

Memorandum

To: ISO Board of Governors
From: Roger Collanton, Vice President, General Counsel & Chief Compliance Officer
Date: March 8, 2017
Re: **Decision on Department of Market Monitoring Oversight Committee**

This memorandum requires Board action.

EXECUTIVE SUMMARY

Currently, the tariff provides that the Department of Market Monitoring (DMM) reports to the ISO Chief Executive Officer for administrative purposes, including the internal administration of DMM, and reports to the Board on all matters pertaining to the core monitoring duties as specified in the tariff. In light of evolving best practices for maintaining independence, and the appearance of independence, of an internal market monitoring function, as communicated by the Federal Energy Regulatory Commission, Management proposes to vest all oversight of DMM with the Board. In a recent audit of the Southwest Power Pool, Inc., FERC made multiple recommendations for changes in administrative oversight of SPP's internal market monitoring unit. The SPP audit report provides relevant guidance as to FERC's evolving thinking on best practices for independence of the market monitoring function. Management has also discussed the SPP recommendations with FERC auditors currently auditing the ISO.

Given similarities between the internal market monitoring structure at SPP and at the ISO, Management recommends that the DMM administrative functions currently overseen by ISO Management be transferred to Board oversight. Specifically, Management recommends that the Board: (1) create a DMM Oversight Committee to assist the Board in its oversight of DMM's market monitoring functions, as defined in the tariff and FERC regulations, and to provide oversight of DMM's administration and operations; (2) approve the proposed tariff amendment, to effectuate this change; (3) approve the proposed charter for the DMM Oversight Committee; and (4) appoint members and a chair for the DMM Oversight Committee.

Governors Galiteva and Bhagwat have expressed a willingness to act as committee members, with Governor Galiteva as the Chair.

Management recommends the following motion:

Moved, that the ISO Board of Governors designates a DMM Oversight Committee as a committee of the Board, pursuant to Article V, Section 1 of the ISO bylaws, with its members to be compensated for their service as provided in the Board's existing compensation resolution, dated December 13-14, 2012;

Moved, that the ISO Board of Governors approves the proposed Charter of the DMM Oversight Committee, as attached to the memorandum dated March 8, 2017;

Moved, that the Board appoints Governors Galiteva and Bhagwat as members of the DMM Oversight Committee, with Governor Galiteva as Chair; and

Moved, that the ISO Board of Governors authorizes Management to make all necessary and appropriate filings with the Federal Energy Regulatory Commission to make the tariff change consistent with the proposal, as provided in the memorandum dated March 8, 2017.

DISCUSSION AND ANALYSIS

In a July 15, 2016 order, FERC approved a report by the Division of Audits and Accounting in its Office of Enforcement documenting its audit of SPP. The audit report makes multiple recommendations for changes in how SPP's internal market monitor interacts with SPP management, to enhance the independence of the internal market monitoring unit.

Under FERC regulations, a market monitoring unit, whether it is external or internal, must report to the board of directors of its Independent System Operator or Regional Transmission Organization. In compliance with these regulations, the ISO proposed and FERC accepted tariff provisions creating a dual reporting structure, separating DMM's core monitoring duties and DMM's administration between the Board and ISO Management, respectively. In particular, Appendix P, Section 3.1 of the tariff provides that:

DMM shall report to the CAISO Governing Board on all matters pertaining to the core monitoring duties specified under Section 5 of ... Appendix P, and shall have direct access to the individual CAISO Governing Board members at any time. DMM shall report to the CAISO CEO or his or her designee for administrative purposes, including matters relating to the internal administration of DMM.

FERC found that for SPP, which had a similar dual reporting structure for its internal market monitor, transferring reporting on various administrative matters from SPP management to the SPP Board's oversight committee would enhance independence of the market monitoring function and eliminate opportunities for the appearance of conflicts of interest between SPP management and the market monitor. Administrative matters of concern to FERC in the SPP audit included: management conducting the market monitoring director's annual performance review and setting his compensation, approving staffing decisions, and influencing the market monitoring unit's annual budget. In addition, the SPP corporate performance metrics affected market monitoring staff's incentive compensation, market monitoring did not have ready access to outside legal counsel, and there was a lack of structural safeguards to ensure sufficient information technology and corporate support services for the market monitoring unit.

Management recommends that the Board create the DMM Oversight Committee, pursuant to Article V, Section 1 of the ISO bylaws to assist the Board in its oversight of DMM's core market monitoring functions, and to have DMM report to the Committee for administrative purposes. These responsibilities will require ongoing oversight and in-depth awareness of DMM activities and the performance of individual DMM staff members, and thus is more feasible and efficient for a Board committee to develop that expertise.

A charter documenting these oversight responsibilities is necessary to establish the responsibilities and administration of the new committee. Management proposes the Board approve the attached charter to define the scope of the Committee's duties, which include:

- Assisting the Board in its oversight of DMM's performance of its core market monitoring functions as defined in the tariff and FERC regulations.
- Providing general oversight of DMM administration and operations, including staffing and compensation issues, DMM departmental goals, and DMM's budget.
- Oversight of the sufficiency of general corporate support services provided to DMM by the ISO.
- Approving the terms of DMM's selection and retention of outside legal counsel.

In fulfilling its responsibilities, the DMM Oversight Committee will have the discretion to solicit and consider feedback from any source, including Management, as it deems appropriate, and will have the responsibility to report regularly on its activities to the Board. Of course, Management will assist the DMM Oversight Committee in this transition, as deemed necessary, or otherwise, as called upon at the discretion of the DMM Oversight Committee.

Governors Galiteva and Bhagwat have expressed a willingness to act as committee members, with Governor Galiteva as the committee chair, and Management recommends that the Board appoint them as the initial DMM Oversight Committee members. Both governors possess the necessary qualifications set forth in the Charter to fulfill this important Board function. Further, as a committee of the Board, the members of the Oversight Committee will be compensated for their service as provided in the Board's existing December 13-14, 2012 compensation resolution, or any further amendment thereto.

To make this change to the DMM oversight structure, a few relatively minor revisions are required to the tariff, Appendix P, Sections 3.1, 4.1, and 9.7. The revisions are shown below in blackline format:

3.1 Department of Market Monitoring

DMM shall report to the CAISO Governing Board on all matters pertaining to the core monitoring duties specified under Section 5 of this Appendix P and for administrative purposes, including matters relating to the internal administration of DMM. ~~DMM, and shall have direct access to the individual CAISO Governing Board members at any time. DMM shall report to the CAISO CEO or his or her designee for administrative purposes, including matters relating to the internal administration of DMM.~~ DMM shall advise the CAISO Governing Board about DMM's independent analysis of the CAISO's markets and its independent identification of market design flaws and market power abuses, and DMM also shall inform CAISO management about such matters.

4.1 DMM shall be adequately staffed by the CAISO with full-time CAISO staff with the experience and qualifications necessary to fulfill the functions referred to in this CAISO Tariff. Such qualifications may include professional training pertinent to and experience in the operation of markets analogous to CAISO Markets, in the electric power industry, and in the field of competition and antitrust law, economics and policy. Subject to the CAISO Governing Board's respective oversight responsibilities, as defined in this CAISO Tariff, ~~of the CAISO Governing Board and the CAISO CEO,~~ responsibility for overseeing the conduct and operations of DMM shall be conferred upon the Director of DMM.

9.7 DMM employees shall advise a supervisor (or in the case of the Director of DMM, the CAISO Governing Board CAISO CEO) in the event they seek employment with a Market Participant, and must disqualify themselves from participating in any matter that would have an effect on the financial interest of the Market Participant.

CONCLUSION

Management recommends that the Board approve the proposed DMM Oversight Committee, its charter, initial membership, and the identified tariff revisions to implement the changes to DMM's management and oversight consistent with FERC's guidance.