Climate Change Legislation:

Strong Cost-Containment Measures Are Needed To Help Protect Electricity Consumers and the U.S. Economy

The Edison Electric Institute (EEI) supports enactment of federal legislation that reduces greenhouse gas (GHG) emissions by 80 percent below current emissions levels by 2050 while providing effective cost-containment measures to help limit electricity price increases for consumers as our country transitions to a low-carbon future.

As the Senate develops climate change legislation, strong measures are needed to help reduce the costs of any cap-and-trade program to energy consumers and the American economy. EEI believes the following consumer-protection measures are critical to ensure broad, long-term public support for climate change legislation.

Reasonable and Achievable Targets and Timetables

For any carbon policy to reduce GHG emissions effectively and to help reduce cost increases to electricity consumers and the U.S. economy, the targets and timetables must correspond to the widespread commercial availability of technologies needed to reduce emissions. Energy efficiency, renewable energy, and natural gas-based generating plants are the resources available to meet near-term targets. Medium-term targets in federal legislation should be set in the 10- to 15-year timeframe to match up with and enable technology development—*e.g.*, new nuclear and advanced coal technologies with carbon capture and storage.

To make significant short- and mid-term emissions reductions without these technologies, electric utilities would be forced, over a relatively short period of time, to switch from using coal to using large amounts of natural gas. Utilities would need to build many new natural gas generating facilities to provide baseload power. This massive fuel switching would constrain natural gas supply, driving up natural gas prices and exposing consumers to sharply higher heating and air conditioning bills. Likewise, industries that use natural gas would be less competitive in global markets, making it even more likely that U.S. jobs would be exported overseas.

H.R. 2454, the American Clean Energy and Security Act passed by the House of Representatives in June 2009, would require a reduction of GHG emissions of 3 percent below 2005 levels by 2012—only three years from now. In reality, accounting for growth in electricity demand since 2005, this 2012 requirement is closer to a 10-percent reduction in projected GHG emissions. Achieving this near-term reduction would impose abrupt and significant price increases on electricity customers. The House bill also would require a very aggressive 17-percent reduction in GHG emissions below 2005 levels by 2020. A more reasonable and achievable 2020 target will help to cushion the cost impact on electricity customers.

Allocation of Allowances

A key design element in a cap-and-trade program is the method by which allowances for emissions permitted under the cap initially are introduced into the market. Allocating allowances—rather than auctioning them—has the broad support of a variety of stakeholders, including the U.S. Climate Action Partnership (USCAP), a group of businesses and leading environmental organizations; labor groups; electric utility companies; and the National Association of Regulatory Utility Commissioners (NARUC), which represents the state public utility commissioners who regulate these utility companies.

Consistent with a proposal developed by EEI, the initial allocation of allowances to the electric power sector should be proportionate to its level of carbon dioxide (CO_2) emissions (currently 40 percent). The vast majority of allowances to the power sector should be allocated directly to the local distribution companies (LDCs), or the "wires" companies that provide local retail electric service. The value of those allowances then would flow directly to all electricity customers—residential, commercial, and industrial—under the strict supervision of state public utility commissions, which closely regulate LDCs. This approach would allow utility regulators to mitigate economic impacts in a way that takes into account the costs incurred by all customers—which will differ across the country—while still maintaining the environmental benefit of implementing a price on carbon.

Within the power sector, the vast majority of allowances should be allocated to LDCs based on an even split between base-year emissions (including emissions associated with purchased power) and retail sales. The relatively small number of remaining allowances would go to merchant coal generators, which would receive allowances equal to 50 percent of their base-year emissions, to help defray their compliance costs, to help mitigate price increases in wholesale electricity markets, and to help maintain a reliable electricity supply in the regions where merchant coal generators are located.

To help reduce electricity price increases for all consumers, allowances should be allocated to electric utilities while new technologies are being developed and deployed, before beginning a gradual transition to a full auction as more climate-friendly technologies become available and new low-carbon infrastructure is built. A phase-out period of at least 15 years—beginning after new technologies are available—is needed to help protect consumers from sudden energy price shocks.

A Price Collar Will Help Limit Harm to Energy Consumers

A price collar consists of both a floor and a ceiling on emission allowance prices in climate change legislation. This critical consumer protection measure would help to protect consumers, U.S. workers, and the economy from volatile carbon prices and possible market manipulation, while supporting emissions reductions.

A price floor would ensure that the price of allowances does not drop below a certain level; a ceiling would ensure that the price does not rise so high that it causes significant economic harm if emissions-reduction costs prove higher than anticipated. A price collar should be narrow to start and gradually expand as cleaner technologies become available. In addition, a price collar should be simple to administer and be formulaic so it is easy to determine the price for allowances at any point in time.

Offsets Will Help To Ensure Emissions Targets Are Met

The term "offsets" refers to projects that reduce, avoid, or sequester GHG emissions, which are undertaken in sectors or countries that are not subject to emission limits under the legislation (*e.g.*, agriculture, forestry). These GHG emissions reductions then are used by regulated entities to "offset" or neutralize their own emissions. In a cap-and-trade system, an offsets program allows regulated entities to meet a certain percentage of their compliance obligation with allowances generated through offsets projects.

In the early years of a cap-and-trade program, offsets will be one of the few tools utilities will have for meeting targets. Quantitative restrictions—such as the House bill's 20-percent discount for international offsets after five years and the annual limits on a covered entity's use of offsets—should be eliminated both to bolster the supply and to lower the price of domestic and international offsets. Moreover, a number of severe qualitative restrictions either should be eliminated or eased in order to assure a full and affordable supply of offsets.

Congress can take important steps to help reduce the costs of climate change policy for all electricity consumers, while also protecting the environment. Climate change legislation must include strong cost-containment measures—including reasonable and achievable targets and timetables; the allocation of allowances; a collar on the price of emissions allowances; and the wide and robust use of emissions offsets—in order to protect electricity consumers and the U.S. economy.

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