Executive Summary . . . . . *xiii*
Preface . . . . . *xvii*

Part I NEEDS AND RESOURCES 1

1.1 THE INFLECTION POINT 2

1.2 CONTEXT: THE PATTERN THAT CONNECTS 4
A dozen drivers of distributed utilities 1.2.1 4
The menu: three kinds of distributed resources 1.2.2 7
Outrunning the headlights: the pursuit of illusory scale economies 1.2.3 11
Discontinuity: a century of size trends reverses 1.2.4 23
Scale: what's the right size? 1.2.5 34
The origins of this study 1.2.6 37
Proximity: how close to home? 1.2.7 43
Control: the center and the periphery 1.2.8 45
Vulnerability: brittle power 1.2.9 46
Diversity: monocultures *vs.* ecosystems 1.2.10 48
Governance: concentrated *vs.* dispersed 1.2.11 48
Transition: the forces of renewal 1.2.12 51
New technologies 1.2.12.1 53
Competitive restructuring 1.2.12.2 54
Distributed benefits start to emerge in the market 1.2.12.3 62
What next? 1.2.12.4 66

1.3 WHERE WE START: THE EXISTING POWER SYSTEM 67
Basic characteristics 1.3.1 69
Scale of existing utility generating units 1.3.2 72
Operating cost and dispatch of existing power stations 1.3.3 73
The invisible grid 1.3.4 77

1.4 FINE-GRAINED THINKING 79
Tapping the area- and time-specific bonanza 1.4.1 79
Basking in the "hot spots" 1.4.2 80

1.5 UNCERTAINTY REIGNS 86

1.6 CAUTIONS AND HERESIES 94
Cost and its allocation 1.6.1 94
Value 1.6.2 95
Risk 1.6.3 96
Synergies between different kinds of resources 1.6.4 97
Smaller can be faster 1.6.5 99
Many littles can make a big 1.6.6 105

Part 2 BENEFITS OF DISTRIBUTED RESOURCES 107

2.1 INTRODUCTION 108

2.2 SYSTEM PLANNING 109
Many timescales, many uncertainties 2.2.1 111

Tutorial 1: Operational Fluctuations 112
Long-term supply/demand balances **2.2.1.1** 115
Valuing modularity and short lead times **2.2.2** 117
Forecasting risk **2.2.2.1** 117
Financial risk **2.2.2.2** 125
Technological obsolescence **2.2.2.3** 131
Regulatory obsolescence **2.2.2.4** 133
Flexibility/modularity value assessed by option theory **2.2.2.5** 134
Tutorial 2: Option Theory 137
Flexibility/modularity value assessed by decision analysis **2.2.2.6** 138
Tutorial 3: Decision Analysis 139
Project off-ramps **2.2.2.7** 140
The extra value of modules' portability and reversibility **2.2.2.8** 141
Avoiding fuel-price volatility risks **2.2.3** 144
Tutorial 4: Utility Accounting vs. Financial Cost Valuation 149
Tutorial 5: Financial Risk 151
Tutorial 6: Valuing Risk 153
Valuing electricity price volatility **2.2.3.1** 156
Reduced overheads **2.2.4** 160
Planning resource portfolios **2.2.5** 160
Fuel diversification **2.2.6** 163
Engineering perspective: diversify fuels and sources **2.2.6.1** 163
Financial-economic perspective: guard against systematic price risk **2.2.6.2** 163
Load-growth insurance **2.2.7** 167
Matching loadshape **2.2.8** 167
Evaluating field data for renewables **2.2.8.1** 172
Improving loadshape match by technical design **2.2.8.2** 175
Prospecting to maximize loadshape-matching's economic value **2.2.8.3** 176
Fine-grained prospecting in time and space **2.2.8.4** 178
Reliability of distributed generators **2.2.9** 179
Renewable energy intermittency **2.2.9.1** 180
Distributed resources' technical availability reduces reserve-margin requirements **2.2.9.2** 181
Modular resources' reduced variance of availability further reduces reserve margin **2.2.9.3** 185
Outage durations and ease of repair **2.2.9.4** 186
Renewable capacity credit is real and valuable **2.2.9.5** 187
Geographic dispersion and technological diversity **2.2.9.6** 188
Generating reliability and grid reliability **2.2.9.7** 190
Diversity, complexity, and resilience **2.2.9.8** 191
Permissible saturation of renewable generators **2.2.10** 193
Simulated penetration limits and available responses **2.2.10.1** 194
A temporary issue? **2.2.10.2** 198
Buying time **2.2.11** 200
2.3 Construction and Operation 201
Generation **2.3.1** 201
Reserve margin **2.3.1.1** 202

Spinning reserve 2.3.1.2 205
Life extension 2.3.1.3 207
Grid 2.3.2 207
The mysterious grid 2.3.2.1 211
Losses 2.3.2.1.1 211
Costs 2.3.2.1.2 213
Grid losses: potential reductions 2.3.2.2 220
*Tutorial 7: **Grid Losses*** *221*
Power factor and reactive power support 2.3.2.3 225
*Tutorial 8: **Power Factor*** *226*
Distributed resources' reactive contribution 2.3.2.3.1 227
Benefits 2.3.2.3.2 229
Avoided voltage drop 2.3.2.4 231
Ampacity savings from daytime-correlated resources 2.3.2.5 232
Capacity expansion 2.3.2.6 234
Life extension 2.3.2.7 237
Repair, rerouting, and outage duration 2.3.2.8 240
Summary: Prospecting for grid-support distributed resource opportunities 2.3.2.9 242
"Negaloads" *vs.* engineering realities 2.3.2.10 242
Grid topologies: radial vs. *web* 2.3.2.10.1 243
Bi/omnidirectional flow 2.3.2.10.2 243
Synchronization and dynamic stability 2.3.2.10.3 245
Self-excitation 2.3.2.10.4 246
Fault protection 2.3.2.10.5 246
Normally interconnected, optionally isolated operation 2.3.2.10.6 249
Safety 2.3.2.10.7 250
Reclosing 2.3.2.10.8 252
Avoided grid connection (stand alone operation) 2.3.2.11 252
The intermediate case: micro-grids 2.3.2.12 260
Non-grid operational benefits 2.3.3 262
Energy generation 2.3.3.1 262
Reduced keep-warm (minimum-load) operation 2.3.3.2 264
Reduced spinning-reserve operational cost 2.3.3.3 264
Reduced startup cycles 2.3.3.4 264
Fast ramping 2.3.3.5 265
Net-metering advantages 2.3.3.6 267
Lower payments to QFs/IPPs 2.3.3.7 268
Unbundled service quality: harmonics, power quality, and reliablility 2.3.3.8 268
Power quality, harmonics, and active harmonic compensation 2.3.3.8.1 269
Premium reliability 2.3.3.8.2 274

2.4 OTHER SOURCES OF VALUE 279
Customer value and marketing considerations 2.4.1 279
Green sourcing 2.4.1.1 279
Community sourcing and local control 2.4.1.2 281
Amenity, comfort, productivity, and customer value 2.4.1.3 281
DSM integration 2.4.2 282

Local fuels **2.4.3** 283
Thermal integration **2.4.4** 284
Byproduct integration **2.4.5** 285
Structural integration **2.4.6** 285
Infrastructural displacement **2.4.7** 286
Land-use integration, land value, and shading **2.4.8** 287
Avoided subsidies **2.4.9** 289
NEEDs **2.4.10** 290
Security of supply 2.4.10.1 294
The megaproject syndrome 2.4.10.2 297
Keeping the money on Main Street 2.4.10.3 297
Support of local economies, employment, and trade balance 2.4.10.4 298
Noise and aesthetics 2.4.10.5 298
Irretrievable commitments of resources 2.4.10.6 300
Conflict avoidance: stakeholders and trust 2.4.10.7 300
Health and safety issues: risk and perception 2.4.10.8 300
Equity 2.4.10.9 301
Accessibility 2.4.10.10 301
Accountability and local control 2.4.10.11 301
Community and autonomy 2.4.10.12 302
Learning institutions, smaller mistakes 2.4.10.13 302
Public image 2.4.10.14 303
Avoided air emissions 2.4.10.15 303
Land conservation 2.4.10.16 304
Fish and wildlife conservation 2.4.10.17 305
Less indirect pollution 2.4.10.18 306
Less depletion 2.4.10.19 306
Less water withdrawal and consumption 2.4.10.20 307
Psychosocial benefits 2.4.10.21 307

Part 3 A CALL TO ACTION: POLICY RECOMMENDATIONS AND MARKET IMPLICATIONS FOR DISTRIBUTED GENERATION 309

3.1 A FRAMEWORK FOR ACTION 310

3.2 POLICY GOALS AND OBJECTIVES 311
Overview **3.2.1** 311
U.S. energy policy goals and objectives **3.2.2** 311
Policy portfolio framework 3.2.2.1 313
Key barriers and issues facing distributed generation **3.2.3** 313
Key barriers 3.2.3.1 314
Regulatory Response 3.2.3.2 315

3.3 POLICY RECOMMENDATIONS 317
Overview **3.3.1** 317
Getting there—crafting an effective policy agenda **3.3.2** 318
Analysis of proposed policy reforms 3.3.2.1 318
Emerging consensus on a policy agenda 3.3.2.2 319

Recommendations to federal regulators **3.3.3** 320
Recommendations to the FERC 3.3.3.1 320
Create uniform national interconnection standards for distributed generation 3.3.3.1.1 321
Integrate distributed resources into wholesale power markets 3.3.3.1.2 322
Integrate distributed generation into ancillary services market 3.3.3.1.3 323
Support locational marginal pricing for transmission resources 3.3.3.1.4 324
Provide greater access to information on the transmission system and wholesale markets 3.3.3.1.5 325
Recommendations to DOE 3.3.3.2 325
Accelerate funding of RD&D for distributed generation 3.3.3.2.1 325
Recommendations to EPA 3.3.3.3 326
Create emission standards for distributed generation 3.3.3.3.1 327
Clarify ownership rights to pollution credits created by distributed resources 3.3.3.3.2 328
Summary: Actions needed to adopt the suite of federal recommendation 3.3.3.4 328
Recommendations to state regulators **3.3.4** 329
Universal state recommendations 3.3.4.1 330
Adopt "plug and play" interconnection standards for distributed generation 3.3.4.1.1 330
Create net-metering rules with buyback rates based on system value 3.3.4.1.2 331
Adopt emissions standards for DG 3.3.4.1.3 332
Provide public support to distributed generation RD&D through wires charges 3.3.4.1.4 333
Update building codes and real estate development covenants to accommodate DG 3.3.4.1.5 333
Recommendations for states with traditional utility regulation 3.3.4.2 333
Decouple utility revenue requirements from kWh sold, and create incentives to lower customers' bills, not price per kWh 3.3.4.2.1 333
Require mandatory ERIS planning as the basis for prudent cost recovery 3.3.4.2.2 334
Restructure distribution tariffs to reduce excessive fixed charges 3.3.4.2.3 335
Adopt renewable portfolio standards (RPS) and tradable credits 3.3.4.2.4 335
Recommendations for states adopting restructuring 3.3.4.3 336
Decouple distribution companies' revenue requirements from kWh throughput 3.3.4.3.1 336
Restructure and *unbundle distribution tariffs* 3.3.4.3.2 336
Impose stranded costs only after production threshold is exceeded 3.3.4.3.3 336
Allow discos to participate in DG only if all competitors enjoy equal access to system information 3.3.4.3.4 337
Uniform and reasonable retail wheeling tariffs 3.3.4.3.5 338
Provide public support for green markets 3.3.4.3.6 338
Summary: Actions needed to adopt the suite of the state recommendations 3.3.4.4 338
Summary: A balanced portfolio **3.3.5** 339
Achieving the energy policy goals 3.3.5.1 339
Creating a policy portfolio to hedge risks 3.3.5.2 341
Addressing barriers to distributed generation 3.3.5.3 341
Resolving key regulatory issues 3.3.5.4 344
The cost-benefit question 3.3.5.5 345
Who wins and who loses 3.3.5.6 348

3.4 IMPLICATIONS FOR THE PRIVATE SECTOR 349
Implications for electric utilities under traditional regulation **3.4.1** 350
Threats to existing business models 3.4.1.1 351
Opportunities for regulated utilities 3.4.1.2 353
Leveraging distributed generation's option value 3.4.1.2.1 353

De-capitalize the wires business 3.4.1.2.2 354
Lower operating expenses 3.4.1.2.3 355
Organizational implications for vertically integrated utilities 3.4.1.2.4 356
Summary for regulated utilities 3.4.1.2.5 356
Implications for restructured electric utilities in states with restructuring **3.4.2** 357
Implications for the distribution company 3.4.2.1 358
Threats to the standalone distribution company 3.4.2.1.1 359
Opportunities for the standalone distribution company 3.4.2.1.2 359
Implications for the generation company 3.4.2.2 361
Threats to existing generation business models 3.4.2.2.1 363
Opportunities for generation companies 3.4.2.2.2 366
Implications for trading 3.4.2.3 367
Opportunities for wholesale energy traders 3.4.2.3.1 367
Implications for retail electricity supply 3.4.2.4 368
Opportunities for retail energy business 3.4.2.4.1 369
Organizational challenge: who should own distributed generation? 3.4.2.5 371
Summary for restructured utilities 3.4.2.6 372
Implications for capital markets **3.4.3** 373
Implications for public power **3.4.4** 374
Implications for commercial and industrial customers **3.4.5** 375
Implications for real estate developers **3.4.6** 376
Challenges 3.4.6.1 377
Owner benefits 3.4.6.2 378
Tenant benefits 3.4.6.3 379
Systematic and societal benefits 3.4.6.4 380

3.5 WHY DISTRIBUTED GENERATION MATTERS TO EVERY CITIZEN 381

Table of defined terms *385*
Table of illustrations *386*
References *388*
About the authors *398*
About the publisher *399*

Table of distributed benefits *(printed on the front and rear endpapers)*