



California ISO
Shaping a Renewed Future

**Proposal for
Elimination of CAISO Tariff
Section 22.1.2.2 Regarding
Annual Operational Review**

August 22, 2014

I. Overview

Section 22.1.2.2 of the CAISO tariff requires that each year an independent party perform a review of the CAISO management's compliance with its operations policies and procedures. As discussed below, the CAISO, after providing an opportunity for market participants to provide input, selects the scope of review each year and then engages an external independent entity to conduct the review. Within the past four years, no market participant has proposed an area for review or commented in this annual process.

In addition, since the requirement for an annual review went into effect in 1998 as part of the original CAISO tariff, the compliance landscape has evolved significantly due to the adoption of mandatory reliability standards and with NERC and WECC audit and enforcement regimes. Further, the CAISO's corporate compliance department administers a formal compliance program that includes, among other things, reliability standards and tariff and operations policies and procedures. The CAISO also has an internal audit department that conducts various audits of its process areas, including a number of audits focused on operational processes and practices.

In light of these developments, the CAISO has concluded that the operational review requirement has become an unnecessary and expensive anachronism and, therefore, the CAISO proposes to file a tariff amendment with FERC to eliminate section 22.1.2.2.

II. Discussion

Section 22.1.2.2 of the CAISO tariff requires the CAISO Audit Committee to appoint an independent party to review, on an annual basis, CAISO 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 CAISO Audit Committee for inclusion in the review. The CAISO implements this requirement by selecting, after seeking input from market participants, the scope of review each year. The CAISO reports the results of the review to the CAISO Governing Board and provides copies to the CAISO Audit Committee and to market participants upon request.¹

Section 22.1.2.2 has been in the tariff in substantially the same form since the CAISO began operations on March 31, 1998.² In the more than sixteen

¹ See, for example, the 2013 review issued in December 2013, which is available on the CAISO website at <http://www.caiso.com/Pages/documentsbygroup.aspx?GroupID=1A07C714-BBC5-4E3B-B485-FF2F4C9699B4>.

² Prior to its current designation as section 22.1.2.2, it 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

years since then, a number of developments have occurred that render the annual operational review required by section 22.1.2.2 an expensive anachronism that is no longer necessary.

First, for the last four years, no market participant has responded to the CAISO's yearly request for input concerning the scope of the annual operational 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 operational review was a topic available for discussion.³

Moreover, removing the operational 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."

Second, in compliance with FERC's implementation of the Energy Policy Act of 2005, the CAISO is now explicitly required by FERC regulations to meet the Reliability Standards implemented by the North American Electric Reliability Corporation ("NERC") and Regional Reliability Standards implemented by the Western Electricity Coordinating Council ("WECC").⁴ These standards include a number of explicit requirements related to operations.⁵ Each year the CAISO must submit a self-certification that it complies with the NERC and WECC standards. The CAISO also reports any instances of non-compliance.⁶

Third, subsequent to the adoption of section 22.1.2.2, the CAISO created its corporate compliance and internal audit departments. The corporate

clarify and distinguish the CAISO's process from how the term "audit" is understood in the financial and accounting context. .

³ The reviews performed under section 22.1.2.2 in recent years have reported only a very few relatively insignificant exceptions.

⁴ See 18 C.F.R. Part 40.

⁵ See, e.g., Reliability Standard BAL-001-1 (regarding real-time balancing control performance); Regional Reliability Standard BAL-002-WECC-2 (regarding contingency reserve). The Reliability Standards and Regional Reliability Standards are available on NERC's website at <http://www.nerc.com/pa/Stand/Pages/ReliabilityStandards.aspx>.

⁶ 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.

compliance department was centralized in 2008.⁷ Corporate compliance has developed a comprehensive compliance program consistent with FERC's requirements. The corporate compliance program includes reliability standards and tariff and operations policies and procedures.⁸ The program also includes review and monitoring of controls and compliance assessments in the event of potential compliance issues.

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, that are still in use today by the CAISO's team of certified auditors.⁹ The internal audit department conducts an annual risk assessment of all process areas within the CAISO, including operational areas, to identify the highest-risk process areas from an auditing perspective. In recent years, the internal audit department has conducted a number of audits focused on operational processes and 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.

The CAISO incurs significant expenses in retaining an independent accounting firm to perform the operational reviews. Given the robust compliance and audit programs now in place, this annual cost is simply unnecessary and can and should be avoided.

Finally, in its review of the tariffs of other ISOs and RTOs, the CAISO did not identify any similar audit requirements applicable to these entities. Therefore, given the unnecessary expense, the lack of comments from market participants over the past four years, and the maturity of the CAISO's compliance and audit programs, the CAISO believes that this anachronistic and expensive requirement should be eliminated from its tariff.

III. Next Steps

The CAISO proposes to prepare and file a tariff amendment to delete section 22.1.2.2 for the reasons discussed above. The CAISO is currently conducting its operational review for 2014. The CAISO plans to file the tariff amendment early in the fourth quarter of 2014 to eliminate annual operational reviews after 2014.

⁷ Before the centralized corporate compliance department was established, compliance activities were the responsibility of the separate business units within the CAISO.

⁸ See <http://www.aiso.com/rules/Pages/Compliance/Default.aspx>.

⁹ A predecessor internal audit group has existed since 2005.

The CAISO will be requesting comments by September 2, 2014 and will be hosting a stakeholder conference call on September 4, 2014 between 9:00 and 10:00 a.m. to discuss this paper and the comments. Given the straightforward nature of the proposed tariff change, the CAISO will not be conducting a separate tariff stakeholder process for this proposed tariff amendment.