
H.R. 2454's Allowance Allocations Help To Reduce Cost Increases To All Electricity Customers

On June 26, 2009, the House of Representatives passed H.R. 2454, the American Clean Energy and Security Act of 2009. The bill establishes a cap-and-trade program to reduce the nation's carbon dioxide (CO₂) and other greenhouse gas (GHG) emissions. Under the cap-and-trade program, a national limit on GHG emissions is established and, over time, that "cap" is lowered. Meeting this declining cap requires regulated facilities to make increasing emissions reductions.

To implement the program, the federal government creates credits or "allowances" for regulated facilities, adding up to the total emissions allowed under the cap. An allowance is a permit to emit a certain amount of GHGs, typically defined as one ton of CO₂. At the end of each compliance period, a regulated facility is required either to cut emissions or to submit allowances or offsets to the federal government to cover the total emissions it was responsible for during that period.

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. There has been considerable debate over whether allowances should be sold by the federal government at an auction or given to regulated facilities through an allocation. Allocating allowances 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.

H.R. 2454 allocates allowances to the electric power sector in the early years of the program. This feature of the bill is critical to help reduce electricity price increases to consumers until new technologies to reduce GHG emissions become available and new low-carbon infrastructure can be built.

How Allowance Allocations Help To Reduce Cost Increases To Customers

Any GHG reduction program will increase electricity and other energy costs to customers, businesses, and industries. Implementing the right allocation strategy, however, can soften the economic impact on electricity customers—particularly the low-income families and energy-intensive businesses that will feel the impact the most. One of the primary benefits of allocating allowances—rather than auctioning them—is that customers, through their electricity bills, would be paying only for the costs of reducing GHG emissions, plus any shortfall of allowances. Customers would not face the additional cost of paying for any allocated allowances as they would if all of the allowances were auctioned.

As compared to a full auction, H.R. 2454's formula for allocations to the power sector helps to limit cost increases to electricity customers of all types—large and small, rural, urban, and suburban—without sacrificing the desired environmental improvements. Customers will receive the benefits of the allowance program whether they receive their electricity from a shareholder-owned electric utility, an electric cooperative, or a municipal utility.

Allocations To The Power Sector Under H.R. 2454

H.R. 2454 allocates 35 percent of the total annual allowances available under the bill (less a set-aside for the strategic allowance reserve) to the electric power sector, starting in 2016. The vast majority of these—or an estimated 30 percent of all allowances—would go to the local distribution companies (LDCs) that provide electric service to homes, businesses, and industries. The bill specifies that these allowances must be used exclusively for the “benefit of all retail ratepayers.” It assures 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. And, it grants the Environmental Protection Agency (EPA) specific authority to assure that the allowances benefit customers as a condition of awarding the allowances to LDCs.

The distribution of allowances to LDCs follows a balanced 50/50 formula: 50 percent based on each LDC's share of average annual electric sector CO₂ emissions to serve retail load during the base period, and 50 percent based on each LDC's share of average annual retail electricity sales during the base period. The emissions component recognizes the higher compliance costs of utilities with significant fossil generation. The sales component recognizes the higher prices that have resulted from utility investments in efficiency and lower-emitting or non-emitting power generation.

All LDCs—whether shareholder-owned electric utilities, electric cooperatives, or municipal utilities—are treated the same. All of their customers will see lower cost increases as compared to those under a full auction of allowances, although the impacts to individual LDCs and their customers will vary.

The remainder of the power sector's 35 percent of allowances (or about five percent of all allowances) will go to merchant coal generators (up to 3.5 percent of all allowances) and other generators with long-term purchase power agreements (about 1.5 percent of all allowances). Merchant coal generators sell coal-fired power into competitive wholesale markets. The limited number of allowances for merchant coal generators is necessary to help defray a portion of their substantial costs of complying with emissions reduction targets. The continued viability of these generators is critical to assuring reliable electric service in those regions and to holding down the price of electricity in those regions during the transition to new technologies.

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