorandum

**To:** ISO Board of Governors  
**From:** John C. Anders, Acting Corporate Secretary  
Yakout Mansour, President and Chief Executive Officer  
**Date:** January 18, 2007  
**Re:** Decision on the Compliance Program

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*This memorandum requires Board action.*

## EXECUTIVE SUMMARY

The California Independent System Operator Corporation (CAISO) is required to comply with all applicable laws and regulations and is committed to continuously and proactively reviewing its operations and activities to assure compliance with legal and regulatory requirements. Establishing an effective Compliance Program has been identified in the recently completed Strategic Business Plan and will serve as a primary vehicle for the CAISO to achieve this overall strategic objective. The ADR/Audit Committee was provided an overview and update on the Compliance Program at its meeting on June 13, 2006. This memorandum presents Management's recommendations for implementation of a Compliance Program consistent with the Strategic Business Plan.

### ***MOVED:***

***That the ISO Board of Governors approve the Compliance Program Policy included as Attachment A to this Memorandum.***

***That the ISO Board of Governors approve the enhancements to the Employees Code of Conduct and Ethical Principles included as Attachment B to this Memorandum.***

***That ISO Board of Governors approve amendment of the ADR/Audit Committee Charter as set forth in Attachment C to this Memorandum.***

***That in accordance with Article VI of the Bylaws of the California Independent System Operator Corporation (the "Corporation"), the ISO Board of Governors appoint a Chief Compliance Officer with responsibility for compliance activities with such powers and***

*duties as are set forth in the Bylaws of the Corporation and such additional powers and duties as may be prescribed by the ISO Board of Governors.*

*That the ISO Board of Governors hereby appoint John Anders as Acting Chief Compliance Officer for the Corporation, effective immediately, and that the term of the officer shall continue until the Board removes the acting designation, appoints another individual to the position, or the effective date of any termination of employment.*

## INTRODUCTION

The CAISO is required to comply with all applicable laws and regulations and is committed to continuously and proactively reviewing its operations and activities to assure compliance with legal and regulatory requirements. Establishing an effective Compliance Program has been identified in the recently completed Strategic Business Plan and will serve as a primary vehicle for the CAISO to achieve this overall strategic objective. This memorandum: (i) describes the Compliance Program Structure, (ii) sets forth the proposed Compliance Program Policy, (iii) recommends corresponding supplemental ethical principles to enhance the existing Employees Code of Conduct, (iv) recommends changes to the ADR/Audit Committee Charter and the appointment of a Chief Compliance Officer, and (v) outlines a suggested roadmap for Compliance Program implementation.

An effective Compliance Program is viewed as a primary vehicle to achieve the strategic objectives of the CAISO for two reasons. First, an effective Compliance Program will help prevent legal and/or policy violations and generally operate to mitigate the CAISO's overall risk exposure and reduce criminal, administrative, and civil liability. This will increase confidence in CAISO operations and activities, which in turn will support other strategic objectives and the core values of the corporation. A secondary benefit is that, as recognized in the Federal Energy Regulatory Commission's (FERC) October 20, 2005 Policy Statement on Enforcement, the CAISO may be afforded greater deference in a criminal or civil prosecution related to violations of applicable laws and/or regulations, and may receive reduced civil or criminal penalties if a violation is found to have occurred. In any enforcement action, FERC will consider multiple factors in determining what credit should be given for a company's commitment to compliance. In the interest of demonstrating the CAISO's full commitment to the Compliance Program, the Board's approval of the Compliance Program Policy provided in Attachment A is requested.

Most corporations follow the seven steps to an effective compliance program outlined in the Federal Sentencing Guidelines as they represent what are viewed as best practices, and the CAISO intends to do just that. Essentially this means the Compliance Program will: (i) underscore written policies and standards; (ii) include a role for the Board of Governors and Executive Management; (iii) undertake reasonable efforts to prevent misconduct (pre-hire); (iv) provide effective communication and training; (v) incorporate effective methods to monitor, audit, evaluate, and publicize the results of the program; (vi) be promoted and consistently enforced; and (vii) be followed up with reasonable preventative measures. The result will be an effective Compliance Program that will help fulfill the strategic objectives of the corporation and afford the secondary benefits of having such a program in place. The proposed Compliance Program outlined in this memorandum is expected to meet the standards for effectiveness provided in the Federal Sentencing Guidelines.<sup>1</sup>

One of the challenges the CAISO faces in developing the Compliance Program will be to mitigate the "paper program" risk that occurs when policies are adopted, but not followed. The best strategy to mitigate this risk is to create a program that is supported at the highest levels ("tone from the top"), fits within the organizational structure (i.e., is "right

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<sup>1</sup> It is important to understand that the Federal Sentencing Guidelines offer a fair amount of discretion in a number of areas, particularly with respect to what smaller corporations are required to undertake, and therefore it is not possible to be certain whether a court or regulatory authority would deem the measures undertaken to be sufficient.

sized”), reflects the core values of the corporation (i.e., a “culture of compliance”), and receives continued attention after implementation, including appropriate resources and funding of the program (i.e., the program remains “effective”).

We are confident the Compliance Program presented in this memorandum incorporates each of these considerations to the greatest extent presently possible and that the Compliance Program will be effective with the foundation to meet or perhaps exceed the expectations established in the Strategic Business Plan. Management’s commitment to compliance is reflected in the establishment of Enterprise Risk Management and Internal Audit functions, and the establishment of a code of conduct reporting framework for employees in May 2006. The Compliance Program will be integrated with and leverage these existing mechanisms to manage risk.

## **I. Compliance Program Structure**

**ADR/Audit Committee (Board)**  
**Compliance Committee (Management)**  
**Chief Compliance Officer**

The overall structure to implement, oversee and administer the Compliance Program will consist of a Management level committee (the “Compliance Committee”) to be established by the Chief Compliance Officer. The Compliance Committee will meet not less than twice annually and the Chief Compliance Officer will report to the ADR/Audit Committee periodically, but in no circumstance less frequently than annually. The Board will have oversight responsibility for the Compliance Program and will delegate this responsibility to the ADR/Audit Committee, which in turn will report to the Board in accordance with its charter.

The Compliance Committee will be responsible for Compliance Program implementation, reporting, administration, and training. Responsibility for compliance would remain with the individual Division, Department or Business Unit engaged in the associated activity. The Compliance Committee, with the direction of Management and if necessary and appropriate the ADR/Audit Committee, would address any issues related to these lines of responsibility. The responsibilities of each Division, Department and Business Unit are discussed in the Compliance Program Policy.

The Compliance Program serves as an important mitigation measure under the CAISO’s Enterprise Risk Management infrastructure, and is entirely complementary to that framework. In fact, the Compliance Program itself is considered part of the Enterprise Risk Management function, although administrative responsibility for the Compliance Program objectives and initiatives will remain within the Legal and Regulatory Department.

## **II. Proposed Compliance Program Policy**

The proposed Compliance Program Policy is included in this Memorandum as Attachment A. The Compliance Program Policy, as its name suggests, establishes the high level objectives for the program and outlines the general framework for implementation, training and monitoring. This document presents new corporate Policy that will be adopted by ISO Management, and is being presented for approval by the Board in accordance with the FERC Policy Statement on Enforcement and the Federal Sentencing Guidelines.

## **III. Code of Conduct and Ethical Principles**

The Employees Code of Conduct has served the ISO well, but Management has determined that several enhancements are appropriate to more fully address conflicts of interest and other ethical issues. Management presents herein the “Employees Code of Conduct and Ethical Principles” (Attachment B) which serves as an umbrella document that includes the existing Employees Code of Conduct as an attachment. The Employees Code of Conduct

and Ethical Principles sets forth key values and objectives, and therefore requires approval by the Board consistent with the Principles, Policies and Standards Framework.

#### **IV. ADR/Audit Committee Charter and Chief Compliance Officer**

Revisions to the ADR/Audit Committee Charter to specifically identify the Committee's oversight responsibility are included in this Memorandum as Attachment C.

The appointment of a Chief Compliance Officer with substantial authority within the CAISO, direct access to the President and Chief Executive Officer, other Executive Management, Legal Counsel, and to the Board of Governors is an element of an effective compliance program. In larger corporations this position can stand on its own, however, it is Management's recommendation to have this function initially included within the General Counsel's office given the nature of the ISO and to evaluate this decision as the Compliance Program matures.

#### **V. Road Map for Implementation**

The road map for implementation will follow the seven steps of an effective Compliance Program as described in the Federal Sentencing Guidelines and lay out the basic approach to be deployed by the Compliance Committee to meet the objectives set forth in the Strategic Business Plan. The outstanding elements for an effective Compliance Program include: (i) disseminating information; (ii) updating and developing additional policies and standards to fill identified gaps; (iii) training of employees; (iv) coordinating with Enterprise Risk Management and Internal Audit; and (v) monitoring the effectiveness of the Compliance Program. Each of these remaining elements is discussed briefly below to provide a sense of the activities that lie ahead.

- **Disseminating Information:** The revised Code of Conduct and Ethical Principles and the Compliance Program Policy would be made effective upon approval by the Board. The basic elements of the revisions and the Compliance Program would be announced shortly thereafter in an e-mail enclosing the new policies covered by the basic text of the Message from the President and CEO. Also communicated would be an outline of upcoming compliance related activities. In the future options such as a Compliance Website, an annual compliance award, and general advertising/marketing will be considered.
- **Updating and Developing Additional Policies and Standards to Fill Identified Gaps:** A preliminary assessment of corporate compliance in key areas has been initiated. The assessment will be based on information obtained from each Division, Department, and Business Unit and organized in a manner intended to identify areas that may need additional attention with respect to compliance. The assessment will remain an iterative process that will require interaction and feedback between the Compliance Committee, Enterprise Risk Management, Internal Audit, and each Division, Department or Business Unit to continually develop an accurate picture of areas that may need additional attention with respect to compliance. The process of filling any identified gaps would also necessarily remain ongoing and it would be the responsibility of the Compliance Committee, again with support and coordination with Enterprise Risk Management and Internal Audit, to support the initiatives of each Division, Department or Business Unit as detailed in the Compliance Program Policy. The Legal Department would continue to support and address questions raised with respect to the assessment.
- **Training of Employees:** Training activities for 2007 will focus on clearly communicating the purpose, structure and requirements of the Compliance Program and describing applicable laws and regulations targeted to each Division, Department or Business Unit's particular activities. This training would be provided consistent with the 2007 objectives and would also satisfy the required Code of Conduct training for 2007. The remainder of the

training efforts in 2007 would include preparation of materials for 2008 and coordination with Enterprise Risk Management and Internal Audit to assure effective training is provided, particularly in identified key risk areas. It is anticipated that this effort will require the most significant amount of time and resources.

- Coordinating with Internal Audit and Enterprise Risk Management: This activity has been initiated and will continue as a part of the assigned duties of the Compliance Committee. The ISO's Enterprise Risk Inventory includes reference to mitigation measures for each identified risk, and the Compliance Program is an important example of a programmatic mitigation measure that is repeatedly referenced. Audit priorities are defined in consideration of risks identified through the Enterprise Risk Inventory, and the procedure for Enterprise Risk Management includes explicit reference to integration with the Compliance Program. Open, timely and effective communication will be essential, and potential enterprise risks identified through the operation of the Compliance Program will be analyzed for possible inclusion in the Enterprise Risk Inventory. Alignment of the activities would remain a focus of the Compliance Committee, of which the Director of Enterprise Risk Management will be a member, in an effort to direct available resources to those areas that represent the most significant risks, with updates provided periodically to the ADR/Audit Committee.
- Monitoring the Effectiveness of the Compliance Program: A number of options are available to measure the effectiveness of the Compliance Program in a manner consistent with the Strategic Business Plan. Options in addition to monitoring non-compliance are surveys (general, specific and post training), audits and measurement of incident reports (hot line calls, open door policy visits, web-site hits, etc.), which will be evaluated as the Compliance Program matures.

## MANAGEMENT RECOMMENDATION

An effective Compliance Program is a dynamic objective and will require constant improvement; however, the recommendations made in this memorandum and pursuing the additional steps identified above, along with adequate resources and funding, will help assure that the Compliance Program can be successful in meeting the Strategic Business Objectives. Accordingly, Management recommends that the ISO Board of Governors take the initial step of creating an effective compliance program pursuant to the following motion.

### ***MOVED:***

***That the ISO Board of Governors approve the Compliance Program Policy included as Attachment A to this Memorandum.***

***That the ISO Board of Governors approve the enhancements to the Employees Code of Conduct and Ethical Principles included as Attachment B to this Memorandum.***

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January 18, 2007

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