

Subj: **Two-fold task of Inadvertent pricing**
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1. **Eliminating perverse incentives for incurring Inadvertent Interchange**, such as being rewarded for Inadvertent that hurts frequency, being penalized for Inadvertent that helps frequency, or being able to bypass price differences across an Intertie that are caused by congestion, transmission usage charges, statutory constraints on export, whatever. This remedy would be achieved by locational pricing of the "Energy component" of the Inadvertent, and eliminates all rewards or penalties for Inadvertent.

2. **Instituting the appropriate incentives for incurring Inadvertent Interchange** by penalizing the parties who incur Inadvertent that is hurting frequency and using those penalties to pay the standby cost of the reserve capacity that is being used by the parties who provide Inadvertent that is helping frequency. This financial transfer from those hurting frequency to those helping frequency would be achieved by pricing the "Frequency-Control-Contribution component" of Inadvertent, since the amount of Inadvertent that is helping frequency always exactly equals the amount of Inadvertent that is hurting frequency, while the amount of good Inadvertent or bad Inadvertent determines the frequency error and therefore the price of the Frequency-Control-Contribution.

Unless the second task of Inadvertent pricing is also achieved, the following perverse market result occurs: Inadvertent pricing becomes a substitute for a spot market for energy. Indeed, unless the second task is also achieved, a party with a long-term contract for energy could adjust for short-term demand fluctuation by simply scheduling the long-term contract amount and transacting for the excess or shortfall in demand as "Inadvertent energy" instead of deliberately going to a scheduled spot market for the excess or shortfall. Additional cost must be imposed to prevent such behavior from hurting frequency, and the extra revenue collected must be used to reward the holding of reserves to offset this behavior and keep frequency from veering from target. Inadvertent pricing thereby necessarily needs to be different from mere spot energy pricing to prevent Inadvertent energy from being used as a proxy for scheduled spot-market energy.