Written Testimony

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On behalf of
The Edison Electric Institute

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Subcommittee on Energy and Environment

Hearing on Allocation of Emissions Allowances

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Chairman Markey, Ranking Member Upton, and members of the Subcommittee, I am grateful for the opportunity to appear before the House Energy and Commerce Committee's Subcommittee on Energy and the Environment to offer testimony on the allocation of emissions allowances under the American Clean Energy Security Act of 2009.

My name is Tom Farrell. I am the chairman, president and CEO of Dominion Resources, a leading provider of commodity energy and energy services in the Midwest, Northeast and Mid-Atlantic regions of the country. Our corporate headquarters is located in Richmond, Va.

Dominion owns and operates a $42 billion energy network that includes more than 27,000 megawatts of electric generating capacity and 1.2 trillion cubic feet equivalent of proved natural gas and oil reserves in the Appalachian Basin. Our transportation and delivery infrastructure includes 14,000 miles of natural gas transmission, gathering and storage pipeline and 6,000 miles of electric transmission lines. We operate the nation's largest underground natural gas storage system, with 975 billion cubic feet of storage capacity. We also serve more than 5 million retail electric and natural gas customers in 12 states.

Dominion operates both regulated and merchant electric generating facilities in the northeastern quadrant of the U.S. We are in the top third of the electric industry in terms of carbon efficiency – the amount of CO_2 produced per unit of output. About two-thirds of our total generating capacity is regulated and one-third is merchant generation. Slightly more than half of Dominion's total electric output is fossil-fired. The remainder is emissions-free nuclear and renewable power, primarily hydro, wind and biomass. Dominion's renewable portfolio includes a 50-percent interest in the two largest wind farms east of the Mississippi River.

I am appearing before you today on behalf of the Edison Electric Institute. EEI is the trade association of U.S. shareholder-owned electric companies, with international affiliate and industry associate members worldwide. The U.S. members of EEI serve 95 percent of the ultimate electricity customers in the shareholder-owned segment of the industry and account for about 70 percent of the total U.S. electric power business.

Introduction

EEI has endorsed climate change principles intended to help ensure that U.S. climate policy is successful in reducing greenhouse gas (GHG) emissions while also addressing the cost implications to consumers. This framework calls for an 80-percent reduction in GHG emissions from current levels by 2050, together with a series of actions to mitigate impacts to electricity customers and the economy.

Under any scenario, reductions in greenhouse gas emissions will be expensive. The most cost-effective way to achieve them in the power sector is through the development and deployment of a full portfolio of climate-friendly technologies and measures over the long term. These include:

- Supply- and demand-side energy efficiency initiatives;
- Renewable energy projects;
- Advanced coal technologies integrated with carbon capture and storage (CCS);
- New nuclear power plants;

- Plug-in hybrid electric vehicles; and
- Smart grid applications.

Some of these technologies are commercially available now (many at a higher cost than conventional generation sources) while others are not. The availability of all of these technologies will be critical if we are to achieve our dual goals of reducing GHG emissions and maintaining reliable, affordable and clean electricity supplies in a carbon-constrained world.

Although technology applications are certainly a necessary component of climate change policy, in and of themselves they are incomplete. EEI's membership spent two years developing a consensus proposal to minimize the economic impact of reducing carbon emissions for all electricity consumers – especially the low-income families and energy-intensive businesses and industries that will suffer the most from higher electricity costs. We thoroughly examined numerous proposals brought forth by EEI member companies and carefully evaluated the rate impacts on our customers. Through extensive modeling, we learned that some proposals widened the disparity in electricity rates across the nation while others reduced this rate spread.

The allowance allocation formula contained in H.R. 2454 is the essence of the EEI proposal. The allowance allocation concept has the broad support of a variety of stakeholders, including the U.S Climate Action Partnership (USCAP), labor groups, and EEI and its member companies.

I will describe our mechanism for allocating allowances and explain why it offers the best means of protecting electricity consumers of all types – large and small, rural, urban and suburban – without sacrificing the desired environmental improvements. Consumers can be assured that whether they receive electricity from a shareholder-owned utility, an electric cooperative or a municipal utility, they will receive the benefits of the allowance program provided for in this legislation.

Key Allowance Allocation Provisions of H.R. 2454

The allowance allocations to the power sector as provided for in H.R. 2454 amount to 35 percent of the total annual allowances available to all major sectors of the economy covered by the bill, starting in 2016. According to the Committee, 30 percent of all allowances will go to local distribution companies (LDCs) and about 5 percent will go to merchant coal generators and other generators with long-term power purchase agreements until direct allocations begin to decline in 2026 and phase out by 2030.

A longer phase-out period of transitional allowances is one of the modifications to the bill that we seek. H.R. 2454 currently provides for allowances to quickly decline from 35 percent to zero in the five-year period from 2025 to 2029. Because the emissions cap declines sharply from 2020 to 2030, consumer protections would be strengthened if allowances were phased out more gradually.

EEI believes these allocations to the electric sector are critical to holding down costs to electricity customers – our fundamental and overriding concern. And just as we believe there should be no exemption for any industry or particular fuel in a climate cap-and-trade regime, so we believe there should be no exclusion of merchant coal generators from the allowance allocation program. I will return to this subject later.

By design, H.R. 2454 allocates 30 percent of *all* allowances to LDCs, the wires companies that provide retail electric service to end-use consumers. The bill specifies that these allowances must be used exclusively for the "benefit of retail ratepayers." The allocation proposal found in new Clean Air Act section 783 ensures that *all* classes of electricity customers receive the benefits of the value of the emissions allowances, regardless of the size, location or ownership structure of the LDC.

Targeting LDCs as the primary allowance recipients ensures that the benefits and costs of those allowances flow directly to end-use electricity consumers. LDCs connect with every electricity

customer—residential, commercial and industrial. They are the entities best equipped to ensure that customers see any costs or benefits derived from the value of the allowances.

LDCs also monitor, record and bill customers for the amount of electricity they use. For that reason, they have a built-in, practical and efficient system in place to flow through the costs and benefits of allowances to their customers.

In addition, LDCs have extensive experience and numerous programs to identify and serve low-income customers. They are in a good position to work with their state public utility commissions (PUCs) to design programs that address industrial customers as well as low-income customers, which supports an important goal of this legislation.

A second important point is that LDC rates are regulated by state commissions. These PUCs have extensive oversight experience and authority to ensure that allowances received by LDCs will be reflected in any ratemaking cases. The bill enhances the role of state commissions and includes safeguards to ensure that allowances directly benefit consumers. EPA is granted specific authority to suspend the awarding of allowances in the event that any PUC or LDC does not use these allowances appropriately.

The utility ratemaking process provides transparency and accountability through a time-tested, public mechanism. Allowance allocations to LDCs under strict PUC supervision should address any concern that utility shareholders would benefit from the allocations instead of customers.

Third, allocations to LDCs can take into account regional variations in electricity use, generation mix and costs. Different regions use different amounts of fossil fuel to produce electricity. Some regions use much more coal than others. Average customer demand for electricity also varies significantly by region, due to such things as weather and the price of power.

In sum, the allocation approach for LDCs that EEI supports has sufficient flexibility to manage and accommodate all of these factors.

Determining Allocations to LDCs

We are pleased that H.R. 2454 provides direct allowances to the electricity sector in the early years of the program. This feature of the bill is critical to protecting consumers until new technologies are available to enable the continued use of our domestic coal resources, and until such time as new low-carbon infrastructure can be built.

It is important to note, however, that significant costs remain for the utility sector to comply with major programs in this Act. The Combined Efficiency and Renewable Electricity Standard and the climate cap-and-trade program will require significant financial investments to either change the current generation profile, purchase renewable energy credits or offsets, make alternative compliance payments, purchase allowances from an auction, or some combination thereof.

H.R. 2454 distributes emission allowances to LDCs based on a calculation of each LDC's share of the total "LDC allowance pool." To give equitable treatment to the expressed concerns of different LDCs, the distribution of allowances will follow a 50/50 formula: 50 percent based on each LDCs share of average annual electric sector CO_2 emissions during the base period (including emissions associated with purchased power) and 50 percent based on each LDCs share of average annual electricity retail sales during the base period.

The EEI approach resulted from years of discussion among its diverse members. It is a blend that responds to varying profiles of companies located in different regions of the country, operating with different fuel strategies and serving different customer needs.

EEI's proposal recognizes that the increased costs of a CO2 cap comes from multiple factors, including the cost of purchasing allowances to cover a utility's own generation, the added fuel costs from reducing coal generation and increasing natural gas generation to comply with the cap, as well as the impact of both of these factors on the price of purchased power.

The emissions component of the formula recognizes the concerns of utilities with significant fossil generation that their customers will face higher compliance costs. Emissions-based allowances would help offset those costs. The sales component factors in the concerns of other utilities whose customers already face higher prices resulting from utility investments in non-emitting power generation.

The 50/50 allocation formula recognizes the validity of both views and ensures that all LDCs are treated the same, regardless of their ownership structure. In short, any LDC that delivers electricity directly to retail consumers – whether it is a shareholder-owned utility, an electric cooperative or a municipal utility—will receive allowances under this program.

Determining Allocations to Merchant Coal Generators

Merchant coal generators sell coal-fired power into competitive wholesale markets where prices are set by market forces and are not subject to state PUC regulation. These merchant generators produce more than 20 percent of total U.S. coal-fired generation.

EEI, as well as USCAP and labor groups, recognize that providing allowances to these generators is essential to ensuring an affordable and reliable supply of electricity during the transition to a low-carbon economy. The continued viability of these generators is critical to maintaining adequate competition in competitive markets, assuring reliability and holding down costs to consumers. Consumers in competitive markets also deserve protections from potential cost increases from reducing GHG emissions.

We believe that H.R. 2454 incorporates valuable safeguards on the use of allowances provided to merchant coal generators as follows:

(1) Merchant generators receive a proportional share of allowances based on one-half of their base-year emissions. Even at the maximum allocation, they will always have to purchase allowances to cover their net compliance costs.

(2) The bill calls for a cap on the share of electric sector allowances available to merchant facilities, which would decline over time.

(3) The bill ensures that allowances to merchant coal generators will be based on actual emissions that occur in the prior year. This ensures that no allowances will be awarded to facilities that are retired. If a plant is retired, its qualifying emissions will be zero and no allowances will be provided for that facility in the following year. If the plant's output declines, it receives fewer allowances. This guards against any generator receiving allowances for emissions that are not occurring and thus protects against concerns about "windfall profits."

As I have previously discussed, we agree that an enhanced role for state PUCs as provided in the bill will be an effective tool for ensuring that LDCs use allowances to directly benefit consumers. However, state commission oversight is not the only method to ensure that allowances mitigate consumer costs.

In competitive markets, it is evident that a limited number of allowances for merchant generators is necessary to help defray the substantial costs of complying with emissions reduction targets. H.R. 2454 directs EPA, working with FERC, to examine and address any potential "windfall profits" or substantially disparate treatment.

As the entire electricity industry invests in new generation to meet renewable energy targets and develops new CCS technologies to ensure a future role for domestic coal, allowances provide a sound public policy platform to help meet the declining cap on emissions.

Determining the Relative Size of LDC and Merchant Generator Allowance Pools

The bill caps allowances available to the merchant generator pool at 10 percent of the total annual allowances provided to the electricity sector. That means the maximum amount of allowances available to merchant generators in any given year is 3.5 percent.

The total amount of allowances issued to merchant generators is then deducted from the total electricity sector allocation to determine the LDC allowance pool. The LDC allowance pool is then allocated to individual utilities using the formula explained earlier. As the emissions cap declines over time, and as the allowances allocated to the electricity sector decline, so will the number of allowances allocated to LDCs and merchant coal generators.

Conclusion

EEI again wishes to commend this Committee for its hard work on the enormously challenging issues related to climate change. The complexity of the allowance distribution formula in the bill is a reflection of the complex nature of the electric industry, with its diverse generating facilities, fuel sources and state regulatory arrangements.

We believe the allowance allocation approach in this bill will minimize the economic impact on electricity customers nationwide during the early years of a federal GHG cap-and-trade program. It also will help ensure that utilities continue to provide reliable, reasonably priced electric service that supports economic growth, job creation and strong communities.

We look forward to continuing our work with the Committee to help ensure that U.S. climate policy is successful in reducing GHG emissions while also addressing the cost implications to consumers.

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