California ISO
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California Independent
System Operator Corporation

Memorandum

To: ISO Board of Governors

From: Keith Casey, Vice President, Market & Infrastructure Development

Date: May 10, 2010

Re: **Decision on Post-Five Day Price Correction Process**

This memorandum requires Board action.

EXECUTIVE SUMMARY

Management undertook the post-five day price correction process initiative to address market participants' concerns about price corrections and their desire for greater price certainty. Price corrections after the five-day price validation window hamper participants' shadow settlement efforts and complicate their bilateral arrangements that often make use of ISO market prices.

In light of these issues, we have worked with stakeholders to revise the price correction process. In dealing with pricing errors and potential price corrections, Management proposes the principles and processes below:

- Price corrections unrelated to data processing issues with posting prices will be made within the five-day price validation time horizon. In the event that the ISO experiences a problem with the public posting of prices, however, Management proposes that the ISO correct such publication issues and republish prices up to twenty days after the applicable trade date; and

- If the ISO identifies price errors beyond the five-day price validation time horizon and has determined that there is material market impact, as is its practice today the ISO will issue a technical bulletin to explain the impact. No price corrections will be made beyond the five-day period, unless ordered by FERC. In the event that the ISO determines it is appropriate to seek permission to correct prices beyond the five-day period, the ISO's practice will be to request permission for a limited look back of no more than sixty days for any requested price corrections and will await FERC direction on whether to perform a price correction.

Management has determined that this approach to limiting price changes best reflects our requirement to apply the filed rates within the tariff while balancing the needs for price accuracy and price certainty.

> ***Moved, that the ISO Board of Governors approves the proposed tariff changes regarding post-five day price corrections, as detailed in the memorandum dated May 10, 2010; 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

The price correction time horizon is the period of time during which the ISO starts and ends its price validation process. The setting of this time horizon is intended to notify market participants of the time during which posted prices may be subject to change because the ISO is still conducting its price validation and correction process. After this five-day window, the ISO does not continue to validate and correct prices and does not change posted prices as a result of its price validation process procedures.

The ISO tariff section 35.3 and section 8 of the business practice manualsfor market operations currently provide for the ISO to make price corrections beyond the five-day price correction time horizon under limited circumstances. In essence, this tariff provision enables the adjustment of prices so that they are consistent with the rates, terms and conditions of service specified in the tariff. Since the start of the new market design on April 1, 2009, there has been a handful of instances in which prices were corrected outside of the price correction time horizon.[1]

Management undertook this initiative to address market participants' concerns regarding uncertainty around post-price correction time horizon changes. In developing the policy around post-five day price correction processes, Management has strived to balance price certainty and price accuracy. That balance has been weighted by resounding feedback from stakeholders that price certainty is critically important. Prices that change after the five-day price correction window hamper their efforts to shadow ISO settlement calculations, and negatively impact the settlement of bilateral agreements that make use of the ISO market prices.

[1] Link to the January 20, 2010 Technical Bulletin: http://www.caiso.com/2724/2724e6e14e940.pdf

POSITIONS OF THE PARTIES

In the written comments provided on the policy outcome of the post-five day price correction initiative, there were several common issues brought forward by stakeholders. Following is a summary of the comments for those specific issues:

- **Five-day cut-off for price corrections**

  With only one exception, comments submitted by stakeholders were very supportive of the proposal to limit price corrections to within five days of the trade date. Southern California Edison is not in favor of the proposal laid out in the final policy proposal and expressed concern that the five-day cut off is not consistent with the settlement dispute process.

  With regard to SCE's concern, Management notes that the dispute process most often leads to a change to the settlement values for a specific resource due to an erroneous calculation using expected energy. Since these adjustments do not result from incorrect market prices, they are not implicated by the policy described here. In the event that the dispute process does bring to light that binding market prices were calculated in a manner inconsistent with the tariff, the proposed process would apply.

- **Price certainty and processing issues**

  Comments submitted by stakeholders highlighted the need for prices to be unchanging, and reasserted that price changes – whether due to price corrections or to processing issues with posting correct prices – is disruptive to the settlement of bilateral agreements and therefore, the ISO proposal of correcting prices within the five-day window should apply in both circumstances.

  Management appreciates this concern and has committed to undertaking analysis of the monitoring and process improvements needed to minimize changes to posted prices that result from processing issues. However, with the current data transfer monitoring limitations it is not possible to identify and correct all of the potential data processing issues that could lead to incorrect posted prices withing the five-day price validation window. Management has commited to developing and implementing the automated monitoring and data validation processes needed to minimize data processing issues leading to incorrect posted prices; these measures, however, are not yet in place.

- **Determination of good cause to undertake a price correction analysis**

  Some stakeholders expressed concern about Management's reservation of discretion over when to undertake analysis of a potential pricing error. These stakeholders expressed that market participants ought to be made aware of all instances of potential price corrections, and that they should be involved in the decision on whether or not to seek permission from FERC to make the price correction. Management clarifies, that as is the ISO's practice today, if there is a market issue that has material market impact, the ISO will analyze the issue and share its analyse through a Technical Bulletin. This process will take place regardless of whether the ISO then pursues FERC-authority to make a price correction outside the five day window. This process will be further described in the ISO's business practice manuals.

  Management's proposal with respect to price corrections comes out of the feedback that market participants highly value price certainty. This policy of price certainty implies, however, that the market prices are final. In addition to being onerous to the organization, a requirement that ISO Management undertake ongoing and continuous analysis of prices outside the five-day window to determine if they should be changed would be in opposition to the principle of price certainty.

MANAGEMENT RECOMMENDATION

Management recommends the establishment of a look-back period limited to five business days. In other words, we will not change prices that are older than five business days, *i.e.* which are outside the price correction time horizon, without explicit permission from FERC. The one exception to this provision is cases where incorrect prices are due to data processing issues with posting prices.

Management recognizes the importance of price certainty and appreciates that processing issues that result in the need to alter posted prices are just as problematic from the perspective of market participants as actual price corrections outside the price correction time horizon. Therefore, in the event that the ISO experiences a problem with the public posting of prices, the ISO will correct such publication issues and republish prices up to twenty days after the applicable trade date. After twenty days from the trade date, there will be no adjustments to published prices unless directed by FERC. Furthermore, Management commits to developing a plan and a timeline for the implementation of internal monitoring and process enhancements with the ultimate goal of price certainty as close to the trade date as possible.

In addition, consistent with its current practice, in the event that the ISO identifies a material market issue, outside of the five-day price correction time horizon, the ISO will follow the following process:

- Perform an analysis that estimates the impact of the market issue to the extent practicable and feasible
- Prepare and post a technical bulletin that provides the market with the results of this analysis and, if appropriate, support for any recommendation to seek permission to make the price correction from FERC. The technical bulletin and recommendation will be discussed with market participants.

Management has determined that this approach to limiting price changes best reflects our requirement to apply the filed rates within the tariff while balancing the needs for price accuracy and price certainty.