Economics of Grid-Supported Electric Power Markets: A Fundamental Reconsideration

Leigh Tesfatsion

Research Professor of Economics, Courtesy Research Professor of Electrical & Computer Engineering, and Professor Emerita of Economics, Iowa State University, Ames, IA 50011-1054

https://www2.econ.iastate.edu/tesfatsi/

tesfatsi@iastate.edu

Slide-Set Materials Summarizing Key Topics Addressed in:

Supporting Document (Attachment A) for e-filed Comments:

L. Tesfatsion, Accession No. 20230117-5051,
U.S. Federal Energy Regulatory Commission (FERC),
Docket No. AD21-10-000 ("Modernizing
Wholesale Electricity Market Design")

Presentation Outline

- **Major Problem:** Current U.S. RTO/ISO-managed wholesale power markets are experiencing increasingly volatile and uncertain net fixed load due to increasing reliance on renewable power and increasingly diverse types of market participants.

- **Major Concern:** Three conceptually-problematic market-design aspects -- product definition & pricing, settlement timing, and supply-offer formulations -- are hindering attempts to remedy this major problem.

- **Possible Remedy:**
  - An alternative conceptually-consistent **Linked Swing-Contract Market Design** has been proposed, developed, and tested at Technology Readiness Level TRL-3.
  - This alternative design is well-suited for scalable, efficient, & reliable support of increasingly decarbonized grid operations with increasingly diverse participants.
  - Adoption of this alternative design by current RTO/ISO-managed markets would require changes in product definition, settlement rules, and supply-offer forms, but not in real-time operations.
  - Thus, adoption of this design could be implemented through gradual transition.

- **References**

Current U.S. Wholesale Power Markets Managed by a ***R***egional ***T***ransmission ***O***rganization (***RTO***) or ***I***ndependent ***S***ystem ***O***perator (***ISO***)

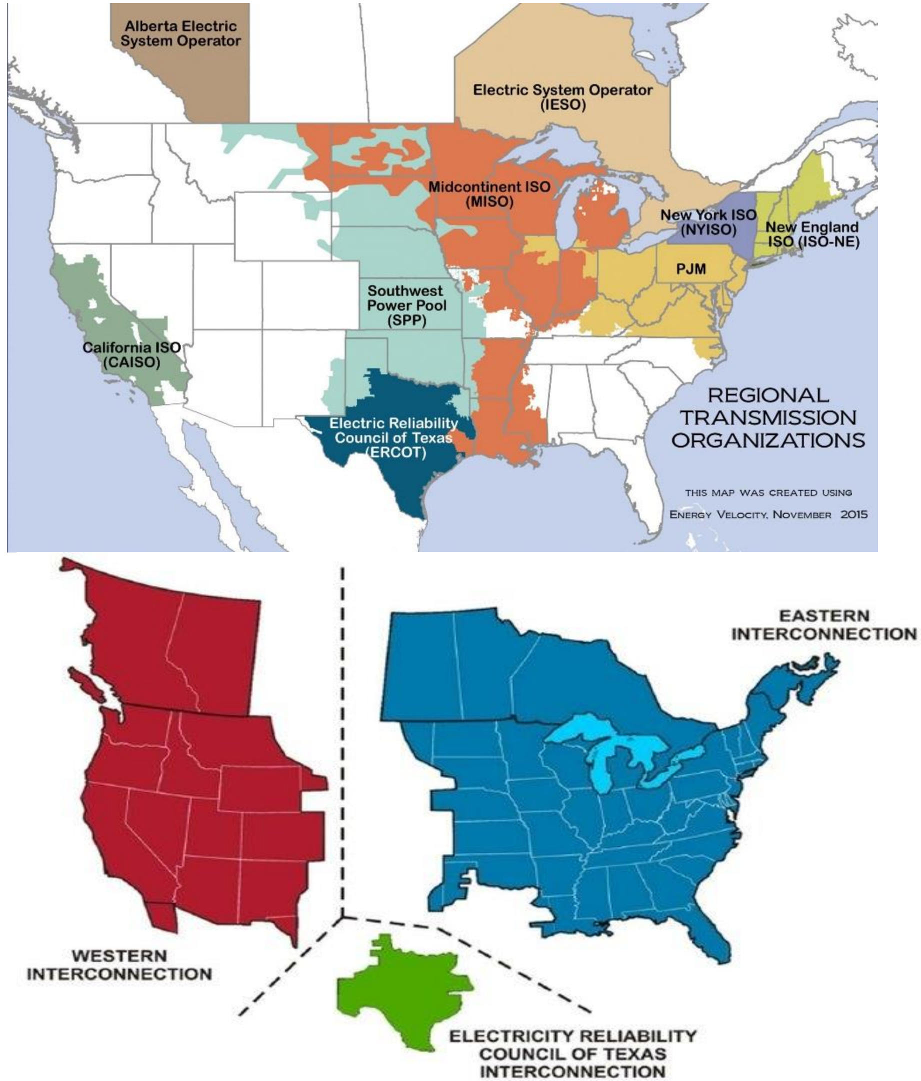


Fig. 1*:* *Seven North-American RTO/ISO-managed wholesale power markets operate over a high-voltage AC transmission grid consisting of three separately-synchronized parts.*

Major Concern:

— Increasing reliance on ***Intermittent Power Resources (IPRs)***
(e.g., wind farms & large solar PV panel arrays ***not*** fully firmed by storage)

— Increasing encouragement of more active participation by *distribution-level* power resources and customers (*FERC Order 2222*, Final Rule, 17 September 2020)

➡ Increasing volatility & uncertainty of

Net Fixed Load =: [Non-Dispatched Load – Non-Dispatched Generation]

➢ **RTOs/ISOs** must function as ***"fiduciary conductors"*** tasked with orchestrating:

— availability & *just-in-time* dispatch of *increasingly diverse* dispatchable power resources

— to service *just-in-time* power demands of *increasingly diverse* customers

— while meeting *just-in-time* power requirements for grid reliability.

➢ **Grids** supporting RTO/ISO-managed wholesale power market operations must function as ***"flexibility-support mechanisms"***

Potential Remedy for Major Concern (Net-Load Volatility & Uncertainty)

- **Physically-Covered Insurance:** Increase the dependable advance availability of *flexible dispatchable power-production capabilities*

  - **from wholesale power resources**

    — Use storage to firm-up dispatchability of *Intermittent **P**ower **R**esources (**IPR**s)*

  - **from distributed power resources (FERC Order 2222)**

    — Permit aggregators (T&D linkage entities) to participate in wholesale power markets as suppliers of RTO/ISO-dispatchable power flows harnessed from ***diverse*** collections of ***distribution-level power resources*** by means of *Transactive **E**nergy **S**ystem (**TES**) designs*.

- **Difficulty:**

  Conceptually-problematic legacy market design aspects affecting the core operation of current grid-supported U.S. RTO/ISO-managed wholesale power markets are *hindering* the pursuit of this potential remedy.

Three Conceptually-Problematic Legacy Market Design Aspects

1) Product Definition and Pricing: *Static focus on grid-delivered energy (MWh), settled via conceptually ill-defined Locational Marginal Prices ($\MWh)*

— *Grid-delivered* energy, conditional on delivery location and time, **strongly** fails to satisfy a unit homogeneity property that is **necessary** for the conceptual coherency of Locational Marginal Pricing (LMP).

2) Settlement Timing: *Pay-for-performance in advance of actual performance*

— Sequential provisional forward-market determination of LMP settlements takes place in advance of final ex-post LMP settlements for actual real-time dispatched performance.

— This results in time-inconsistent settlements, hence in unnecessarily complex and confusing settlement rules.

3) Supply-Offer Forms: *Revenue Insufficiency & Reliance on Out-of-Market Payments*

— Suppliers are forced to express supply costs as functions of grid-delivered energy amounts.

— Suppliers are not required to distinguish between avoidable and non-avoidable fixed costs.

— Suppliers are unable to specify and submit their market supply offers in a manner that ensures *supplier revenue sufficiency: [revenue] ≥ [variable cost + avoidable fixed cost]*

Fundamental Reconsideration of These Three Legacy Market-Design Aspects: *Ref. [1]*

Product Definition and Pricing:

Two basic types of product are provided by dispatchable power resources:

- ***Reserve (physically-covered insurance) for future operating-periods T:*** Dependable advance availability of dispatchable power-production capabilities for possible RTO/ISO dispatch during a future operating-period T to protect against volumetric grid risk (net load imbalance);

- ***Real-time delivery of power during an operating period T*** in response to RTO/ISO dispatch signals.

Settlement Timing and Supply-Offer Formulations:

A **conceptually-sound** definition of revenue sufficiency for a supplier requires:

- Partitioning of the supplier's Total Cost into **three** components:

  Total Cost =: *Unavoidable ("Sunk") Fixed Cost + Avoidable Fixed Cost + Variable Cost*

- Use of this 3-part partitioning to define revenue sufficiency for this supplier as follows:

  Supplier Revenue Sufficiency =: [Market-Attained Revenue ≥ Market-Incurred Avoidable Cost]

  where:

  Avoidable Cost =: [Avoidable Fixed Cost + Variable Cost]

Time-consistent settlements that assure supplier revenue sufficiency (as defined above) can be achieved in RTO/ISO-managed forward markets **without** resort to Out-of-Market (OOM) make-whole payments **if** suppliers are permitted to submit their supply offers in appropriate **two-part pricing** form.

Fundamental Reconsideration of Product Definition & Pricing: Essential Definitions

DEF 1: Asset =: Anything in physical or financial form that can function as a store of value

Examples: Health; batteries; common stock shares, …

DEF 2: Spot Market for an Asset =: Transacted asset amounts, payments for these transacted asset amounts, and deliveries of these transacted asset amounts *all occur at the same time* ("*on the spot*").

Example: Asset Street-Vending. A person offers candy for sale to people who happen to pass by.

DEF 3: Forward Market for an Asset =: Transacted asset amounts and payment obligations for these transacted asset amounts *are determined in advance of the delivery* of these transacted asset amounts.

Example: Physically-Covered Insurance Market. In return for an up-front fee ("insurance premium"), a supplier *i* offers a buyer *j now* the guaranteed advance availability of production facilities for buyer *j*'s possible use at a designated location *b* during a designated *later* time-period T, where any actual use of these production facilities by buyer *j* at *b* during T is subject to an additional specified use-fee ("insurance co-payment").

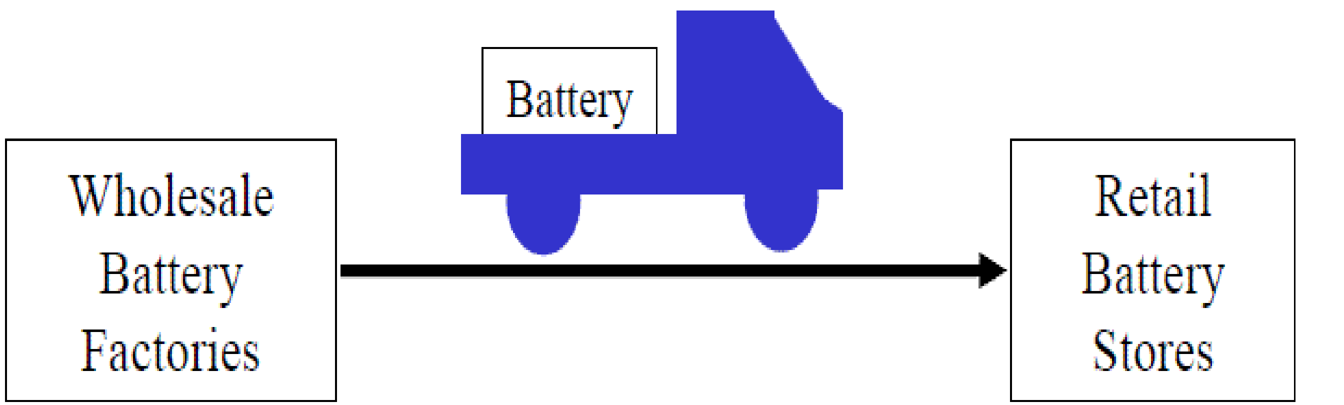
DEF 4: Commodity =: Physically-exchangeable asset *A* with standard unit of measurement *u* such that, conditional on location and time, each *A*-trader (supplier and/or buyer) considers all *A*-units *u* available for trade to be ***perfect substitutes*** ("economically equivalent''); that is, the substitution of ***any*** *A*-unit *u'* available for trade by ***any other*** *A*-unit *u'' available for trade* does ***not*** change the economic value that the *A*-trader assigns to this *A*-unit.

Example: Standardized manufactured products, e.g., DURACELL AA 1.5v batteries with *u* = 1 Battery

Energy (MWh) as a Commodity -- A Spot Market Example

— Suppose energy (MWh) is produced and sold in the form of identical units = : identical DURACELL AA 1.5v batteries.

— At any given retail location and time, each unit (battery) sells at a common per-unit retail price π^{Ret} (\$/battery) that covers wholesale production cost ("**W**") plus transport/damage cost ("**Trans**").



π^{W} π^{Trans} $\pi^{Ret} = \pi^{W} + \pi^{Trans}$

Fig. 3: *Energy (MWh) in uniform battery form **can** be transacted as a commodity.*

Note: The decomposition of the "spot price" π^{Ret} into "energy" and "transport/damage" components is analogous to the standard decomposition of LMPs into "energy," "congestion," and "loss" components.

Grid-delivered energy (MWh) is not a commodity

❑ Why Not?

- Exact way that power (MW) injected at a grid-location *b* during an operating period T accumulates up into a grid-delivered energy amount E* (MWh) can matter greatly to producers, customers, and/or the RTO/ISO.

- That is, the dynamic attributes of the sequence of injections and/or withdrawals of power (MW) used to implement the delivery of E* at *b* during T typically matter, not simply the static amount E* (MWh) of grid-delivered energy.

Examples:

— Producers care about depreciation costs from ramping wear & tear ***during*** T;

— Customers benefit from flexible just-in-time power availability ***during*** T;

— RTO/ISO, with fiduciary responsibility for grid reliability, benefits from having flexible just-in-time availability of net-load balancing services ***during*** T.

LMP is Not Conceptually Well-Defined for Grid-Delivered Energy

Point 1:

The standard economic **competitive (marginal cost = marginal benefit) spot-pricing rule** *requires* the transacted asset *to be a commodity*. *See Ref. [2] for a rigorous proof.*

Point 2:

Grid-delivered energy is an asset with a standard unit of measurement (u = 1MWh); but grid-delivered energy is typically *not a commodity* because, conditional on location and time, each trader k (supplier or buyer) does *not* consider *all* "next" units u of grid-delivered energy available for trade to be perfect substitutes (economically equivalent). Thus:

(2.1) A *supplier k* of grid-delivered energy typically does *not* have a conceptually well-defined *marginal cost (MC)* function for grid-delivered energy, conditional on location and time;

(2.2) A *buyer k* of grid-delivered energy typically does *not* have a conceptually well-defined *marginal benefit (MB)* function for grid-delivered energy, conditional on location and time.

(2.3) Competitive (MC = MB) spot-pricing typically *cannot* be implemented in a *conceptually coherent manner* for *grid-delivered energy (MWh),* conditional on location and time.

Major Implication of Points 1 and 2:

The justification commonly asserted for use of ***Locational Marginal Pricing (LMP)*** for price-settlement of grid-delivered energy in U.S. RTO/ISO-managed wholesale power markets – namely, the efficiency and optimality properties of competitive (MC = MB) spot-pricing -- ***is not conceptually supportable.***

U.S. RTO/ISO-managed wholesale power markets are "power-path" markets

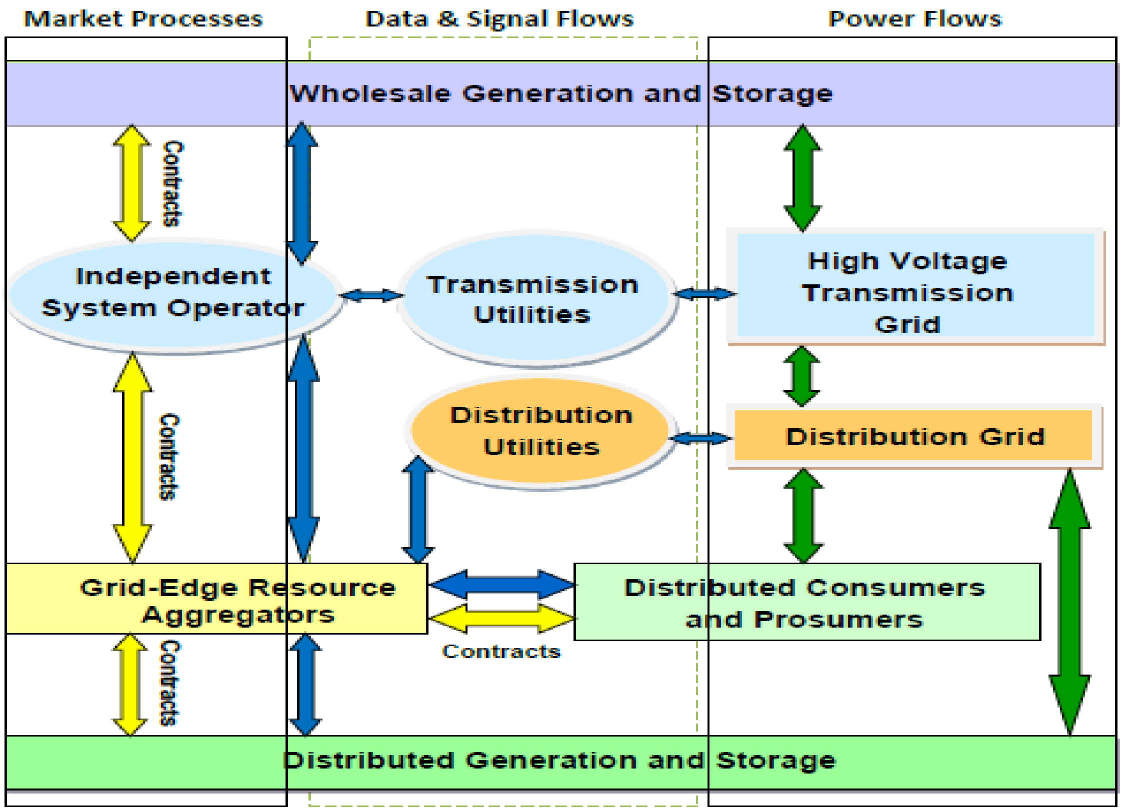


Fig. 4: The basic purpose of *U.S. RTO/ISO-managed wholesale power markets is to support the efficient just-in-time production and transmission of bulk power to satisfy just-in-time customer power demands as well as just-in-time power requirements for reliable transmission-grid operation.*

Grid-Edge Resource (GER) =: Any entity capable of power usage and/or power output that has a *direct* electrical point-of-connection to a *distribution* grid.

Power-path for an operating period T =:

Sequence of injections and/or withdrawals of power (MW) that take place at a *single* grid location *during* operating period T.

===

Important*:** a ***power-path is a ***path through time*** taking place at a ***fixed location.***

===

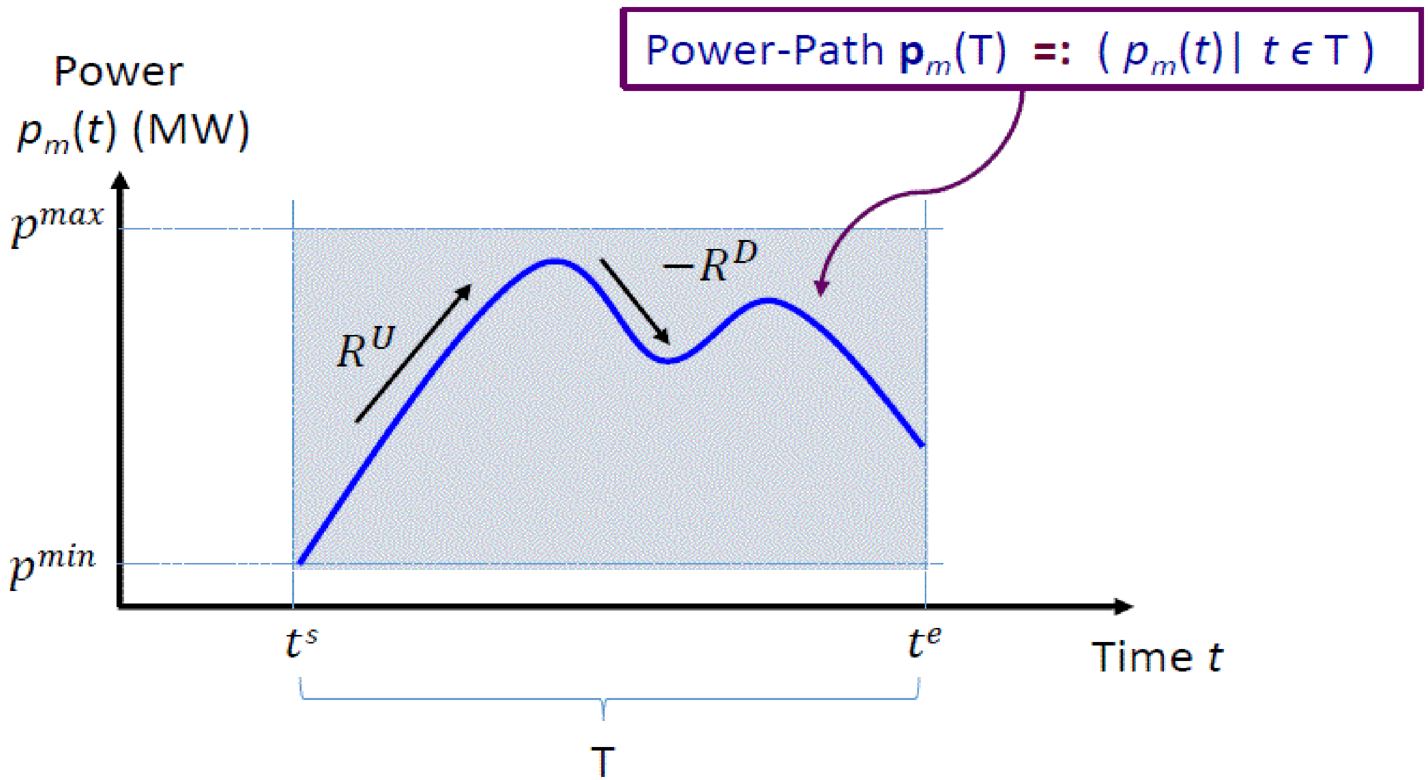


Fig. 2: *Power-Path Illustration.* *One of many power-paths offered by a dispatchable power resource m for possible RTO/ISO dispatch at its grid location b(m) during a future operating period T, where m has min/max limits on its generation capacity p, on its ramp-down-rate R^D, and on its ramp-up-rate R^U.*

Power-paths are *not a commodity* for grid-supported power markets

❑ Why Not?

- **Power-paths** have multiple types of dynamic and static attributes that affect how they are evaluated by power producers, power customers, and the RTO/ISO itself.
- Thus, power-paths do not have a standard unit of measurement *u* such that, conditional on location and start-time for an operating period T, each trader (supplier or buyer) considers any unit *u′* available for period-T trade to be a perfect substitute for any other unit *u′′* available for period-T trade.

Examples of Dynamic Power-Path Attributes:

— Down/up ramp-rate (MW/min) ***profile*** during T can affect producer cost (wear & tear) during T;

— Active power (MW) ***profile*** during T can affect customer benefit during T;

— Power factor (MW/MVAR) ***profile*** during T can affect power system reliability during T,

where:

profile during T =: *Form that some measured attribute takes **during** operating period T.*

❑ However, as carefully analyzed in **Ref. [3],** reviewed in **Ref. [1],** outlined in **Ref. [2]**, and briefly discussed in the following slides, "swing-contracts" are well-suited for the support of power-path transactions in U.S. RTO/ISO-managed markets.

Linked Swing-Contract Market Design: Brief Overview

- **Purpose**
  - Facilitate balancing of increasingly volatile & uncertain net load in grid-supported centrally-managed wholesale power markets.
- **Novel Aspects**
  - Each swing-contract market is a *forward reserve market;*
  - Reserve consists of *RTO/ISO-dispatchable power-paths*;
  - Reserve offers take the form of *swing contracts;*
  - Each swing ("flexibility") contract is a *physically-covered insurance contract with two-part pricing;*
  - This two-part pricing permits reserve suppliers to guarantee their *revenue sufficiency.*

General Swing-Contract Reserve Offer Formulation

- **The general form of a swing contract** submitted by a dispatchable power resource *m* to a swing-contract market M(T) for a future operating period T consists of four components:

$$\mathrm{SC}_m = \left(\alpha_m, \mathbb{T}^{\mathrm{ex}}_m, \mathbb{PP}_m, \phi_m\right)$$

$\boldsymbol{\alpha}_m$ =: offer price (insurance premium)

$\mathbf{T}^{\mathrm{ex}}_m$ =: Set of RTO/ISO exercise times

$\mathbf{PP}_m$ =: Power-path production possibility set

$\boldsymbol{\varphi}_m$ =: Performance payment method

- **The swing contract $\mathbf{SC}_m$ permits a dispatchable power resource *m*:**

— to offer the RTO/ISO a *production-possibility set* $\mathbf{PP}_m$ consisting of reserve (power-paths **p**) for possible RTO/ISO-dispatched delivery during T at *m*'s grid location *b(m)*;

— to specify with care the *swing* (*flexibility*) in the physical attributes of the offered power-paths **p** in $\mathbf{PP}_m$.

- **The physical attributes of each offered power-path p** can include:

static attributes: grid delivery location *b(m)*; grid-delivered energy amount (MWh) …

dynamic attributes: power level *profile*; power-factor *profile*; ramp-rate *profile*; power-path *length* (*mileage*); …

General Swing-Contract Reserve Offer Formulation ... *Continued*

- In addition, the swing contract $\mathrm{SC}_m = \left(\alpha_m, \mathbb{T}_m^{\mathrm{ex}}, \mathbb{PP}_m, \phi_m\right)$

— permits *m* to request an **offer price** $\boldsymbol{\alpha_m}$ **($) --** i.e., an insurance premium – that is sufficient to cover *ex ante* (i.e., in advance of T) any **avoidable fixed cost ($)** that *m* must incur in order to guarantee the availability of the power-paths in $\mathbf{PP}_m$ for possible RTO/ISO dispatch at *m*'s grid location *b(m)* during T.

Avoidable fixed cost examples: Capital investment cost; transaction cost (insurance, licensing, …); unit commitment cost; opportunity cost; … *Ref. [1, Appendix A.4]*

— permits *m* to specify a **performance payment method** $\boldsymbol{\varphi_m}$ that maps each power-path $\mathbf{p} \in \mathbf{PP}_m$ into a required performance payment $\boldsymbol{\varphi_m}(\mathbf{p})$ (measured in $). This allows *m* to recover *ex post* (i.e., after T) any **variable cost** that m incurs for verified period-T power-path delivery in accordance with RTO/ISO dispatch signals received during T.

Variable cost examples: Fuel cost; labor cost; transmission service charges; equipment wear and tear due to ramping; … *Ref. [1, Appendix A.4]*

- The performance payment method φ_m should be explicitly expressed in terms of **performance metrics**.

- These performance metrics **should permit the RTO/ISO and *m*:**
  - — to agree *ex ante* (i.e., *in advance of T*) on nature of *m*'s *offered* power-path production *capabilities* for *possible* RTO/ISO-dispatched delivery *during* T;
  - — to verify *ex post* (i.e., *after T*) the extent to which *m's actual* period-T power-path delivery deviates from admissible dispatch set-points that the RTO/ISO has communicated to *m* during T (if any).

Example:

Determine performance cost $\varphi_m(\mathbf{p})$ of each power-path **p** in $\mathbf{PP}_m$ as a linear combination of metrics that separately assign costs to correlated attributes of **p**, such as **delivered energy (*E*), ramp (*R*), duration (*D*)**, etc.

$$\underbrace{\varphi_m(\mathbf{p}) \quad = \quad c^E(\mathbf{p}) + c^R(\mathbf{p}) + c^D(\mathbf{p}) + \ldots}$$

Costs assigned to ***correlated*** attributes of a ***single*** power-path **p**

Swing Contract Illustrative Examples: See *Ref. [3, Chapter 5]*

Example 1: *A simple energy-block swing contract in firm form*

Remark: This simple type of swing contract can easily be modified to express current types of supply offers, such as ERCOT's three-part supply offer.

$$\mathrm{SC}_m = [\alpha,\ \mathbb{PP},\ \phi]$$

where:

$$\alpha = \text{Offer price}$$

$$\mathbb{PP} = (b, t^{\mathsf{s}}, p^{\mathsf{disp}}, t^{\mathsf{e}})$$

$$b = \text{Delivery location}$$

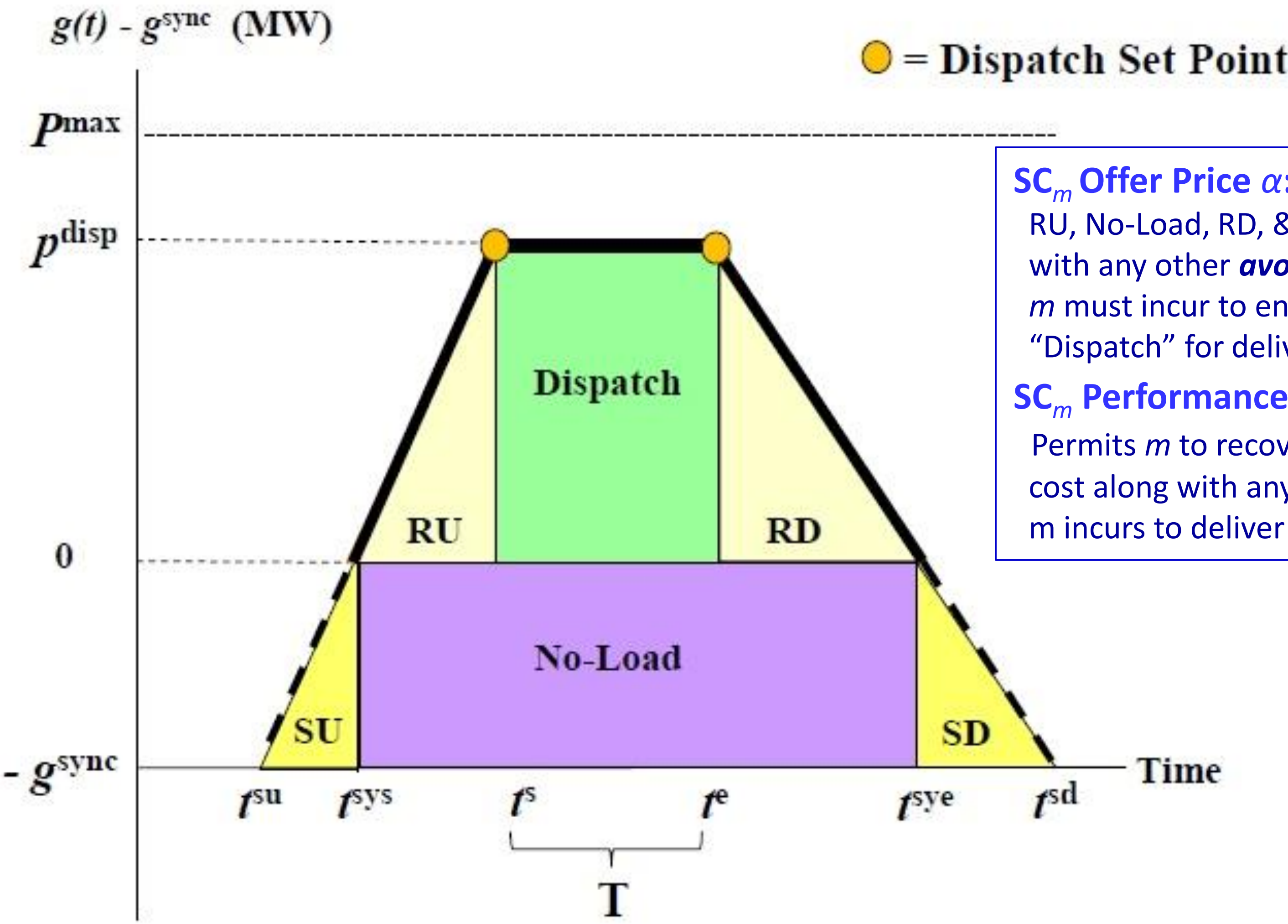
$$t^{\mathsf{s}} = \text{Start time for energy block E}$$

$$p^{\mathsf{disp}} = \text{Maintained power injection for energy block E}$$

$$t^{\mathsf{e}} = \text{End-time for energy block E}$$

$$\phi = \text{Pre-specified price } \pi \text{ for delivered energy}$$

Example 1: *A simple energy-block swing contract … Continued*



SC_m Offer Price α: Permits *m* to cover SU, RU, No-Load, RD, & SD energy costs along with any other ***avoidable fixed*** *cost* that *m* must incur to ensure the availability of "Dispatch" for delivery at *b(m)* during T.

SC_m Performance Payment Method φ: Permits *m* to recover "Dispatch" energy cost along with any other **variable** cost that m incurs to deliver "Dispatch" at *b(m)* during T.

Fig. 5: *Illustration of m's **energy** requirements for delivery of energy-block "Dispatch" at m's grid-location b(m) during operating period T: the energy block ("Dispatch"); start-up ("SU"); ramp-up ("RU"); no-load ("No-Load"), ramp-down ("RD"), and shut-down ("SD").*

Example 2: *A piecewise-linear swing contract in firm form*

$$\mathrm{SC}_m = [\alpha, \mathbb{PP}, \phi]$$

where:

α = Offer price

$\mathbb{PP} = (b, t^{\mathsf{s}}, p^{\mathsf{s}}, \mathbb{RR}(\mathrm{R1}), t^{\mathsf{E1}}, \mathbb{P}(\mathrm{E1}), t^{\mathsf{R2}}, \mathbb{RR}(\mathrm{R2}), t^{\mathsf{E2}}, \mathbb{P}(\mathrm{E2}), t^{\mathsf{e}})$

b = Delivery location

t^{s} = Start-time for ramp interval R1

p^{s} = Power injection level at start-time t^{s}

$\mathbb{RR}(\mathrm{R1})$ = Set of feasible ramp-rates $r(p^{\mathsf{s}}, p_i(\mathrm{E1}))$ for R1

t^{E1} = Start-time for energy block E1

$\mathbb{P}(\mathrm{E1})$ = Set of feasible maintained power-steps $p_i(\mathrm{E1})$ for E1

t^{R2} = Start-time for ramp interval R2

$\mathbb{RR}(\mathrm{R2})$ = Set of feasible ramp-rates $r(p_i(\mathrm{E1}), p_j(\mathrm{E2}))$ for R2

t^{E2} = Start-time for energy block E2

$\mathbb{P}(\mathrm{E2})$ = Set of feasible maintained power-steps $p_j(\mathrm{E2})$ for E2

t^{e} = End-time for E2

ϕ = Payment for ramp and delivered energy calculated by means of power-path mileage and a pre-specified price $\pi(p)$ for each $p \in \mathbb{P}(\mathrm{E1}) \cup \mathbb{P}(\mathrm{E2})$

Example 2: *A piecewise-linear swing contract … Continued*

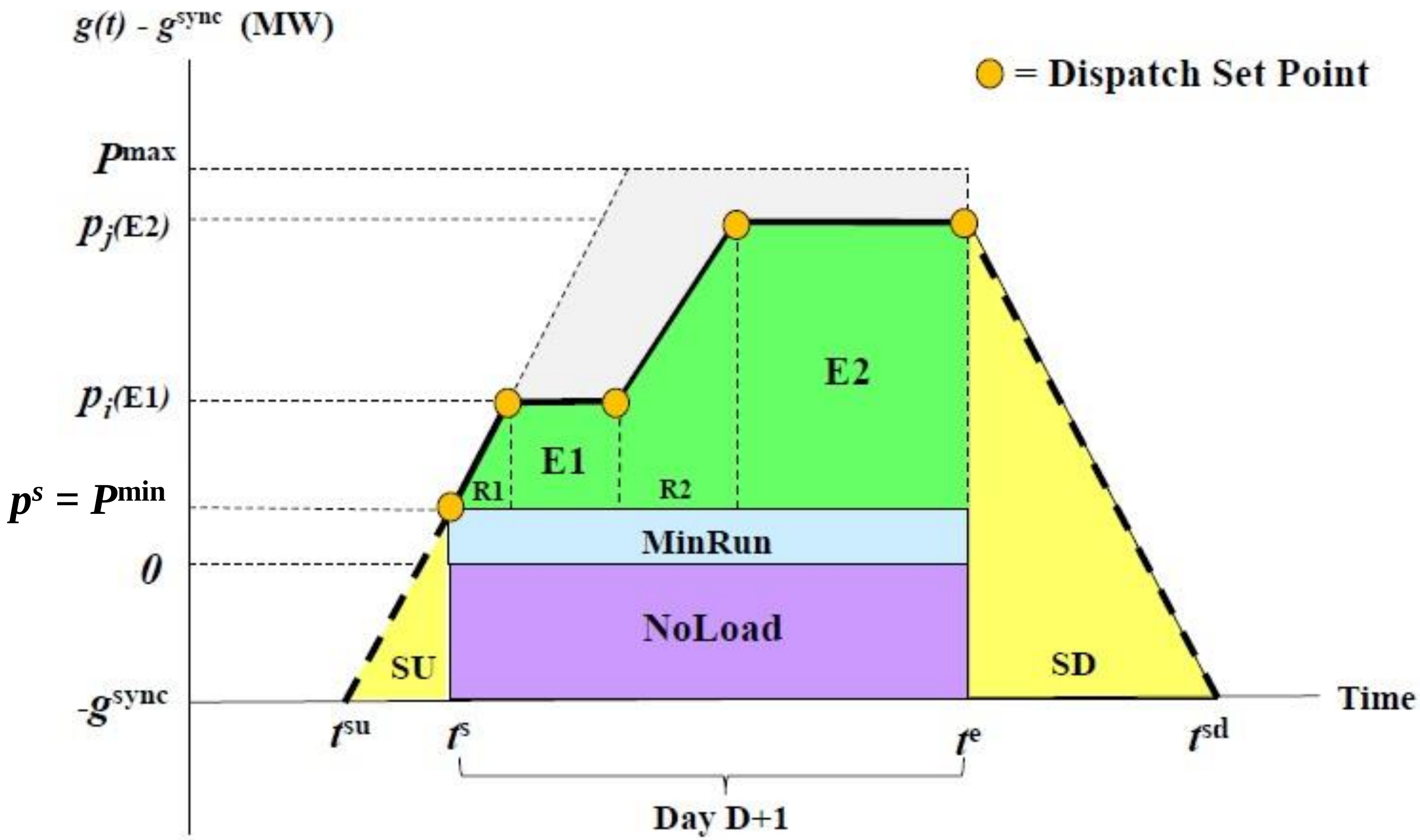


Fig. 6: *The depicted dispatched power-path is one among many possible power-paths* ***p*** *the RTO/ISO could dispatch m to deliver at m's grid-location b(m) during operating day D+1 if the RTO/ISO clears m's piecewise-linear swing-contract SC_m submitted to a swing-contract day-ahead market M(D+1) on day D.*

Example 3: *A swing contract in firm form offering battery charge/discharge as an ancillary service*

$$\mathrm{SC}_m = [\alpha, \mathbb{PP}, \phi]$$

where:

$$\alpha = \text{Offer price}$$

$$\mathbb{PP} = (b, ECap^{\mathsf{max}}, \eta, t^{\mathsf{s}}, \mathbb{SOC}^{\mathsf{s}}, \mathbb{RR}, \mathbb{P}, t^{\mathsf{e}}, \mathbb{SOC}^{\mathsf{e}})$$

$$b = \text{Delivery location}$$

$$ECap^{\mathsf{max}} = \text{Maximum energy storage capacity}$$

$$\eta = \text{Round-trip efficiency}$$

$$t^{\mathsf{s}} = \text{Start-time for power discharge/charge}$$

$$\mathbb{SOC}^{\mathsf{s}} = \text{Set of feasible state-of-charge percentages at } t^{\mathsf{s}}$$

$$\mathbb{P} = [P^{\mathsf{min}}, P^{\mathsf{max}}] = \text{Range of feasible discharge/charge levels } p$$

$$\mathbb{RR} = [-R^{\mathsf{D}}, R^{\mathsf{U}}] = \text{Range of feasible ramp-rates } r$$

$$t^{\mathsf{e}} = \text{End-time for power discharge/charge}$$

$$\mathbb{SOC}^{\mathsf{e}} = \text{Set of feasible state-of-charge percentages at } t^{\mathsf{e}}$$

$$\phi = \text{Performance payment method for down/up power-path delivery}$$

Example 3: *A swing contract in firm form offering battery … Continued*

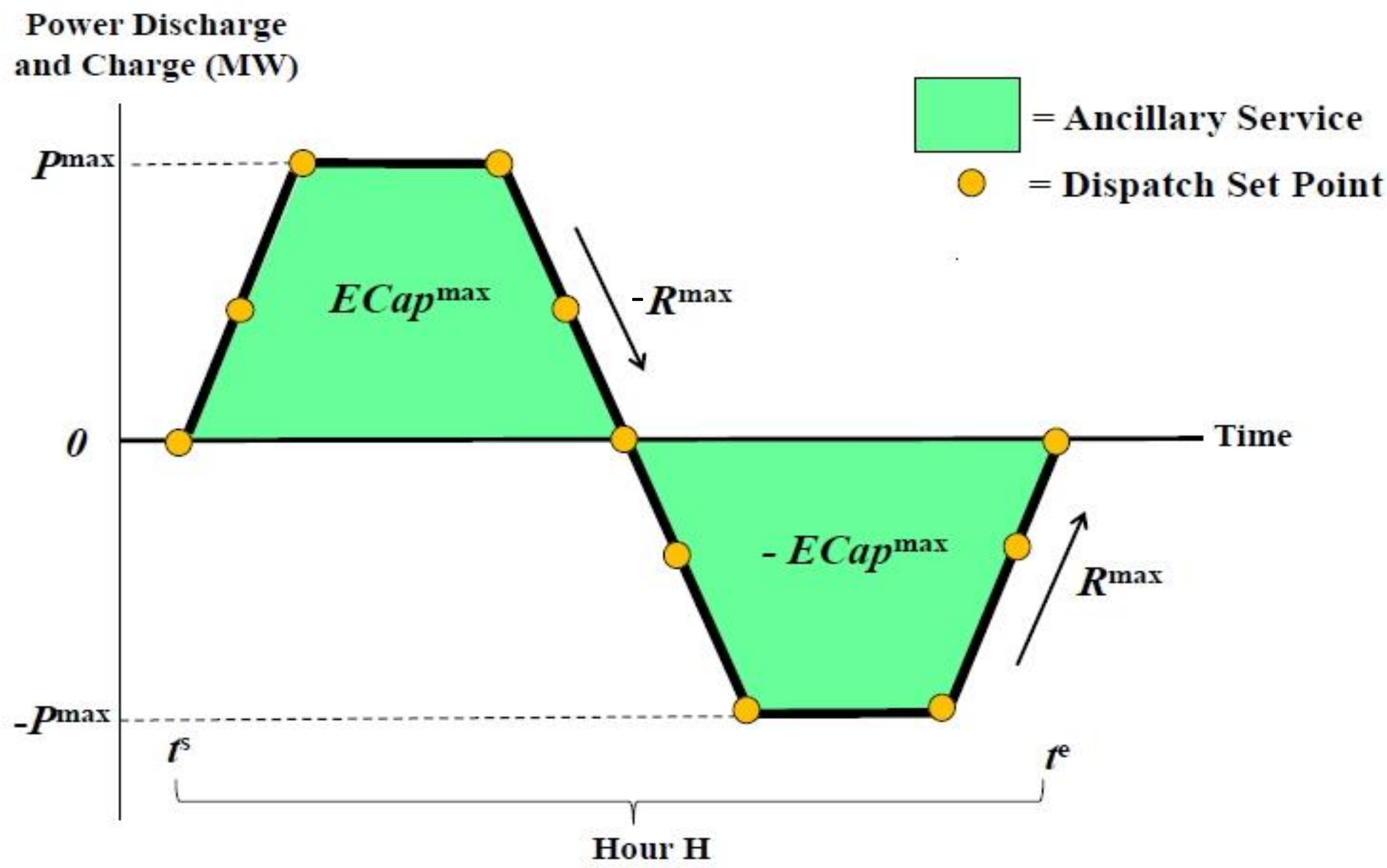


Fig. 7: *Suppose* **SOC**^{s} = **SOC**^{e} = {**100%**}, **P**^{min} = **- P**^{max}, *and* $R^{D} = R^{U} =: R^{max}$. *Then the depicted dispatched power-path is one among many possible power-paths* **p** *the RTO/ISO could dispatch m to deliver at m's grid-location b(m) during hour H = [t^{s}, t^{e}) if the RTO/ISO clears m's battery service swing-contract SC_{m} submitted to a swing-contract market M(H) held in advance of H.*

Example 4: *Swing contract (firm) with flexible power & ramp*

Note: Proposed for Integrated T&D support (FERC Order No. 2222) in SC book *Ref. [2]*

$$\mathrm{SC}_m = [\alpha, \mathbb{PP}, \phi]$$

where:

$$\begin{aligned}
\alpha &= \text{Offer price} \\
\mathbb{PP} &= (b, t^{\mathrm{s}}, p^{\mathrm{s}}, \mathbb{P}, \mathbb{RR}, t^{\mathrm{e}}) \\
& \quad b = \text{Delivery location} \\
& \quad t^{\mathrm{s}} = \text{Start-time for power delivery} \\
& \quad p^{\mathrm{s}} = \text{Initial power level at time } t^{\mathrm{s}} \\
& \quad \mathbb{P} = [P^{\mathrm{min}}, P^{\mathrm{max}}] = \text{Range of feasible down/up power levels } p \\
& \quad \mathbb{RR} = [-R^{\mathrm{D}}, R^{\mathrm{U}}] = \text{Range of feasible down/up ramp-rates } r \\
& \quad t^{\mathrm{e}} = \text{End-time for power delivery} \\
\phi &= \text{Performance payment method for power-path delivery}
\end{aligned}$$

Example 4: *Swing contract (firm) with flexible power & ramp … Continued*

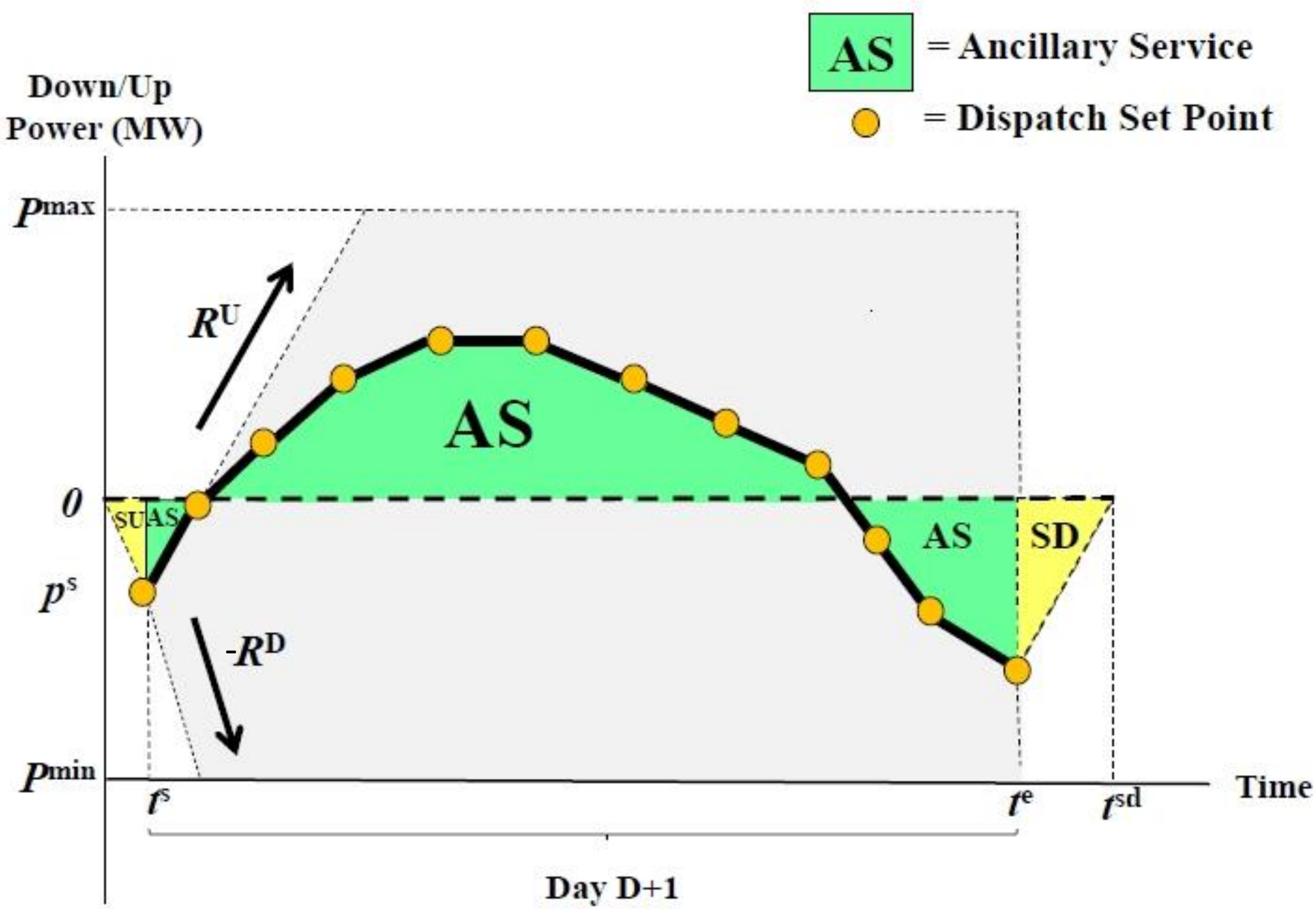
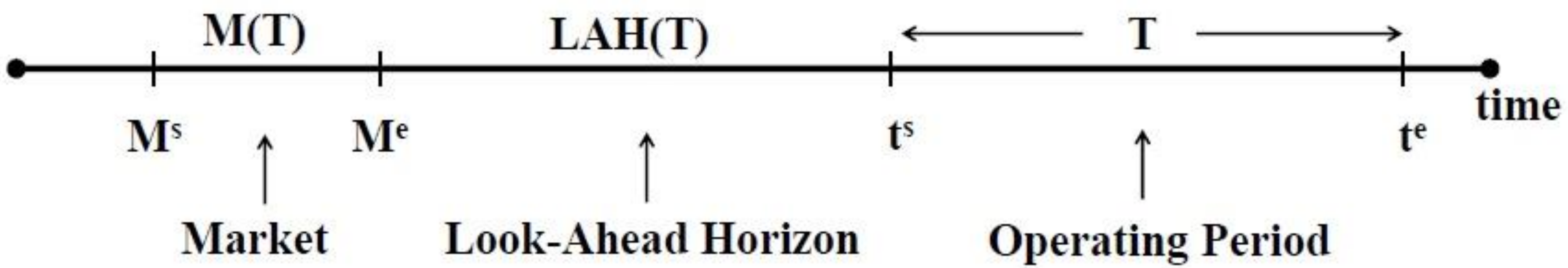


Fig. 8: *The depicted dispatched power-path is one among many possible power-paths p the RTO/ISO could dispatch m to deliver at m's grid-location b(m) during operating day D+1 if the RTO/ISO clears m's flexible power/ramp swing-contract SC_m submitted to a swing-contract day-ahead market M(D+1) held on day D.*

❑ Swing-Contract Market M(T): Key Features *Ref. [1, Sec. 6]; Ref. [2, Chapter 6]*

➢ *A swing-contract market M(T) for a future operating period T* is an RTO/ISO-managed forward reserve market for T.

➢ *General time-line for M(T):*



—The **L**ook-**A**head-**H**orizon **LAH**(**T**) can range from very long (multiple years) to very short (minutes);

—The operating period **T** can range from very long (multiple years) to very short (minutes).

Load-Serving Entities (LSEs)

— Each LSE submits to M(T) a ***reserve bid*****,** i.e., a request for power-path delivery during T in price-sensitive and/or *fixed* (*non-dispatched must-service*) form.

Dispatchable Power Resources (DPRs) denoted $m \in M$

— Each *m* submits to M(T) a ***reserve offer*** consisting of a portfolio

$$\mathbf{SC}_m = (SC_{m1}, \ldots, SC_{mN(m)})$$

of $N(m) \geq 1$ swing contracts SC_{mi}, each offering a physically characterized collection of power-paths for possible RTO/ISO dispatched delivery during T.

Intermittent Power Resources (IPRs)

— The RTO/ISO inputs into M(T) a ***forecast*** for IPR power-path at each transmission grid bus during period T.

- **Contract-Clearing Optimization Problem for RTO/ISO Managing M(T):**
  - Which price-sensitive reserve bids to clear for T ?
  - Which reserve offers to clear for T?

- **Objective function:** *Expected Total Net Benefit* of the M(T) participants from period-T operations, where:

  Total Net Benefit **=:** [Reserve Benefit **–** Reserve Cost]

  Reserve Benefit **=:** [Customer benefit expressed by their reserve bids]

  Reserve Cost **=:** [Offer Cost (OC) **+** Performance Cost (PC) **+** Imbalance Cost (IC)]

- **Optimization:** ***Select*** contract-clearing binary (yes/no) decisions ***that***

  maximize Expected Total Net Benefit

  — ***conditional on*** initial state conditions ***plus*** information extracted from submitted reserve offers and reserve bids

  — ***and subject to*** the usual types of SCED system constraints (e.g., nodal power-balance, transmission capacity limits, reserve uncertainty sets, …)

Swing-Contract Market M(T): Key Features … RTO/ISO Cost Allocation Rules

- Allocate **M(T) net reserve cost** across M(T) participants based on *anticipated volatility/size* and *ex-post realization* of their **net fixed load during T**, where:

  M(T) Net Reserve Cost

  =: RTO/ISO ***net*** reserve procurement cost from M(T) operations

  =: [Offer cost] ***plus*** [performance cost] ***minus*** [revenue from price-sensitive demand]

  Net Fixed Load of an M(T)-participant *j* during T

  =: [**Fixed** (*non-dispatched must-service)* power **demand** by *j* during T]
  minus **Fixed** *(non-dispatched must-service)* power **supply** by *j* during T]

- Allocate **M(T) transmission service cost** across M(T) participants based on:

  — relative power imbalance **RPI(**b,T**)** recorded at each grid location b during T; and

  — relative contribution of each M(T)-participant *j* to **RPI**(b(*j*),T), where b(*j*) **=:** *j*'s grid location.

Linked Swing-Contract Markets *Key Source: Ref. [2, Chapters 10-11]*

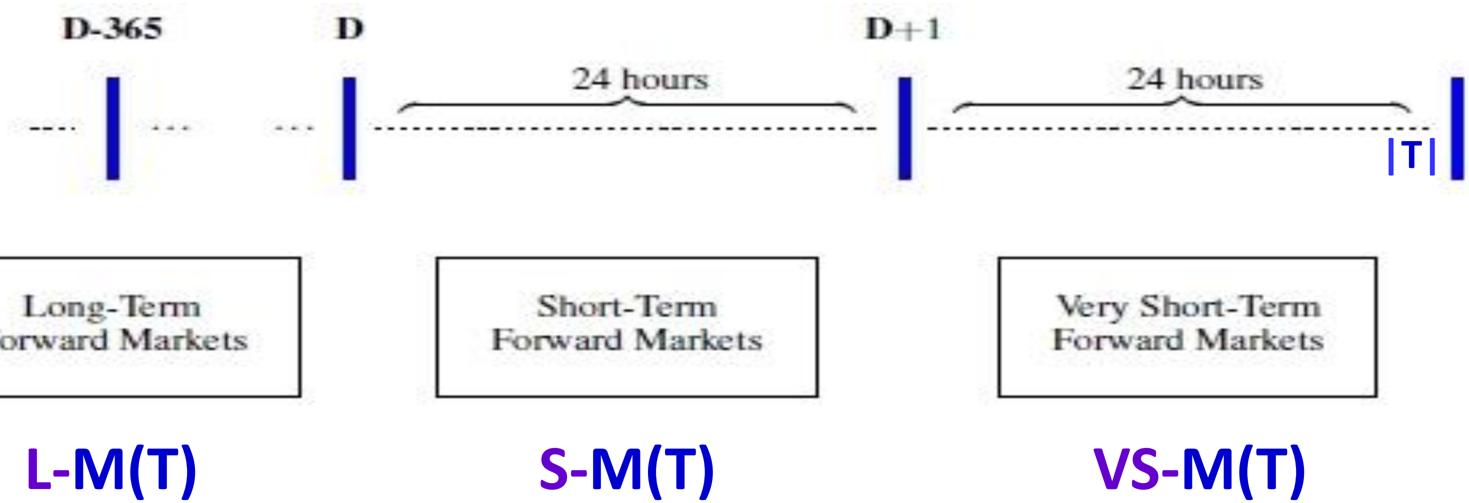
Case 1: Intertemporal Linkages for a Given Operating Period T

Linked SC markets **M(T)** for a *given* future operating period **T** with **L**ook-**A**head **H**orizons **LAH**(**T**) ranging from *long* (**L**) to *short* (**S**) to *very short* (**VS**)

— *Linkage* is established among the *successive* SC markets **M**(**T**) for the *given* **T** by

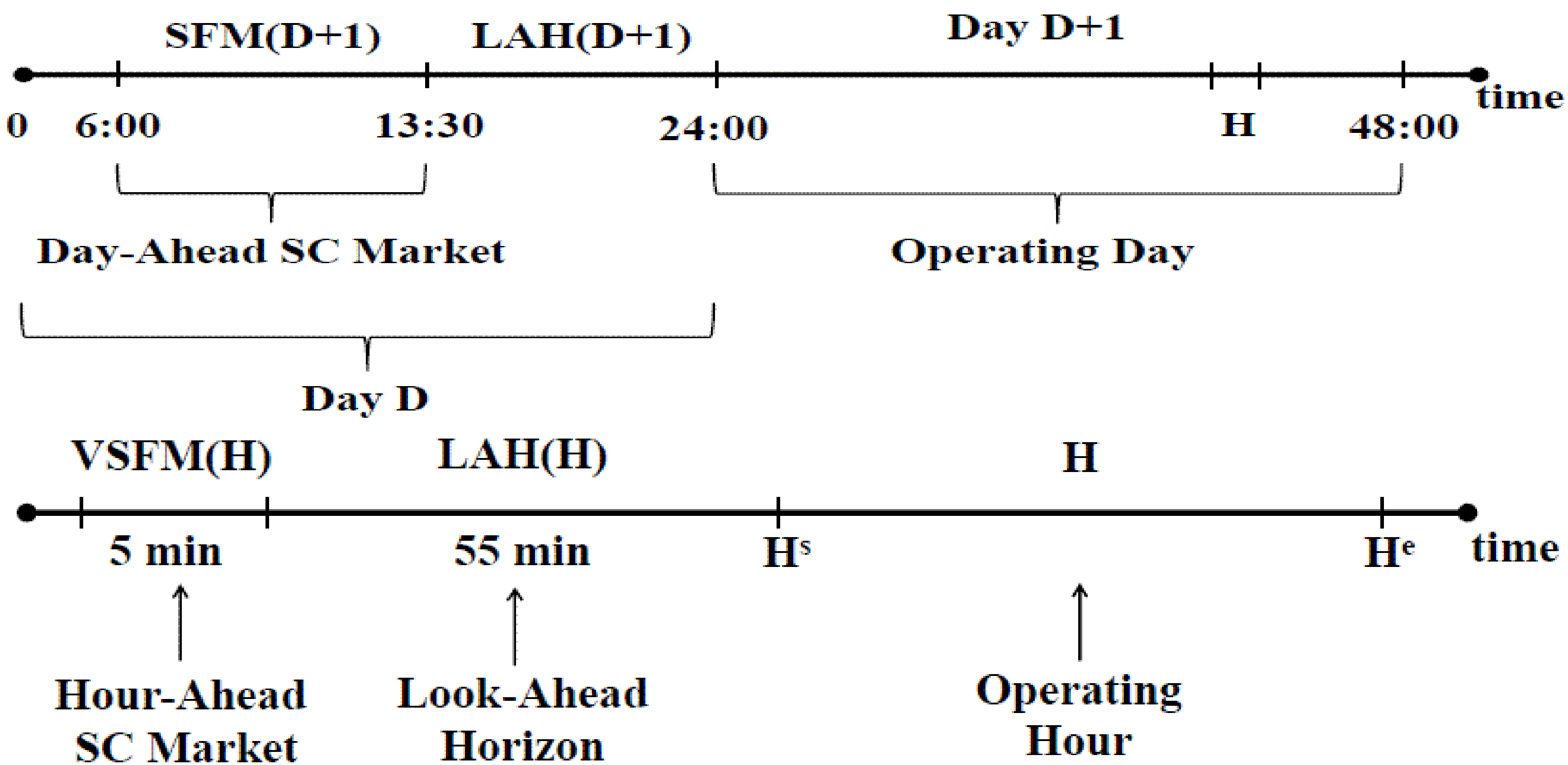
ISOPort(T) **=:** Portfolio of RTO/ISO-cleared reserve offers and reserve bids for **T,** plus past RTO/ISO-signaled dispatch set-points**,** that the RTO/ISO carries forward through time for use during **T**.

— The RTO/ISO *updates* **ISOPort(T)** in *successive* SC markets **M**(**T**) held *prior to* **T** to include any *newly-cleared* swing contracts for **T** and/or any *newly-signaled* dispatch set-points.



Case 2: Nested Operating Periods

— *Linked day-ahead* & *hour-ahead SC markets* for a *given* operating hour **H** during a *given* operating day **D+1**



Comparisons with Current U.S. RTO/ISO-Managed Markets

- Detailed comparisons with current RTO/ISO-managed wholesale power market designs are given in *Ref. [2, Chps. 2-3, 12-15].*

- The next two tables outline key similarities & differences between the two designs for the special case of a **D**ay-**A**head **M**arket (**DAM**).

Important Note:

— The ***essential differences*** between current U.S. RTO/ISO-managed DAM designs and the swing-contract DAM design proposed in *Ref. [2]* are ***differences in product definition, contractual forms, settlement rules, and RTO/ISO management practices --- not*** differences in real-time operations.

— ***These differences can be introduced gradually*** into current RTO/ISO-managed wholesale power markets; see *Ref. [2, Ch. 16]* for a “Transitional DAM” example.

Illustrative DAM Comparisons: Basic Features

		Current DAM	SC DAM
Similarities		• Conducted day-ahead to plan for next-day operations • RTO/ISO-managed • Market participants include LSEs, DPRs, & IPRs • Same types of system constraints: Nodal power balance, zonal reserve requirements, line capacity limits, …	
Differences	Optimization form	SCUC & SCED	Optimal contract clearing
	Settlement	Locational marginal prices	Swing contracts are two-part pricing contracts
	Market payments	Payment for next-day energy before actual energy delivery	Payment for resource availability now & resource performance ex post
	OOM payments	Make-whole payments	No make-whole payments
	Info released to participants	Unit commitments, LMPs, & next-day dispatch schedule	Which swing contracts have been cleared

LSE =: Load Serving Entity; IPR =: Intermittent Power Resource; DPR =: Dispatchable Power Resource

Illustrative DAM Comparisons: Optimization Formulations

		Current DAM SCUC	Current DAM SCED	SC DAM Optimization
Similarities		• Both SCUC and swing-contract (SC) market clearing are solved as Mixed Integer Linear Programming (MILP) optimization problems subject to system constraints		
Differences	Objective	Min [Start-up/shut-down costs + no-load costs + dispatch costs + reserve costs + constraint penalties]	Min [Dispatch costs + reserve costs + constraint penalties]	Min [Availability cost + performance cost + constraint penalties]
	Unit commitment constraints	Yes	No	Each DPR includes its unit commitment constraints in its submitted swing contract
	Key RTO/ISO decision variables	Unit commitments	Energy dispatch & reserve levels	Which swing-contracts are cleared
	Settlement	No	LMPs calculated as SCED dual variables	Each cleared DPR receives the offer price it has included in its submitted swing contract

DPR =: Dispatchable Power Resource

Conclusion

- This presentation first identified three conceptually-problematic aspects of current U.S. RTO/ISO-managed wholesale power markets hindering smooth transition to decarbonized grid operations with diverse participants: product definitions; settlement rules; and supply-offer formulations.

- Attention next focused on product definition and settlement-rule concerns:

  - Static focus on <u>grid-delivered</u> energy (MWh) as the basic transacted product.

  - Failure of grid-delivered energy to satisfy a fundamental unit homogeneity property necessary for Locational Marginal Pricing (LMP) to provide a conceptually-coherent settlement process for grid-delivered energy transactions

- Key features of a new Linked Swing-Contract Market Design were then briefly reviewed.

  - This design provides proof-of-concept (at TRL-3) that alternative conceptually-consistent designs can be developed for grid-supported centrally-managed wholesale power markets that are well-suited for decarbonized grid operations with diverse market participants.

  - Adoption of this design would require changes in current U.S. RTO/ISO-managed market product definition, settlement rules, and supply-offer forms, but <u>*not*</u> in real-time operations. Thus, the adoption could proceed gradually, without disruption of real-time operations.

Key References

Ref. [1] Leigh Tesfatsion (2023), **"Economics of Grid-Supported Electric Power Markets: A Fundamental Reconsideration,“** Econ WP #22005, ISU Digital Repository, Ames, IA, 65pp.
https://www2.econ.iastate.edu/tesfatsi/EconomicsGridSupportedPowerMarkets.ISUDR22005.LTesfatsion.pdf

> ***NOTE:*** **Ref. [1]** is the Supporting Document (“Attachment A”) for *Comments* (Accession No. 20230117-5051) e-filed in January 2023 to the U.S. Federal Energy Regulatory Commission (FERC) for Docket No. AD21-10-000 ("Modernizing Wholesale Electric Power Market Design").

Ref. [2] Leigh Tesfatsion (2023), **“Locational Marginal Pricing: When and Why Not,”** Working Paper #23003, ISU Digital Repository, Iowa State University, Ames, IA.
https://www2.econ.iastate.edu/tesfatsi/LMPWhenAndWhyNot.LTesfatsion.pdf

Ref. [3] Leigh Tesfatsion (2021), ***A New Swing-Contract Design for Wholesale Power Markets***, 20 Chapters, 288pp., John Wiley & Sons, Inc. (IEEE Press Series on Power Engineering), Hoboken, New Jersey, USA. **(Wiley/IEEEPressBookFlyer,pdf)**.