Comments on Draft Final Proposal:
Price Inconsistency Caused by Intertie Constraints

Department of Market Monitoring
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Summary

As summarized in the ISO's Draft Final Proposal, the Department of Monitoring (DMM) has expressed concern that Option B can create an adverse market outcome. Under Option B, when the physical import constraint is binding, virtual exports can profit at the expense of day-ahead revenue adequacy.

We have not identified an adverse market outcome or serious gaming concern caused by Option A. Thus, DMM prefers Option A (two prices) as the most promising option in the ISO's Draft Final Proposal. However, we support the ISO allowing additional time for stakeholders and the Market Surveillance Committee to further analyze Option A for potential adverse market outcomes as well as propose other alternatives.

Discussion of Option A

The ISO enforces two constraints for energy at each intertie - one for net physical schedules and one for net physical plus virtual schedules. Physical schedules at the interties can therefore impact total system costs differently than virtual schedules. Option A correctly assigns prices to physical and virtual schedules at the interties according to their respective incremental impacts on total system costs.

Under Option A, virtual schedules can clear at a different price than physical schedules at the same node when the physical constraint is binding. The possibility of two different prices has created some concern that participants could strategically take advantage of this pricing rule. In particular, if the physical import constraint is binding then virtual schedules could clear at a higher price than physical schedules. A single entity could therefore profit from this price difference by clearing an equal quantity of virtual imports and physical exports at the intertie. However, DMM does not believe this scenario creates an adverse market outcome.

If the physical import constraint is binding, the cleared virtual exports will equal or exceed the cleared virtual imports at the intertie. Therefore, the cleared virtual imports will have a cleared virtual export counterpart clearing at the same virtual intertie price in the day-ahead and hour-ahead markets. Similarly, the cleared physical exports in the day-ahead market will have a physical import counterpart clearing at the same physical intertie price. When the physical import constraint is binding, virtual imports and physical exports have counterparts clearing at the same prices. Therefore, in instances where congestion creates a price separation at the intertie, virtual imports cannot be cleared against physical exports. This mitigates concern over the creation of uplift from bids attempting to arbitrage the physical and virtual intertie price difference.