More on Legislative–Regulatory Relations: Layers, Protections, and Cost-Effectiveness

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In our legislative–regulatory relations, uneasiness arises from three uncertainties: over who should make which decisions; over locating the sweet spot on the predictability–flexibility spectrum; and over whether legislative oversight of regulation is amicable intergovernmental cooperation or an attack on regulation's objectivity and independence.

These uncertainties accumulate as we learn more about how utility services affect our economies, our personal lives, and our descendants. Addressing these uncertainties, we sometimes add new layers of law that rest uneasily on what lies underneath. At other times, we enact forms of constituent "protection" that undercut our aims. And we struggle with the concept of cost-effectiveness, which should be central to these decisions.

Policy Layers: Are They Consistent?

Responding to each era's urges, we tend to layer policies without accounting for redundancies, contradictions, and gaps. Consider our renewable-energy experience. Over 35 years, the nation's efforts to boost renewables have produced four separate structural policies, each dating from a different political era but all aimed at the same subject: relationships among renewable generators, utilities, and consumers.

PURPA, a federal statute, requires utilities to purchase from eligible cogenerators and renewables producers. The price is the utility's "avoided cost." **Net metering**, a state law concept, allows consumer-producers to "run their meters backwards," with utilities required to accept the output. The compensation is not the utility's avoided cost, but the full retail rate—a rate exceeding avoided cost because it recovers both fixed and variable cost. **Renewable portfolio standards**, currently a state law concept, require utilities to buy a specified percentage of total requirements from eligible producers. These statutes usually specify neither total quantity, nor specific price, nor total cost. **Feed-in tariff**, the newest contestant, is a state law concept that obligates the utility to buy unspecified output from eligible renewables producers, at a price designed to attract sufficient providers to meet the state's goals. The price is not the utility buyer's avoided cost but, in effect, the renewable seller's opportunity cost.

These policies overlap, duplicate, and at times conflict on key variables: eligible sellers, seller compensation, and interconnection rights and obligations. Notice especially the four different approaches to compensation: utility avoided cost, seller opportunity cost, retail rate, and none-of-the-above. That's hardly a rational, cost-effective approach to renewable power.

Beneath, or on top of, these policies are other efforts to send money to renewables developers, from either taxpayers or ratepayers. These efforts include **direct taxpayer or**

ratepayer funding (e.g., grants, leases, loans, loan guarantees, systems-benefit charges, return-on-equity adders) and **tax benefits** (e.g., accelerated depreciation, capital-based tax incentives, production-based tax incentives, sales- or property-tax relief, manufacturing and other tax credits). The final layer contains efforts to influence customer behavior, efforts like retail rate design, home efficiency programs, and offers to buy demand reduction.

Selecting the funding source—taxpayers or ratepayers—is a separate issue, usually decided by this principle: One gets more political mileage from enacting a benefit than assigning a cost—which is why so many policies are promulgated by legislative action but funded by regulatory action.

How do these overlapping policies interact with each other? Do they duplicate, undermine, or reinforce? The absence of answers—or much traction on the question—seems attributable to at least one of two causes: We don't know what works, so we try everything; or every interest group wants something, and the easiest approach is to placate every petitioner rather than break eggs. It's not likely because we've studied this issue carefully and arrived at the most cost-effective mix of policies.

Do Some "Protections" Undercut Our Aims?

We consistently hesitate to raise rates to reflect real costs, especially during economic downturns. We worry that our poor can't pay or industries can't compete. So we delay increases and even grant discounts. But the overconsumption induced by these discounts benefits no one in the long run. Overconsumption leads to overinvestment; then stranded costs, stranded investors, stranded taxpayers, and cynical citizens who lose faith in their governments because their high rates are compensating for their parents' low rates. Is not the obviously better approach to set prices properly and help people learn the effects of their behavior, then use other resources, like taxpayer resources, to assist our poor and our industries?

Do We Define Cost-Effectiveness Clearly?

It's easy to define cost-effectiveness: It's biggest bang for the buck. But whose bang and whose buck? Is the relevant bang local, state, national, or global? Who gets the bang -- this year's voters or next century's citizens? Who pays -- the parents or the children? And if we insist on a perfect bang-buck balance in every electoral cycle, is cost-effectiveness ever possible?

Clouding the cost-effectiveness calculation is the myth of the "self-made man." In U.S. energy policy, there is no such thing. Every technology has multiple helpers—loan guarantees, accelerated depreciation, tax credits, caps on producer liability, bankruptcy protection, and more. (This long list of government assists no doubt reminds some readers of C. Wright Mills: "Nobody talks more of free enterprise and competition and of the best man winning than the man who inherited his father's store or farm.") When the technology succeeds commercially, how do we assess the value of each contributor? How do we know which help to withdraw, on the grounds that technology can succeed without it?

And—do we realize that aid to one technology can increase the cost of another technology? Spending money to invent new technologies is one thing; but aiming aid to make existing technology "competitive" is another. We subsidize nuclear power, oil, and coal, giving pricing advantages over wind, solar, and geothermal. Then we subsidize wind, solar, and geothermal to make them "competitive" with nuclear, oil, and coal. Does this approach make cost-effectiveness sense?

Recommendations

The most alert regulators not only look ahead; they evaluate past policies too. Contrast merger policy. Since the mid-1980s, dozens of electricity and telecommunications utilities have merged: horizontal, vertical, and conglomerate mergers, even some none-of-the-above mergers. Each merger applicant predicted "synergies," often carbon copies of prior mergers' claims. A quarter century later, after billions have been spent on acquisition premiums, we have no studies testing these claims against reality—even when the son of and grandson of the original merger appear in the same state. Merger policy is only one example of gaps between assertions and evidence.

It may sound sleep-inducing, but a continuous study process, organized by legislators and regulators together, is one solution. It would produce more improvement than "sunset reviews" that ask only about budget and bureaucracy. Injecting also the perspectives (not the positions) of regulated entities, users, investors, technologists, and academics, all aimed at an agenda of objectivity and cost-effectiveness, would smooth out policy evolution. Then we can avoid the lurches and overreactions that reduce public trust in both legislators and regulators.