ALLOCATION

Nicholas Institute Discussion Memo on H.R. 2454,
American Clean Energy and Security Act of 2009

Todd Wooten, Director, Southeastern Climate Resource Center,
Nicholas Institute for Environmental Policy Solutions

The question of whether or not to allocate credits to the utility industry has always been central to the climate debate. The Waxman-Markey bill does elect to “give” utilities allowances, but the restrictions placed on those allowances severely limit the utilities’ ability to use them for compliance or to improve their bottom line. Instead, the allowances given to utilities must be used solely to protect consumers.

The bill includes a large allocation to the utility industry via Local Distribution Companies (LDC) This is not usually thought of as consumer protection, but restrictions on the allocations usage force it to be.

LDC is a term typically associated with the natural gas industry. Here it refers broadly to a utility company that provides the distribution, customer, and energy services for natural gas and electricity. In essence, the bill defines an LDC as the entity a consumer pays their utility bill to.

The LDC will receive allowances based upon a 50/50 split between the historic emissions of the LDC power supply and its sales. The bill mandates that all allowances allocated to LDC must be sold within a year. This reduces the ability of an LDC to hold allowances in order to speculate on the future of the market at the expense of their customers. Most importantly, the LDC must use the allowances solely for the benefit of their customers.

By mandating that the allowances be used in this manner, the allocation becomes part of the utilities ratemaking, which then necessitates the involvement of the state Public Utility Commission (PUC). The involvement of the PUC in oversight significantly reduces the likelihood of electric utilities realizing windfall profits from this allocation. This has long been a concern based upon Europe’s experience in the early years of EU-ETS.

The LDC provision’s primary strength as a consumer protection program is its acknowledgment of regional differences in power supply. Areas that are still heavily dependent on coal will receive more allowances than areas that are not. This is because they will receive allowances not only for the power sold, but also for the carbon intensive fuel used to produce it. In contrast, an area heavily dependent on hydroelectric power will receive allowances commensurate with the power sold, but little else.

At first blush, this seems counter-intuitive to developing a low carbon power sector. However, by dividing the credits between the two systems (emissions vs. sales), power customers in areas that are still dependent on coal will not be forced to bear a larger burden than those customers in areas heavily dependent on hydro. On the other hand, areas with significant low emission power production will receive more than pat on the back for a job well done. They will receive allowances for the sale of power, but will not have to turn in to compliance credits for its generation.

From a political standpoint, this provision has the support of USCAP and EEI as well as support from IBEW and the mineworkers. Many consider it essential to the passage of this bill as it stands to at least mitigate some of the attacks likely to come from members of utility industry who are not interested in seeing climate legislation pass. By winning concessions that the distribution will be based partially on

sales, not emissions, the dirtiest actors will not be rewarded with all the allowances. By mandating that those allowances be used for consumer rebates, the bill ensures that companies will use them for the benefit of the public, not solely their shareholders.