

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

<b>California Independent System Operator Corporation</b>	) ) ) )	<b>Docket No. ER14-2963-000</b>
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**ANSWER OF THE  
CALIFORNIA INDEPENDENT SYSTEM OPERATOR CORPORATION  
TO COMMENTS AND LIMITED PROTEST**

The California Independent System Operator Corporation (“CAISO”)<sup>1</sup> submits this answer to the comments and limited protest submitted<sup>2</sup> in response to the CAISO’s September 29, 2014 tariff amendment (“September 29 tariff filing”).<sup>3</sup> The CAISO seeks to eliminate Section 22.1.2.2 of the CAISO tariff, which requires an independent entity to perform an annual review of CAISO operations. It is appropriate to remove this provision. The operations review has little incremental value due to the maturity of the CAISO’s internal compliance and audit programs and increased oversight by the Commission and reliability organizations, and the operations review is costly for the CAISO and its customers.

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<sup>1</sup> Capitalized terms not otherwise defined herein have the meanings set forth in the Master Definitions Supplement, Appendix A to the CAISO tariff.

<sup>2</sup> The following entities filed motions to intervene in the proceeding: the California Department of Water Resources State Water Project (“SWP”); City of Santa Clara, California; Modesto Irrigation District; Powerex Corp. (“Powerex”); Pacific Gas and Electric Company; and Western Power Trading Forum (“WPTF”). In addition, Powerex and SWP filed comments and WPTF filed a limited protest. Powerex, SWP, and WPTF are collectively referred to in this answer as “Commenters.”

<sup>3</sup> The CAISO submits this motion and answer pursuant to Rules 212 and 213 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. §§ 385.212, 385.213 (2014). The CAISO respectfully requests waiver of Rule 213(a)(2), 18 C.F.R. § 385.213(a)(2), to permit it to make an answer to WPTF’s limited protest. Good cause for this waiver exists here because the answer will aid the Commission in understanding the issues in the proceeding, provide additional information to assist the Commission in the decision-making process, and help to ensure a complete and accurate record in the case. *See, e.g., Equitrans, L.P.*, 134 FERC ¶ 61,250, at P 6 (2011); *California Independent System Operator Corp.*, 132 FERC ¶ 61,023, at P 16 (2010); *Xcel Energy Services, Inc.*, 124 FERC ¶ 61,011, at P 20 (2008).

Three parties submitted comments or limited protests on the September 29 filing: California Department of Water Resources, State Water Project (“SWP”); Powerex Corp. (“Powerex”); and Western Power Trading Forum (“WPTF”) (collectively, “Commenters”). These three parties argue that the Commission should direct the CAISO to maintain the operations review requirement. As explained below, their arguments do not have merit.

## **I. ANSWER**

The Commission should accept the September 29 tariff filing and reject arguments made by commenters for retaining the operations review set forth in Section 22.1.2.2. Commenters misconstrue the nature of the operations review. The operations review is not a full-fledged “audit,” but rather a limited review of a specifically identified CAISO operational procedure or portion thereof, identified in a given year by the CAISO’s Audit Committee, that is reasonably capable of being reviewed by an external entity.<sup>4</sup> Given the limited scope of the review, the relative lack of market participant interest, the CAISO’s implementation of more comprehensive internal compliance and audit procedures, the attendant costs of the operations review—which are ultimately borne by CAISO customers—and diversion of CAISO resources, it is just and reasonable for the CAISO to remove Section 22.1.2.2 from its tariff.

Even in the absence of the annual external operations review, market participants have sufficient recourse through existing CAISO procedures and Commission oversight to raise issues of concern regarding the CAISO’s operations, and

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<sup>4</sup> Historically, the CAISO has used Price Waterhouse Coopers (“PwC”) to perform the operations reviews.

Commenters fail to provide any concrete examples to the contrary. The fact that a few commenters might prefer the CAISO to retain an additional review process, albeit it one of dubious value, is not a compelling reason to deny the CAISO's request to eliminate Section 22.1.2.2.

**A. Commenters Misunderstand the Scope of the Operations Review.**

Commenters' arguments that Section 22.1.2.2 should not be eliminated from the CAISO tariff are based on several fundamental misunderstandings regarding the nature of the operations review and the CAISO's ongoing audit processes. During the stakeholder process that resulted in the September 29 tariff filing, the CAISO addressed similar misunderstandings that arose in the stakeholder process. Unfortunately, none of the Commenters offered any written or oral comments during that process, including the public meeting of the CAISO Governing Board that authorized the September 29 tariff filing.

First, Commenters misconstrue and overstate the scope of the operations review set forth in Section 22.1.2.2. Contrary to SWP's assertion, Section 22.1.2.2 does not mandate an "audit,"<sup>5</sup> because it does not require a formal assessment of compliance with externally developed criteria, such as accounting standards or NERC/WECC criteria.<sup>6</sup> Rather, as described below, Section 22.1.2.2 requires a "review" of the ISO's "operations policies and procedures."

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<sup>5</sup> See, e.g., SWP at 4 ("SWP believes that these *audits* may be useful in the coming years").

<sup>6</sup> Section 22.1.2.2 was amended from its original form to replace the term "audit" with "review" to clarify and distinguish the operations review from how the term "audit" is understood in financial and accounting contexts. See transmittal letter for September 29 tariff filing at 2-5. The Commission accepted that amendment to Section 22.1.2.2 as just and reasonable in *California Independent System Operator Corp.*, 125 FERC ¶ 61,262, at PP 106-11 (2008). However, the CAISO never performed an

WPTF argues that CAISO operators exercise significant discretion when running the CAISO's markets, and that this discretion highlights a continued need for an independent assessment of whether the CAISO's practices are consistent with its authority under the tariff.<sup>7</sup> What WPTF fails to understand is that CAISO's exercise of discretion has never been reviewed, nor could it reasonably be reviewed (or audited). External firms are unable to review processes where the CAISO exercises significant discretion—such as decisions to issue exceptional dispatches—and instead can review only those processes with very specific and repeatable requirements—such as specific logging requirements for exceptional dispatches. Even then, the CAISO must expend significant internal resources to familiarize the individuals conducting the review to make the scope of the operations review understandable.

Moreover, because of these challenges and costs, it would be practically impossible for the operations review to examine the CAISO's compliance with *all* of its operations policies and procedures on an annual basis, and therefore the CAISO has never done so. Rather, the CAISO has implemented the annual operations review requirement under Section 22.1.2.2 by first seeking input from market participants. Based on that input, the CAISO Audit Committee then determines the focus of the operations review for that year. Past areas of focus have included, for example, pre-schedule and check-out validation, NERC tagging requirements, manual dispatch on interties, and interchange schedule curtailments. Within these areas, only specific

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"audit" as understood in the financial and accounting contexts even prior to the amendment and "audit" was never defined in the tariff. The CAISO amended the tariff simply to clarify this point.

<sup>7</sup> WPTF at 3.

processes that can be reviewed and evaluated against discrete criteria have been assessed.<sup>8</sup>

Commenters also argue that further review is prudent because of ongoing market changes. WPTF, for example, argues that the CAISO's market processes are undergoing significant changes that may result in a "renewed interest" in the annual operations review, and cites the implementation of the Fifteen Minute Market and the Energy Imbalance Market as such significant changes.<sup>9</sup> Southern California Edison Corporation ("SCE") raised a similar argument in its stakeholder comments. As the CAISO explained in response to SCE during the stakeholder process, the CAISO's annual operations review has focused only on procedures performed within operations; that is, procedures performed by CAISO staff within grid or system operations. The operations review does not focus on market or automated processes, such as the CAISO's market software.<sup>10</sup>

In this regard, SWP seems to argue that the CAISO could interpret Section 22.1.2.2 more broadly to include areas outside operations, such as market processes. While the CAISO is certainly at liberty to broaden its use of external reviews—as the CAISO has done in implementing its Energy Imbalance Market, and may do so here regardless of the Commission's determination—the CAISO obtains much less value from such reviews compared to its internal audit and compliance reviews, functions that did not exist when Section 22.1.2.2 was adopted at the inception of the CAISO. As the

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<sup>8</sup> Transmittal letter for September 29 tariff filing at 2.

<sup>9</sup> WPTF at 5. See also Powerex at 4.

<sup>10</sup> The CAISO's market settlement software is audited by an independent firm pursuant to section 11.29.5.4 of the CAISO tariff.

CAISO evolves, it is critically important for it to allocate its resources efficiently. The CAISO Audit Committee and Board of Governors has determined that, given the adoption of a robust and comprehensive internal compliance process, the annual operations review is not a prudent or valuable use of CAISO resources and should be eliminated as a requirement.

**B. Commenters Fail to Demonstrate That the CAISO's Internal Compliance Procedures are Inadequate**

The CAISO devotes substantial resources to its audit and compliance departments, and doing so has greatly contributed to the CAISO's culture of compliance. As described in the September 29 filing, subsequent to adopting Section 22.1.2.2, the CAISO created a comprehensive internal compliance program, including a centralized compliance department. This compliance program includes monitoring and reviewing the CAISO's operational practices, and thus overlaps with the scope of the operations review required by Section 22.1.2.2. In addition, the CAISO is subject to external compliance processes and audits, such as those conducted by NERC and WECC to ensure compliance with reliability standards.<sup>11</sup>

The CAISO's internal audit department also overlaps with the scope of the operations review required by Section 22.1.2.2. The CAISO's internal audit department has a dual reporting structure—similar to the CAISO's Department of Market Monitoring—that ensures independence. The Director of the internal audit department reports to the General Counsel for administrative purposes, but has a direct reporting

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<sup>11</sup> See transmittal letter for September 29 tariff filing at 2-5.

relationship to the Audit Committee.<sup>12</sup> The CAISO internal audit department performs its own annual risk assessment to identify the areas to audit and has full independence to determine which area to review, subject to Audit Committee approval. The department also has no operational responsibility or authority over any activities that it audits. Thus, WPTF's contention that the CAISO's internal compliance procedures are insufficient because they are not "independent" is erroneous.<sup>13</sup>

In addition, WPTF fails to present any evidence that the CAISO's internal compliance process is biased or otherwise flawed. The example WPTF provides to support its allegation is the 2011 operations review that identified a logging error relating to exceptional dispatch, resulting in CAISO management instituting procedural improvements and additional training requirements. However, it was *CAISO internal audit personnel, not stakeholders*, who identified exceptional dispatch logging as an area of concern. The CAISO's internal audit personnel would have reviewed this area but for the annual operations review. Instead, they recommended that the operations review focus on this area because there had been no stakeholder input as to a topic for the operations review that year.<sup>14</sup>

Commenters also contend that eliminating the operations review will leave market participants without sufficient recourse to raise issues of concern regarding the CAISO's operations.<sup>15</sup> In the September 29 filing, the CAISO explained, however, that

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<sup>12</sup> See also CAISO Audit Committee charter, <http://www.caiso.com/Documents/AuditCommitteeCharter.pdf>.

<sup>13</sup> WPTF at 2-3.

<sup>14</sup> Moreover, the discovered logging error had no financial impact on market participants. CAISO Memorandum, Acceptance of the 2011 Operations Audit (Dec. 8, 2011), available on the CAISO website at <http://www.caiso.com/Documents/Acceptance-2011OperationsAudit-MemoDec2011.pdf>.

<sup>15</sup> Powerex at 4; SWP at 6; WPTF at 3-4.

Section 22.1.2.4 of the CAISO tariff allows, and will continue to allow, the CAISO Audit Committee to institute an audit in response to a market participant's request.<sup>16</sup> SWP argues that this provision is not a "replacement" for the operational review because the CAISO Audit Committee can decide, at its sole discretion, whether an issue presented to it under Section 22.1.2.4 warrants an audit. The CAISO Audit Committee, however, has precisely the same discretion with respect to the operations review under Section 22.1.2.2, which states that this review "*may also include material issues raised by Market Participants and approved by the CAISO Audit Committee for inclusion in the review.*"<sup>17</sup> In this respect, Section 22.1.2.2 provides no comparative benefit to market participants. WPTF and SWP also argue that Section 22.1.2.4 generally imposes the costs of such an audit on the requesting market participant unless the Audit Committee orders otherwise. Although Section 22.1.2.4 *permits* the CAISO Audit Committee to impose the costs of an audit on the requesting market participant(s), in practice, the Audit Committee has not required the requesting market participant to bear the costs of an audit. Also, the Audit Committee maintains the discretion to impose costs that pertain solely to an issue that affects just the market participant or the group of market participants requesting a review. Assuming the Commission accepts the September 29 tariff filing, the CAISO Audit Committee would appropriately have the discretion on how best to allocate CAISO resources using either internal audit or an external reviewer, and what portion of costs should be borne by CAISO ratepayers or market participants.

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<sup>16</sup> See transmittal letter for September 29 tariff filing at 4.

<sup>17</sup> CAISO Tariff Section 22.1.2.4 (emphases added).



Finally, market participants have multiple additional avenues by which to pursue relief in addition to raising concerns with the Audit Committee or Board of Governors. The CAISO's tariff contains a robust dispute process that includes the option for parties to seek alternative dispute resolution. In addition, parties can seek relief from the Commission. This can, as WPTF points out, take the form of a Section 206 complaint under the Federal Power Act, but also consists of less formal options such as the Commission's enforcement hotline and dispute resolution services.

### **C. The Operations Review Does Not Provide Benefits Commensurate with its Costs**

Commenters argue that the operations review has been of value to market participants over the years, despite recent lack of interest.<sup>18</sup> While the operations review has provided benefit in some years, given the expense and the overlap with subsequently adopted internal CAISO compliance and audit processes, it no longer provides a value to market participants commensurate with its costs.

The CAISO incurs significant vendor expenses in retaining an independent accounting firm to perform the annual operations reviews. In addition, CAISO staff must devote a substantial amount of time each year to agree on and then develop the relatively narrow scope of each's year's annual review well in advance of the actual review by the independent firm. As described above, the CAISO also must devote significant time and expense familiarizing the individuals performing the review with the relevant CAISO operational practice selected for review. In contrast, the CAISO's internal audit department independently develops a risk-based audit plan, which it

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<sup>18</sup> SWP at 4; WPTF at 4-5.

presents to the Audit Committee for approval each year. The internal audit department historically has shared its audit plan with the independent accounting firm responsible for performing the annual operations review to minimize the likelihood of duplicating efforts. The CAISO's compliance department also performs control assessments. Thus, the internal audit and compliance departments perform a corporate-wide review function that renders the review under Section 22.1.2.2 unnecessary and duplicative.

Given the robust internal compliance and audit programs now in place and the limited utility of the operations review, there is no justification for the CAISO to continue to incur the costs of conducting an external operations review,<sup>19</sup> costs which are ultimately borne by CAISO customers through the CAISO's grid management charge. It is therefore just and reasonable for the CAISO to eliminate the operations review required by Section 22.1.2.2.

Commenters have failed to demonstrate that removing the operations review from the CAISO tariff would cause the tariff to be unjust or unreasonable. In this respect, it is also significant that no other Independent System Operators ("ISO") or Regional Transmission Organizations ("RTOs") have such an obligation in their tariff, and instead rely on their internal audit and compliance personnel. As far as the CAISO is aware, no ISO or RTO conducts such an external review as part of its standard governance practices.<sup>20</sup> This fact further reinforces the justness and reasonableness of the CAISO's proposal to eliminate this requirement from its own tariff. The Commission

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<sup>19</sup> Transmittal letter for September 29 tariff filing at 4.

<sup>20</sup> See transmittal letter for September 29 tariff filing at 5; Section 11.29.5.4 of the CAISO tariff.

therefore should reject Commenters' arguments and accept the September 29 amendment as filed.

## II. CONCLUSION

For the reasons discussed above, the Commission should accept the September 29 tariff amendment without condition or modification.

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Dated: October 28, 2014

## CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each party listed on the official service list for this proceeding, in accordance with the requirements of Rule 2010 of the Commission's Rules of Practice and Procedure (18 C.F.R. § 385.2010 (2014)).

Dated at Folsom, California on this 28th day of October, 2014.

/s/ Sarah Garcia  
Sarah Garcia