

Memorandum

To: ISO Board of Governors

From: Eric Schmitt, Vice President, Operations

Date: September 11, 2014

Re: **Decision on elimination of annual operations review**

This memorandum requires Board action.

EXECUTIVE SUMMARY

Management seeks Board approval to eliminate Section 22.1.2.2 of the tariff. This provision requires the ISO's Audit Committee to select an independent party to perform an annual review of Management's compliance with the ISO's operations, policies, and procedures. Since the requirement for an annual review went into effect in 1998, the compliance landscape has evolved significantly. With FERC's oversight, NERC and WECC have established compliance programs for such matters, which include extensive audit and compliance mechanisms for ensuring compliance with mandatory reliability standards. FERC also conducts periodic audits of the ISO to assess tariff compliance and compliance with FERC regulation and orders. In addition, the ISO corporate compliance department administers a formal compliance program. The ISO also has an internal audit department that conducts various audits of ISO practices and procedures based upon risk assessments, including audits focused on operational processes and practices.

No stakeholder opposed the elimination of the annual operations review. In light of the developments noted above and the lack of stakeholder opposition, Management has concluded that the operations review requirement has become an unnecessary and expensive anachronism and, therefore, proposes to file a tariff amendment with FERC to eliminate section 22.1.2.2.

Moved, that the ISO Board of Governors approves Management's proposal to eliminate the annual operations review requirement from the ISO tariff, as described in the memorandum dated September 11, 2014; and

Moved, that the ISO Board of Governors authorizes Management to make all necessary and appropriate filings with the Federal Energy Regulatory Commission to implement the proposed tariff change.

DISCUSSION AND ANALYSIS

Section 22.1.2.2 of the tariff requires the ISO Audit Committee to appoint an independent party to review, on an annual basis, Management's compliance with its operations, policies, and procedures. The section also states that the review may include material issues raised by market participants and approved by the ISO Audit Committee. The ISO implements this requirement by seeking input from market participants and then selecting the scope of review each year. Management reports the results of the review to the ISO Audit Committee and provides copies to market participants upon request.

Section 22.1.2.2 has been in the tariff in substantially the same form since the ISO began operations on March 31, 1998, and Management believes that it is no longer necessary for the following reasons.

First, for the last four years, no market participant has responded to the ISO's annual request for input concerning the scope of the operations review. And during that time, no market participant has provided comments in a public meeting of the ISO Audit Committee or Board of Governors.

Removing the operations review requirement will affect neither market participants' ability to raise issues of concern nor the ISO's ability to perform audits when necessary. Specifically, tariff section 22.1.2.4, which will not be impacted by this proposed amendment, provides the ISO Audit Committee the authority to initiate audits relating to "specific issues and concerns of Market Participants."

Second, in compliance with FERC's implementation of the Energy Policy Act of 2005, the ISO is now required to meet the Reliability Standards implemented by NERC and the Regional Reliability Standards implemented by WECC. These standards include a host of requirements for operations. Each year the ISO must submit a self-certification that it complies with the NERC and WECC standards, and report on any instances of non-compliance. In addition, FERC may conduct unannounced audits of the ISO in all areas of compliance with reliability standards, the Federal Power Act, the ISO tariff, and all FERC orders and regulations. NERC may also conduct unannounced audits for compliance with reliability standards.

Third, after the adoption of section 22.1.2.2, the ISO created its corporate compliance and internal audit departments. The corporate compliance department was formalized in 2008 and has developed a comprehensive compliance program consistent with FERC's requirements. The corporate compliance program reviews and monitors controls and performs compliance assessments including areas related to reliability standards and tariff and operations policies and procedures.

The internal audit department was formalized in 2010 with the creation of an internal audit charter, methodology, and audit processes based on the Institute of Internal Auditors' Professional Practices Framework. The internal audit department consists of certified

auditors who conduct an annual risk assessment of all process areas within the ISO to identify the highest-risk process areas from an auditing perspective. The internal audit department has conducted a number of audits focused on operational practices, including metering, market price validation and correction, real-time transmission, full network model maintenance, outage management, operations training, bid collection and validation, and market clearing.

Fourth, the ISO incurs significant expenses in retaining an independent accounting firm to perform the operation reviews. Given the robust compliance and audit programs now in place, Management believes that this annual cost is simply unnecessary and should be avoided.

Finally, Management did not identify any similar audit requirements in its review of the tariffs of other ISOs and RTOs. Therefore, in light of each of these factors, Management believes that it is appropriate to remove the operations review requirement from the tariff.

POSITIONS OF THE PARTIES

The ISO published a written proposal on August 22, 2014, requesting comments on September 2, 2014. The ISO held a stakeholder call to discuss the proposal on September 4, 2014.

Only one stakeholder submitted a comment on the proposal: Southern California Edison commented that the operations review has provided some value to stakeholders, and that with changes to the ISO market, an independent review appears prudent. Southern California Edison also asked whether the other independent system operators and regional transmission organizations conduct an external operations review even if their tariffs do not require them to do so, and, if so, for the ISO to continue to do so. ISO staff spoke with individuals from regional transmission organizations, who confirmed that their organizations do not conduct an annual external operations review. ISO staff shared this information with stakeholders participating in the conference call and also explained that the more market-oriented changes of concern to Southern California Edison had never been in the scope of an operations review. ISO staff reminded stakeholders that the ISO is not proposing to eliminate either section 11.29.5.4, which requires the ISO settlement software to be audited by an independent firm of auditors, or section 22.1.2.4, which provides that the ISO audit committee may initiate audits relating to concerns of market participants.

CONCLUSION

Management recommends that the Board approve Management's proposal to eliminate the annual operations review requirement for the reasons described in this memorandum.