ENERGY MARKETS AND POLICY

BEPP/OIDD 763

Spring Semester 2020, Tu/Th 3-4:20 p.m., JMHH 360

Note: Due to potential guest speaker schedule changes, this syllabus may be updated during the semester. I will also update readings up to the first class session. Please check Canvas for the latest version.

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Course overview. Over the last several decades, energy markets have become some of the most dynamic markets of the world economy. Traditional fossil fuel and electricity markets have seen a partial shift from heavy regulation to market-driven incentives, while rising environmental concerns have led to a wide array of new regulations and “environmental markets”. The growth of renewable energy is another source of rapid change, but brings with it a whole new set of technological and policy challenges. This changing energy landscape requires quick adaptation from energy companies, but also offers opportunities to turn regulations into new business. The objective of this course is to provide the economist’s perspective on a broad range of topics that professionals in the energy industry will encounter. Topics include the effect of competition, market power and scarcity on energy prices, extraction and pricing of oil and gas, geopolitical uncertainty and risk in hydrocarbon investments, the environmental policies related to the energy and transportation sectors and their effectiveness, cap-and-trade markets, and energy efficiency. There is special emphasis on the economics and finance of renewable energy, including an introduction to energy storage.

Readings. A mix of newspaper articles, academic papers, reports, plus the following textbook: Nathaniel Keohane and Sheila Olmstead (KO), Markets and the Environment, Washington, D.C.: Island Press, second edition, 2016. Starred (*) readings are required. Many starred readings are short. Non-starred readings are optional but I will discuss them in class, and you are highly encouraged to read them if you want further background on a specific topic. The best way to use the readings is as a supplement to the lectures, which overlap partially (but certainly not perfectly!) with the readings. You will be responsible for required readings not covered in class.

Prerequisites. Managerial Economics (MGEC 611/612) or an equivalent intermediate microeconomics course approved by the instructor.
Attendance. Attendance is mandatory. Please email me in advance if you have a good reason not to attend a particular session.

Strategy games. Students will participate in two strategy games. The OPEC game is a series of simulations of the world oil market. Student teams represent countries and try to maximize profits by making output decisions that determine the world oil price. The Electricity Strategy Game is a simulation of an electricity market. Student teams manage a portfolio of generation units (coal, natural gas, nuclear and renewables) and bid into an electricity market.

Guest lectures. The course has five guest lectures by various energy experts. This year’s emphasis will be on renewable energy finance, energy storage, energy entrepreneurship, the role of the media in the energy debate, and energy politics. Attendance is mandatory and the content is fair game for questions on assignments and exams. Some guest lectures are followed by drinks (open to all students) and dinner (signup in advance; first-come-first-served) with the speaker.

Assignments and grading. Three equally weighted assignments (25%), an exam (35%), the OPEC game (15%), the Electricity Strategy Game (15%), and class participation (10%). The assignments are take-home. You may discuss assignments with other students but you need to formulate and submit answers on your own or joint with at most two other classmates. The exam will be on the last day of class (in the evening). You should plan to attend the exam. Contact the MBA Program Office if you have a scheduling conflict with another class, a medical issue, or an emergency. No other exceptions. Please do not email me about alternative exam dates for other reasons as I have no flexibility to accommodate such requests in all fairness to other students.

Practice questions. An extensive set of practice questions and solutions will be posted early in the semester. You can discuss them with the TA or with me during office hours if needed.

Cheating policy. It should not be necessary to say this – but for completeness: all students are expected to comply with the University of Pennsylvania’s Code of Academic Integrity. It is the policy of the department, and this course, to immediately fail any student for the course who is in violation of the University’s Code of Academic Integrity. Cheating in any manner, on a graded assignment or exam, or violating the rules of the strategy games, will result in a failing grade for this course. Additional sanctions may be imposed of the Office of Student Conduct. The Code of Academic Integrity can be reviewed at: https://catalog.upenn.edu/pennbook/code-of-academic-integrity/.

Electronics. No phones, laptops, tablets or other electronics.

Other details: The course is included in the MBA major in Business, Energy, Environment and Sustainability and in the BEPP-Law School certificate. Non-Wharton students are welcome and encouraged to contact the professor in advance to discuss prerequisites.
ELECTRICITY MARKETS

Lecture 1 (Jan 16): Course Introduction & Energy Overview


Lecture 2 (Jan 21): Market Efficiency and Scarcity Pricing

Topics: market efficiency; scarcity pricing; electricity markets; refined products markets.

(*) KO Chapter 4: “The Efficiency of Markets”.


Lecture 3 (Jan 23): Market Power in Electricity Markets (1)

Topics: market power; deregulation.


Lecture 4 (Jan 28): Market Power in Electricity Markets (2)

Topics: the California electricity crisis; the rise and fall of Enron.


OIL AND GAS MARKETS

Lecture 5 (Jan 30): Oil and Natural Gas Extraction and Pricing (1) & Introduction to the OPEC Game

*Topics*: trends in oil and gas reserves; optimal extraction; Hotelling model.

(*) KO Chapter 6: “Managing Stocks: Natural Resources as Capital Assets”.

(*) Lecture notes on the Hotelling model for optimal resource extraction (on Canvas).


Lecture 6 (Feb 4): Oil and Natural Gas Extraction and Pricing (2)

*Topics*: oil price volatility; oil price forecasting; oil futures.

(*) J. Hamilton, 2009. “Understanding Crude Oil Prices.” *The Energy Journal* 30(2): pp. 179-188 (remainder is optional; link). *(Note: this reading is old but still relevant!)*


Lecture 7 (Feb 6): Upstream Investment under Uncertainty

*Topics*: NOCs vs. IOCs; upstream contracts; drilling investment under uncertainty; geopolitical risk; expropriations.


ENERGY AND ENVIRONMENTAL POLICY

Lecture 8 (Feb 11): **Global Climate Change**

*Topics:* climate change impacts; the climate change debate; discounting; risk and uncertainty.

(*) Lecture notes on climate change mitigation and discount rates (on Canvas).


Intergovernmental Panel on Climate Change, Summary for Policymakers, 2018 ([link](#)).

Lecture 9 (Feb 13): **Externalities and Policy Instruments**

*Topics:* environmental externalities; tragedy of the commons; Coase Theorem; property rights; taxes vs. subsidies vs. standards; effect of regulations on business; double dividend.

(*) KO Chapter 5: “Market Failures in the Environmental Realm”.

(*) KO Chapter 8: “Principles of Market-Based Environmental Policy”, pp. 139-162.

(*) A. Lustgarten, “Palm Oil Was Supposed to Help Save the Planet. Instead It Unleashed a Catastrophe”, *New York Times*, 11/20/18 ([link](#)).

Z. Colman and E. Wolff, “Why Greens Are Turning Away from a Carbon Tax”, *Politico*, 12/9/18 ([link](#)).

Lecture 10 (Feb 18): **Cap-and-Trade & OPEC Group Meetings**

*Topics:* basics of cap-and-trade; cost-effectiveness; introduction to market design issues.

(*) Lecture notes on the economics of cap-and-trade (on Canvas).


Lecture 11 (Feb 20): **Designing Real-World Environmental Markets**

*Topics:* market design issues in cap-and-trade markets; EU Emissions Trading Scheme; RECLAIM; acid rain trading program.


Lecture 12 (Feb 25): **U.S. and Global Policy Developments & International Environmental Agreements**

*Topics:* U.S. climate change policy; global carbon trading developments; emissions leakage; international climate agreements; Kyoto Protocol; Paris Accord; free-riding; carbon offsets.


**THE ECONOMICS AND FINANCE OF RENEWABLE ENERGY**

Lecture 13 (Feb 27): **The Economics of Renewable Energy**

*Topics:* levelized cost of electricity; environmental benefits of renewables; energy storage basics.

(*) S. Mundy, “India’s Renewable Rush Puts Coal on the Back Burner”, Financial Times, 1/1/19 (link).


Lecture 14 (Mar 3): Energy Policy and the Media


Topics: recent environmental policy developments; regulatory rollbacks; public opinion and energy policy; the role of the media in the debate about energy and climate change.


Lecture 15 (Mar 5): OPEC Game Debriefing

--- SPRING BREAK ---

Lecture 16 (Mar 17): Introduction to the Electricity Strategy Game & Renewable Energy Finance (1)

Topics: electricity strategy game; intro to renewable energy finance.

(*) Student instructions for the Electricity Strategy Game (on Canvas).

Lecture 17 (Mar 19): Energy Storage

Guest speaker: Judy Chang, Principal, The Brattle Group

Topics: the economics of storage; the various technologies; the connection between storage and large-scale renewables deployment.
Lecture 18 (Mar 24): Electricity Strategy Game Auction & Renewable Energy Finance (2)

Topics: tax credits; tax equity; solar leasing; securitization; renewable portfolio standards; (S)RECs.


(*) Lecture notes on renewable energy incentives (on Canvas).


Lecture 19 (Mar 26): Renewable Energy Policy (1)

Topics: PACE; net metering; feed-in tariffs; tenders.


Lecture 20 (Mar 31): Renewable Energy Policy (2)

Topics: import tariffs; green subsidy vs. carbon tax; waterbed effect.


Lecture 21 (Apr 2): Renewable Energy Policy (3)

Guest speaker: Anne Hoskins, Chief Policy Officer, Sunrun
Topics: market for residential solar, solar energy policy, regulatory risk, case study: net metering in Nevada

Lecture 22 (Apr 7): **Renewable Energy Project Finance**

**Guest speaker:** Gianluca Signorelli, VP, Head of Project Finance and M&A Execution, U.S. SB Energy (SoftBank)

*Topics:* renewable energy project finance, tax equity, capital structure, PPAs, hedging.

Lecture 23 (Apr 9): **Electricity Strategy Game Debriefing**

Lecture 24 (Apr 14): **Clean Energy Entrepreneurship**

**Guest speaker:** Pier LaFarge, Co-Founder and CEO, Sparkfund

*Topics:* energy efficiency business models; economic and behavioral incentives for energy savings; government regulations for energy efficiency.

**TOPIC: TRANSPORTATION POLICY**

Lecture 25 (Apr 16): **Fuel-Economy Policy (1)**

*Topics:* policy developments in the car industry; fuel-economy standards; gasoline tax; electric vehicle policy.


(*) V. McConnell, 2013. “The New CAFE Standards: Are They Enough on Their Own?”, *RFF Discussion Paper 13-14*, pp. 1-14 (Sections I and II; remainder is optional and less relevant for this course; [link](#)).

Lecture 26 (Apr 21): **Fuel-Economy Policy (2)**

*Topics:* unintended consequences from fuel-economy standards; cost-benefit analysis.

(*) A. van Benthem and M. Reynaert, “Can Fuel-Economy Standards Save the Climate?”, *The Economist*, 7/16/15 ([link](#)).

Lecture 27 (Apr 23): **Unintended Consequences of Transport Policies & Course Wrap Up**

*Topics*: congestion policies; enforcement; cheating; emissions leakage; course summary.


“Day without a Daft Idea”, *The Economist*, 7/16/14 (link).

Lecture 28 (Apr 28): **Exam**

*Note*: the exam will be held outside the regular class time (6-8 p.m.; location to be announced). *Class will not meet during the regular hours from 3-4:20 p.m.*
PRELIMINARY DUE DATES

Assignment dates

Assignment 1: posted on February 6, due by February 20
Assignment 2: posted on February 27, due by March 19
Assignment 3: posted on April 9, due by April 23 (before class)

OPEC Game

<table>
<thead>
<tr>
<th>Date</th>
<th>Activity</th>
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<tbody>
<tr>
<td>January 30</td>
<td>Introduction to the OPEC game in class</td>
</tr>
<tr>
<td>February 5</td>
<td>Production quantities due by 10 p.m. for phase 1, period 1</td>
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<tr>
<td>February 7</td>
<td>Production quantities due by 10 p.m. for phase 1, period 2</td>
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<tr>
<td>February 11</td>
<td>Production quantities due by 10 p.m. for phase 2, period 1</td>
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<tr>
<td>February 12</td>
<td>Production quantities due by 10 p.m. for phase 2, period 2</td>
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<td>February 14</td>
<td>Production quantities due by 10 p.m. for phase 2, period 3</td>
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<tr>
<td>February 17</td>
<td>Production quantities due by 10 p.m. for phase 2, period 4</td>
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<tr>
<td>February 18</td>
<td>OPEC group meetings in class</td>
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<tr>
<td>February 20</td>
<td>Production quantities due by 10 p.m. for phase 3, period 1</td>
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<tr>
<td>February 24</td>
<td>Production quantities due by 10 p.m. for phase 3, period 2</td>
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<tr>
<td>February 25</td>
<td>Production quantities due by 10 p.m. for phase 3, period 3</td>
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<tr>
<td>February 26</td>
<td>Production quantities due by 10 p.m. for phase 3, period 4</td>
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<tr>
<td>March 5</td>
<td>OPEC strategy memo due before class</td>
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<tr>
<td>March 5</td>
<td>OPEC game debriefing in class</td>
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Electricity Strategy Game

<table>
<thead>
<tr>
<th>Date</th>
<th>Activity</th>
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<tbody>
<tr>
<td>March 17</td>
<td>Introduction to the Electricity Strategy Game in class</td>
</tr>
<tr>
<td>March 21</td>
<td>Bids due for the ESG test run</td>
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<tr>
<td>March 24</td>
<td>First ESG divestiture auction, in class</td>
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<tr>
<td>March 25</td>
<td>ESG strategies due by 10 p.m. for year 1, day 1</td>
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<tr>
<td>March 26</td>
<td>ESG strategies due by 10 p.m. for year 1, day 2</td>
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<tr>
<td>March 27</td>
<td>ESG strategies due by 10 p.m. for year 1, day 3</td>
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<tr>
<td>March 30</td>
<td>Sealed portfolio bids for year 2 due by 10 p.m.</td>
</tr>
<tr>
<td>March 31</td>
<td>ESG strategies due by 10 p.m. for year 2, day 1</td>
</tr>
<tr>
<td>April 1</td>
<td>ESG strategies due by 10 p.m. for year 2, day 2</td>
</tr>
<tr>
<td>April 2</td>
<td>ESG strategies due by 10 p.m. for year 2, day 3</td>
</tr>
<tr>
<td>April 9</td>
<td>ESG strategy memo due before class</td>
</tr>
<tr>
<td>April 9</td>
<td>ESG debriefing in class</td>
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Exam

Tuesday April 28, 6-8 p.m., location to be announced