Let the Tough Choices Begin: Affordable or Green?

Jonathan A. Lesser

On both coasts of the United States, utilities and regulators are grappling with the conflict between mandated purchases of above-market-cost renewable generation and the need to avoid further burdening consumers and businesses with higher rates in this recessionary economy.

Utilities and regulators are grappling with the conflict between mandated purchases of above-market-cost renewable generation and the need to avoid further burdening consumers and businesses with higher rates.

A couple of cases illustrate the conflict. On the West Coast, the city of Los Angeles is in a dispute with its utility, the Los Angeles Department of Water and Power (LADWP), over proposed rate increases. The LADWP says it needs the rate increases to reach its goal of meeting 40 percent of all electricity demand with renewable resources. Back east, in an April 2 order, the Rhode Island Public Utility Commission rejected a proposed long-term power agreement between Deepwater Wind, LLC, and National Grid based on a finding that the contract price for wind-generated electricity was not commercially viable.

Jonathan A. Lesser, PhD, is president of Continental Economics, Inc., an economic and litigation consulting firm, with offices in Washington, DC, and Albuquerque, New Mexico. He can be reached at (202) 446-6062 or via e-mail at: jlesser@continentalecon.com.

Regardless of one's views on mandatory renewable portfolio standards—as perhaps being environmentally beneficial, helpful in reducing reliance on foreign oil, or important in creating new industries and millions of "green" jobs—regulators and politicians must address a fundamental initial trade-off between keeping costs low and increasing supplies of more expensive renewable energy. Of course, such trade-offs are not new: many environmental regulations increase costs—for example, emissions controls required under the Clean Air Act's New Source Review, regulation of thermal discharges into bays and estuaries under the Clean Water Act, and prevention of generation resource development (renewable or otherwise) and construction of new transmission lines because of Endangered Species Act requirements.

Recent events in California and Rhode Island have a different flavor, because they deal directly with specific and significant cost trade-offs rather than falling back on vague "motherhood and apple pie" arguments.

However, recent events in California and Rhode Island have a different flavor, because they deal directly with specific and significant

DOI 10.1002/gas / © 2010 Wiley Periodicals, Inc.

cost trade-offs rather than falling back on vague "motherhood and apple pie" arguments in favor of green resources.

LA FACES REALITY

In Los Angeles, Mayor Antonio Villaraigosa set a goal for the city to obtain 40 percent of its electric generation from renewable resources by the year 2020. This goal is more stringent than the 33 percent state standard imposed last year by Governor Arnold Schwarzenegger in an Executive Order. To pay for these renewables, the LADWP proposed, with the mayor's and former Vice President Al Gore's support, a series of four rate increases.

Mayor Antonio Villaraigosa set a goal for the city to obtain 40 percent of its electric generation from renewable resources by the year 2020.

These increases would have raised average rates for commercial customers by more than 20 percent and rates for residential customers by almost 30 percent. Although the mayor promised that the rate increases and the renewable resources that would be developed would create "green" jobs, local businesses feared that those jobs would be created at their employees' expense. Carol Shatz, president and chief executive of the Central City Association, a downtown Los Angeles business group, stated, "You don't want to risk the jobs you have for the jobs you might have in the future."[1]

"You don't want to risk the jobs you have for the jobs you might have in the future."

According to mayoral spokesperson Sarah Hamilton, the mayor's initiative would create 16,000 new jobs for solar photovoltaic installers and 1,600 new jobs for "green doctors" who would be hired by the LADWP to tell customers whether their homes were energy-efficient.[2] No doubt, unemployed customers struggling to pay higher electric bills, in part to pay the salaries of these "green doctors," would be especially appreciative of advice on the energy efficiency of their homes.

RHODE ISLAND PUC LOOKS AT THE BOTTOM LINE

In Rhode Island, the facts were more concrete. Under the Long-Term Contracting Standard for Renewable Energy Act signed last year by Governor Donald L. Carcieri,[3] National Grid was required to solicit renewable energy proposals of 10 megawatts or less that would "enhance the electric reliability and environmental quality of the Town of New Shoreham." Duly ordered, National Grid solicited proposals and received one, from Deepwater Wind. National Grid then began negotiations with Deepwater Wind to develop a "commercially reasonable contract"[4] as required under the act.

At the end of the contract term, the price would have been over 48 cents a kilowatt-hour. Consider this: in 2009, [the price] was less than 4.5 cents a kilowatt-hour.

Rather than being confronted with rate increases to acquire unspecified renewable resources in the future (like Los Angeles), the Rhode Island PUC was confronted with a specific, long-term power contract. The contract price was to start at 24.4 cents a kilowatt-hour and escalate at a 3.5 percent annual rate over the contract's 20-year term. At the end of the contract term, the price would have been over 48 cents a kilowatt-hour. Consider this comparison: in 2009, the weighted average wholesale price of electricity in the Rhode Island zone of ISO-NE was less than 4.5 cents a kilowatt-hour.

These "real values" were indeed hard to quantify, because, as the commission's Order noted, Nickerson failed to quantify any of them.

In David P. Nickerson's testimony on behalf of Deepwater Wind, he testified that the above-market cost would be offset by "real values" to Rhode Island that are "hard-to-quantify," including direct and indirect economic benefits (i.e., green jobs) and "suppression" of electric and natural gas prices.[5]

The "price suppression" benefit is particularly misleading. Notwithstanding that "price suppression" might be interpreted as market manipulation and seen to be as damaging as artificially raising prices by withholding supplies, the primary result of price suppression as Nickerson used it is not to improve welfare but to simply transfer benefits from energy suppliers to consumers.[6] Forcing consumers to purchase electricity at prices that are 500 percent higher than the market price and then arguing how those consumers will benefit from the "real value" of market-price suppression brought about by adding 10 megawatts of intermittent generation to the supply mix is, to be charitable, odd.

Forcing consumers to purchase electricity at prices that are 500 percent higher than the market price and then arguing how those consumers will benefit from the "real value" . . . is, to be charitable, odd.

Nickerson further testified that the project would meet the goals of the act, including stabilizing long-term energy prices, enhancing environmental quality, and creating jobs in Rhode Island by creating the opportunity for industry development. Again, it is difficult to see how adding 10 megawatts of intermittent wind generation would accomplish any of those objectives. The Rhode Island PUC agreed that the plan would not meet its expressed goals and rejected the contract between Deepwater Wind and National Grid. The PUC concluded the following:

> The fundamental question in this case is whether the PPA between Deepwater and Grid is commercially reasonable, and if so, does this Project provide other direct economic benefits to Rhode Island such as job creation. Based on the evidence, upon which this Commission is legally bound to render all its decisions, the Commission must regrettably, but unanimously, respond in the negative.[7]

WEIGHING THE TRADE-OFFS

Renewable energy proponents may argue that the additional costs are a worthy trade-off for cleaner energy and green jobs. Some may even applaud the higher electricity prices that will result, because they will reduce consumption and improve the cost-effectiveness of energy-conservation measures. Yet these two cases point once again to the overselling of renewable energy as something that will create both economic and environmental nirvana.

Economists like me are always saying there is no such thing as a free lunch. Politicians, perhaps because their lunches are always paid by someone else, continue to ignore what economists say. But as the real bills affect real consumers and real businesses, the free lunch promises are likely to become harder to sustain. As Los Angeles and Rhode Island have discovered, selling the benefits of renewable generation then becomes more difficult. It will be interesting to see what other jurisdictions learn from these examples.

NOTES

1. Zahniser, D. (2010, March 25). Business leaders decry plan to raise DWP rates. *Los Angeles Times*, http://articles.latimes.com/2010/mar/25/local/la-me-mayor-business25-2010mar25.
2. Ibid.
3. R.I. Gen. Laws § 39- 26.1-1 to 8.
4. R.I. Gen. Laws § 39- 26.1-2, defined as "terms and pricing that are reasonably consistent with what an experienced power market analyst would expect to see in transactions involving newly developed renewable energy resources."
5. Rhode Island Public Utilities Commission, *In Re: Review of Proposed Town of New Shoreham Project Pursuant to R.I. Gen. Laws § 39-26.1-7*, Docket No. 4111, Pre-Filed Testimony of David P. Nickerson (Deepwater Wind Ex. 1), 2.
6. Beginning economics students are taught that the overall value of a market equals the sum of consumers' surplus and producers' surplus. Suppose there is just one buyer in this market, "monopsony." That one buyer will be able to suppress the price paid to suppliers compared to the market price were there many buyers. However, the total value of the market will decrease.
7. Rhode Island Public Utilities Commission, *In Re: Review of Proposed Town of New Shoreham Project Pursuant to R.I. Gen. Laws § 39-26.1-7*, Docket No. 4111, Report and Order, April 2, 2010, 65.

DOI 10.1002/gas / © 2010 Wiley Periodicals, Inc.