



California Independent  
System Operator Corporation

September 29, 2014

The Honorable Kimberly D. Bose  
Secretary  
Federal Energy Regulatory Commission  
888 First Street, NE  
Washington, DC 20426

**Re: California Independent System Operator Corporation  
Docket No. ER14-\_\_\_\_-000  
Amendment to CAISO FERC Electric Tariff to Eliminate  
Annual External Operations Review**

Dear Secretary Bose:

The California Independent System Operator Corporation (“CAISO”) submits this tariff amendment to eliminate Section 22.1.2.2 of the CAISO tariff, a provision that traces back to the original CAISO tariff and requires that an independent party annually review CAISO management’s compliance with policies and procedures related strictly to operations.<sup>1</sup> In light of the significant advancements in the electric industry generally and the maturity of CAISO’s specific audit and compliance programs, the CAISO believes Section 22.1.2.2 is no longer necessary and should be removed from the CAISO tariff.

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<sup>1</sup> The CAISO submits this filing pursuant to Section 205 of the Federal Power Act, 16 U.S.C. § 824d, and Part 35 of the Federal Energy Regulatory Commission’s regulations, 18 C.F.R. Part 35, and in compliance with Order No. 714 regarding electronic filing of tariff submissions, *Electronic Tariff Filings*, Order No. 714, FERC Stats. & Regs. ¶ 31,276 (2008). Undefined capitalized terms have the same meaning as set forth in Appendix A of the CAISO tariff.

## **I. BACKGROUND**

The tariff requirement for an annual operations review, which currently is set forth in Section 22.1.2.2, resulted from the stakeholder process leading up to the filing of the original proposed CAISO tariff in 1997 and, therefore, has been in the tariff in substantially the same form since the CAISO began operations on March 31, 1998.<sup>2</sup> It states:

Each year, an independent review shall be conducted of the CAISO management's compliance with its operations policies and procedures. The CAISO Audit Committee will appoint an independent party to perform this review. This review may also include material issues raised by Market Participants and approved by the CAISO Audit Committee for inclusion in the review. The report will be addressed to the CAISO Governing Board, copies provided to the CAISO Audit Committee, and upon request, to Market Participants.

Section 22.1.2.2 thus requires the CAISO Audit Committee to appoint an independent party to review annually CAISO management's compliance with its operations policies and procedures. The CAISO implements this requirement by first seeking input from market participants, and then determining the focus of the operations review each year. During the CAISO's first few years of operation—when market participants were just becoming familiar with ISO-type entities and control room processes, stakeholders showed considerable interest in the annual review. As discussed in more detail below, as time has passed, this interest has declined precipitously.

Past areas of focus in the annual operations review have included Pre-Schedule and Check-out Validation, North American Reliability Corporation ("NERC") Tagging Requirements, Manual Dispatch on Interties, and Interchange Schedule Curtailments.<sup>3</sup> Once complete, the CAISO reports the results of the review to the CAISO Audit Committee, provides copies to market participants upon request, and posts the results on the CAISO website.<sup>4</sup>

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<sup>2</sup> Previously, section 22.1.2.2 was designated as section 12.2.2. In its original form the tariff used the undefined term "audit" rather than "review." The CAISO amended the tariff to utilize the undefined term "review" to replace the undefined term "audit" to clarify and distinguish the CAISO's process from how the term "audit" is understood in the financial and accounting context.

<sup>3</sup> See, e.g., the 2013 review issued in December 2013, *available at* <http://www.caiso.com/Pages/documentsbygroup.aspx?GroupID=1A07C714-BBC5-4E3B-B485-FF2F4C9699B4>.

<sup>4</sup> *Id.*

## **II. AUDIT AND COMPLIANCE REGULATIONS HAVE RENDERED SECTION 22.1.2.2 ANACHRONISTIC AND UNNECESSARY**

Since the creation of the CAISO tariff 16 years ago, significant advancements in the electric industry generally and the CAISO's specific advancements in operations compliance have rendered the annual operations review anachronistic and unnecessary.

First, the Commission's regulations promulgated as a result of the Energy Policy Act of 2005<sup>5</sup> now require the CAISO to comply with the Reliability Standards implemented by NERC and Regional Reliability Standards implemented by the Western Electricity Coordinating Council ("WECC").<sup>6</sup> These standards include a number of explicit requirements related to operations.<sup>7</sup> Each year the CAISO must submit a self-certification that it complies with the NERC and WECC standards. The CAISO also self-reports any instances of non-compliance, and NERC and WECC have the ability to audit or spot check the CAISO's compliance at any time.<sup>8</sup>

Second, subsequent to adopting section 22.1.2.2, the CAISO created its corporate compliance and internal audit departments. The CAISO centralized the corporate compliance department in 2008 and has developed a comprehensive compliance program consistent with the Commission's requirements.<sup>9</sup> The compliance program includes reliability standards and tariff and operations policies and procedures.<sup>10</sup> The program also includes reviewing and monitoring controls and conducting compliance assessments in the event of potential compliance issues.

The CAISO formalized its internal audit department in 2010 by creating an internal audit charter, methodology, and audit processes, based on the Institute

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<sup>5</sup> Energy Policy Act of 2005, Pub. L. No. 109-58, Title XII, Subtitle A, 119 Stat. 594, 941 (2005).

<sup>6</sup> See 18 C.F.R. Part 40.

<sup>7</sup> See, e.g., Reliability Standard BAL-001-1 (regarding real-time balancing control performance); Regional Reliability Standard BAL-002-WECC-2 (regarding contingency reserve).

<sup>8</sup> In 2012, the CAISO was the subject of a NERC audit, which resulted in a finding of no instance of the CAISO failing to meet standards. A NERC audit for 2013-15 is scheduled to be performed in 2015.

<sup>9</sup> Before the CAISO established a centralized corporate compliance department, compliance activities were the responsibility of the separate business units within the CAISO.

<sup>10</sup> See <http://www.caiso.com/rules/Pages/Compliance/Default.aspx>.

of Internal Auditors' Professional Practices Framework. These are still used today by the CAISO's team of certified auditors.<sup>11</sup> The internal audit department conducts an annual risk assessment of all process areas within the CAISO, including operations, to identify the highest-risk processes. In recent years, the internal audit department has conducted a number of audits focused on operational processes, 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.

Third, for the last four years, no market participant has responded to the CAISO's yearly request for input concerning the scope of the annual operations review. And during that time, no market participant has provided comments in a public meeting of the CAISO Audit Committee or Governing Board, at which the annual operations review was a topic available for discussion.<sup>12</sup>

Fourth, 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 the relatively narrow scope of each's year's annual review well in advance of the actual review by the independent firm. In contrast, the CAISO's internal audit department works independently with the CAISO Audit Committee to develop a risk based determination of the areas to audit each year and provides no advance notice to the business unit. The CAISO's compliance department also performs control assessments. Thus, the internal audit and compliance departments essentially are performing the operational review function contemplated in section 22.1.2.2. Given the robust internal compliance and audit programs now in place and the lack of significant benefit from the operations review, it is difficult to justify these costs.

Fifth, removing the operations review requirement will not affect the ability of CAISO market participants to raise issues of concern, or the ability of the CAISO to perform audits to address such concerns when deemed necessary. Specifically, tariff section 22.1.2.4, which will not be impacted by this proposed amendment, provides the CAISO Audit Committee the authority to initiate audits relating to "specific issues and concerns of Market Participants" that the CAISO Audit Committee determines to be of "significant and critical magnitude." Likewise, the CAISO is not proposing to eliminate section 11.29.5.4, which requires that an independent firm of auditors to audit the CAISO settlement software.

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<sup>11</sup> A predecessor internal audit group has existed since 2005.

<sup>12</sup> The reviews performed under section 22.1.2.2 in recent years have reported only a very few relatively insignificant exceptions.

Finally, in its review of the tariffs of other independent system operators (“ISOs”) and regional transmission organizations (“RTOs”), the CAISO did not identify any similar audit requirements applicable to these entities. CAISO staff also contacted staff at other RTOs who confirmed that they do not conduct external audits of control room processes or operations.<sup>13</sup> Because of the lack of comments from market participants over the past four years, the maturity of the CAISO’s compliance and audit programs, and the expenses associated with the use of an external entity for the annual review, the CAISO believes that this annual review requirement is unnecessary and anachronistic and therefore should be eliminated.

### **III. STAKEHOLDER PROCESS**

The CAISO published a written proposal on August 22, 2014, requesting comments on September 2, 2014. The CAISO 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 over the years, and that with continuous changes to the CAISO market, an independent review appears prudent. Southern California Edison also asked whether other ISOs or RTOs conduct an external operations review even if their tariffs do not require them to do so, and, if so, the CAISO should continue to conduct such review. CAISO staff spoke with individuals from certain RTOs, who confirmed that their organizations do not conduct an annual external operations review. CAISO staff shared this information with stakeholders participating on the conference call. The CAISO also explained that the more market-oriented tariff changes of concern to Southern California Edison had never been in the scope of the annual operations review and were never intended to be covered by section 22.1.2.2, which was limited to system or grid operations. CAISO staff reminded stakeholders that the CAISO is not proposing to eliminate either section 11.29.5.4, which requires the CAISO settlement software to be audited by an independent firm of auditors, or section 22.1.2.4, which provides that the CAISO audit committee may initiate audits relating to concerns of market participants.

The proposal was presented to the CAISO Governing Board during its public meeting on September 18, 2014. No stakeholder commented on the proposal at that time. The Board voted unanimously to authorize this filing, with the Chairman of the Audit Committee publicly expressing his unqualified support for eliminating the annual operations review.<sup>14</sup>

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<sup>13</sup> Not including market practices, such as settlements.

<sup>14</sup> The materials presented to the CAISO Governing Board of Governors regarding elimination of the annual external operations review are provided as Attachment C to this filing.

Accordingly, the CAISO believes that the elimination of Section 22.1.2.2 from its tariff is just and reasonable for the reasons described above. Moreover, operations review and internal compliance processes are matters of internal CAISO governance only, and not a rate, charge, or classification under the Federal Power Act.<sup>15</sup> As such, these processes do not belong in the CAISO's tariff.<sup>16</sup>

#### **IV. EFFECTIVE DATE**

Pursuant to Section 35.13 of the Commission's regulations, the CAISO requests an effective date of November 29, 2014, 61 days from the date of this filing.<sup>17</sup>

#### **V. COMMUNICATIONS**

The CAISO requests that all correspondence, pleadings, and other communications concerning this filing be served upon the following:

Roger E. Collanton  
General Counsel  
Sidney M. Davies  
Assistant General Counsel  
William H. Weaver  
Counsel  
California Independent System  
Operator Corporation  
250 Outcropping Way  
Folsom, CA 95630  
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<sup>15</sup> See, e.g., *California Independent System Operator Corp. v. FERC*, 372 F. 3d 395, 399 (2004); *City of Cleveland v. FERC*, 773 F.2d 1368, 1376 (D.C. Cir. 1985) (the statutory requirement for the setting forth of practices "must reasonably be read to require the recitation of only those practices that affect rates and services significantly, that are realistically susceptible of specification, and that are not so generally understood in any contractual arrangement as to render recitation superfluous").

<sup>16</sup> As stated above, the CAISO was unable to find similar provisions in the tariffs of the other ISOs or RTOs.

<sup>17</sup> 18 C.F.R. § 35.13.

## **VI. SERVICE**

The CAISO has served this filing upon the California Public Utilities Commission, the California Energy Commission, and all parties with effective Scheduling Coordinator Service Agreements under the CAISO tariff. In addition, the CAISO has posted the filing on its website.

## **VII. ATTACHMENTS**

The following documents, in addition to this transmittal letter, support this filing:

- |              |                                                                                       |
|--------------|---------------------------------------------------------------------------------------|
| Attachment A | Revised CAISO tariff sheets that incorporate the proposed changes described above;    |
| Attachment B | The proposed changes to the CAISO tariff shown in black-line format; and              |
| Attachment C | Materials presented to the CAISO Board of Governors and the Board of Governors' vote. |

## **VIII. CONCLUSION**

For the foregoing reasons, the CAISO requests that the Commission accept this tariff amendment to eliminate Section 22.1.2.2 of the CAISO tariff. Please feel free to contact the undersigned if you have any questions concerning this matter.

Respectfully submitted,

**By: /s/ William H. Weaver**

Roger E. Collanton  
General Counsel  
Sidney M. Davies  
Assistant General Counsel  
William H. Weaver  
Counsel  
California Independent System  
Operator Corporation  
250 Outcropping Way  
Folsom, CA 95630

Counsel for the California Independent System  
Operator Corporation

**Attachment A – Clean Tariff Sheets**  
**Amendment to Eliminate Annual External Operations Review**  
**California Independent System Operator Corporation**

## **22.1.2 CAISO Audit Committee**

The CAISO Governing Board shall have overall audit responsibility for the CAISO. The CAISO Audit Committee shall make recommendations to the CAISO Governing Board in relation to the approval, initiation and scheduling of the following audits:

### **22.1.2.1 Certified Financial Statement Audit**

Each year, an audit by an external independent certified public accounting firm shall be performed. This audit will be conducted in accordance with generally accepted auditing standards to verify that the CAISO's financial statements are in compliance with generally accepted accounting principles and fairly present, in all material respects, the financial position, results of operation and cash flows for the audit period. The audit report will be addressed to the CAISO Governing Board, copies will be provided to the CAISO Audit Committee, and, upon request, to Market Participants.

### **22.1.2.2 [Not Used]**

### **22.1.2.3 Code of Conduct Audits**

On a periodic basis, but not less than once a year, an independent accounting firm shall conduct a management review of governors, officers, employees, substantially full-time consultants, or contractors of the CAISO for compliance with the CAISO Code of Conduct to ensure adherence to the highest standards of lawful and ethical conduct in their activities. The audit report shall be addressed to the CAISO Audit Committee with copies provided to the CAISO Governing Board and, upon request, to Market Participants.

### **22.1.2.4 Interim Audits**

At such other intervals agreed upon by a majority of the CAISO Audit Committee members, audits may be undertaken for specific issues and concerns of Market Participants that the CAISO Audit Committee believes, at its sole discretion, to be of significant and critical magnitude to the CAISO. Such audits will be conducted by an independent accounting firm. The costs of such an audit will be borne by the requesting Market Participant(s), unless the CAISO Audit Committee determines otherwise. Interim audits will be conducted during normal business hours, after reasonable notice has been given to the CAISO, and in accordance with the guidelines to be established by the CAISO Audit Committee.

**Attachment B – Marked Tariff Sheets**  
**Amendment to Eliminate Annual External Operations Review**  
**California Independent System Operator Corporation**

## **22.1.2 CAISO Audit Committee**

The CAISO Governing Board shall have overall audit responsibility for the CAISO. The CAISO Audit Committee shall make recommendations to the CAISO Governing Board in relation to the approval, initiation and scheduling of the following audits:

### **22.1.2.1 Certified Financial Statement Audit**

Each year, an audit by an external independent certified public accounting firm shall be performed. This audit will be conducted in accordance with generally accepted auditing standards to verify that the CAISO's financial statements are in compliance with generally accepted accounting principles and fairly present, in all material respects, the financial position, results of operation and cash flows for the audit period. The audit report will be addressed to the CAISO Governing Board, copies will be provided to the CAISO Audit Committee, and, upon request, to Market Participants.

### **~~22.1.2.2 Review of Compliance with Operations Policies and Procedures~~[Not Used]**

~~Each year, an independent review shall be conducted of the CAISO management's compliance with its operations policies and procedures. The CAISO Audit Committee will appoint an independent party to perform this review. This review may also include material issues raised by Market Participants and approved by the CAISO Audit Committee for inclusion in the review. The report will be addressed to the CAISO Governing Board, copies provided to the CAISO Audit Committee, and upon request, to Market Participants.~~

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At such other intervals agreed upon by a majority of the CAISO Audit Committee members, audits may be undertaken for specific issues and concerns of Market Participants that the CAISO Audit Committee believes, at its sole discretion, to be of significant and critical magnitude to the CAISO. Such audits will be conducted by an independent accounting firm. The costs of such an audit will be borne by the requesting Market Participant(s), unless the CAISO Audit Committee determines otherwise. Interim audits will be conducted during normal business hours, after reasonable notice has been given to the CAISO, and in accordance with the guidelines to be established by the CAISO Audit Committee.

**Attachment C – Materials Presented to the Board of Governors and Board of Governors' Vote**

**Amendment to Eliminate Annual External Operations Review**

**California Independent System Operator Corporation**

# Memorandum

**To:** ISO Board of Governors

**From:** Eric Schmitt, Vice President, Operations

**Date:** September 11, 2014

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

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***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.

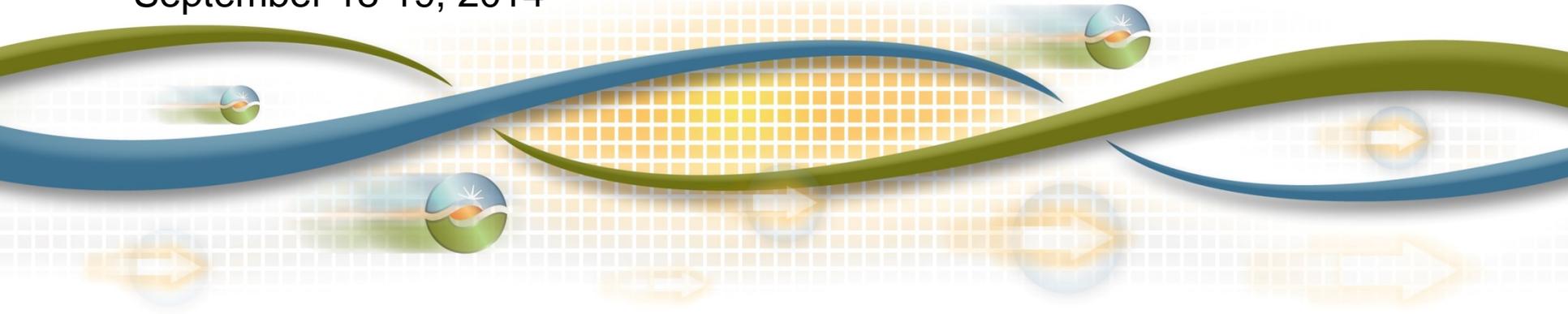
## **CONCLUSION**

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

# Decision on elimination of annual operations review

Nancy Traweek  
Executive Director, System Operations

Board of Governors Meeting  
General Session  
September 18-19, 2014



# Operations review background:

- Since 1998, tariff section 22.1.2.2 has required annual independent review of operational policies and procedures
- Each year the ISO seeks market participant input on suggested scope
- Management reports review results to the Board with opportunity for market participant comment
- Review results are provided to market participants upon request
- Past 4 years participants have not responded to request for input or commented on review results

# Since 1998, the compliance landscape has evolved significantly.

- 2008 formation of ISO compliance program includes:
  - NERC Reliability Standards and WECC Regional Standards effective June 2007
    - Requires annual self certification
    - On-Site audit every three years
  - FERC audit on ISO tariff
  - Annual SSAE 16 settlements audit
  - Annual financial audit
- Expanded focus of Internal Audit team in 2010
  - Audits conducted based on risk assessment
  - Audits focused on operational practices include:
    - Real time transmission, outage management, training, network model maintenance, bid collection and validation and market clearing

# Stakeholder process:

- Proposal posted to stakeholders on August 22, 2014
- Stakeholders support the elimination of the annual operations review requirement
- Conference call held on September 4, 2014 to walk through proposal
  - One comment received from SCE regarding benefits in conducting multiple reviews

Management is seeking Board approval to eliminate the annual operations review requirement for the following reasons:

- Eliminates redundancy
- Reduces expense
- Aligns with other ISOs
- Retains market participants ability to raise concerns
- Retains the ISO's ability to perform audits to address concerns



**Board of Governors      September 18-19, 2014      Decision on elimination of annual operations review**

**Motion**

**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.**

**Moved: Galiteva      Second: Foster**

|                                                    |   |
|----------------------------------------------------|---|
| <b>Board Action: Passed      Vote Count: 5-0-0</b> |   |
| Bhagwat                                            | Y |
| Foster                                             | Y |
| Galiteva                                           | Y |
| Mullin                                             | Y |
| Olsen                                              | Y |

**Motion Number: 2014-09-G5**