


Senators Lieberman and Warner's Climate Change Proposal – A Windfall for Big Polluters?

	United States Tax Payers	Date: <u>Upon enactment</u>
Pay to:	<u>America's most polluting power companies</u>	\$ <input type="text" value="9,000,000,000.00"/>
<u>Nine billion dollars and 0/100 ---</u>		DOLLARS
Memo:	<u>More to come!</u>	<u>America's Climate Security Act</u>

Clean Air Watch

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In August, Senators Joseph Lieberman (I-CT) and John Warner (R-VA) released a draft framework to establish an economy-wide cap-and-trade program aimed at reducing U.S. greenhouse gas (GHG) emissions 70 percent below current levels by mid-century. We are encouraged that they have taken this initiative in the face of dogged opposition to emission limits by the Bush Administration.

But as they work out the details of the bill, which is expected to be introduced in late September or early October, several questions loom large: Are the ultimate reductions enough to protect the planet? (Probably not.) Should interim reductions take place more rapidly? (Absolutely!) And will the bill be a give away to the biggest polluters at the expense of the households and businesses that will ultimately foot the bill for the program? (Read on.)

The last question has been the focus of discussion and debate for many months. For example, Senators Barbara Boxer (D-CA) and Jeff Bingaman (D-NM) have warned companies investing billions of dollars to build coal-fired power plants not to expect Congress to give those plants allowances for free.¹ Senators Boxer and Bingaman explained last January that any successful legislative proposal would not contain a provision that “would allow those building traditional coal-fired power plants to economically benefit from coming in ‘under the wire’ and being considered part of the emissions baseline. Rather, they indicated the opposite would occur and cautioned against companies trying to “game” the system by increasing their emissions right before the legislation is passed. Despite these statements, the legislation Senator Bingaman introduced in July appears to do just that – it would allow future conventional coal-fired power plants to receive allowances. As the Chairman of the Senate Committee on Environment and Public Works, Senator Boxer obviously will play a significant role in deciding whether the taxpayers subsidize coal-fired power plants into the future or whether the legislation creates important market incentives for low- and zero-emission forms of energy generation. Senator Boxer, however, will likely be looking to Senators Lieberman and Warner to bring a consensus-building bill to the Committee. While we believe Senators Lieberman and Warner are both sincere about their desire to do something positive to arrest global warming, it is a pity that they seem to believe they have to appease the worst global warming polluters at the expense of consumers and renewable energy technologies.

The draft proposal released by Senators Lieberman and Warner allocates a substantial share of the total economy-wide cap to power plant operators (20%) based on their historic emissions. The bottom line of this apparent political calculation is that coal-fired power plants receive more than 80% of the electric sector allowances or more than \$9.5 billion in allowance value in 2012 alone.² Economists and Wall Street analysts suggest that this approach could be a windfall to coal-based utilities, boosting corporate profitability at the expense of electricity rate payers. The appearance is that of a Congressional bill that seeks to placate the biggest polluters with an over-allocation of allowances. One consequence of this over-allocation is that it will only become more profitable to continue to operate the older, dirtier coal-fired power plants in the future – which not only could make combating global warming more difficult – but will also mean that these older plants will continue to emit higher amounts of NO_x, and SO₂, and mercury.

But wait, there is more – the Senators also propose to return a large portion of the revenue generated from the federal government's sale of allowances to the coal sector. Revenues would be used to pay

¹ Jeff Bingaman and Barbara Boxer, *Utilities that rush new coal plants now won't get bigger emission breaks later*, Dallas Morning News (January 19, 2007) (available at: http://www.dallasnews.com/sharedcontent/dws/dn/opinion/viewpoints/stories/DN-bingaman_19edi.ART.State.Edition1.290de70.html).

² Assuming an allowance price of \$10/metric ton of CO₂. In addition, 4% of the total economy-wide cap would be allocated directly to coal mine operators.

for carbon capture and storage technologies and mercury, NO_x, and SO₂ control technologies for coal-fired power plants (technologies that the industry should be installing already).

One ray of sunshine in the Lieberman-Warner proposal is the innovative proposal to distribute a portion of the allowances to electric distribution companies for the benefit of low- and middle-income consumers. However, even this aspect of the proposal is in doubt because they would divert an unknown quantity of these allowances to – you guessed it – coal-fired power plants.³

There is still time to improve this legislation significantly. But the clock is ticking.

Windfall Profits

As our previous report, *Should Big Polluters Own the Sky*,⁴ explained, power plant operators will recover a substantial portion of their CO₂ compliance costs by increasing their electricity prices. Any allowances they receive above-and-beyond their unrecovered costs produces windfall profits. In a carbon-constrained future, the market clearing price will reflect the price of carbon dioxide emissions. As a result, a power plant operator early in the dispatch curve (like a baseload coal plant) will cover a significant portion of its CO₂ compliance cost with the additional revenue that it earns. In other words, an electric generator does not need to receive an allocation equal to its emissions to maintain profitability. In fact, even if a coal-plant operator receives an allocation equivalent to only a fraction of its current emissions, the profitability of the facility may still increase because of the higher market clearing price. The *draft* proposal by Senators Lieberman and Warner provides an excessive allocation to electric generators, guaranteeing significant windfall profits to the top ten emitters of CO₂.

For example, assuming electric utilities recover 80 percent of the value of the allowances they need to cover their annual emissions,⁵ the highest emitter of CO₂, AEP, would reap a windfall profit of over \$430 million in 2012 alone and more than \$2 billion in the first five years of the program. The table and chart below summarize the potential windfalls that would be enjoyed by the industry's largest emitters.

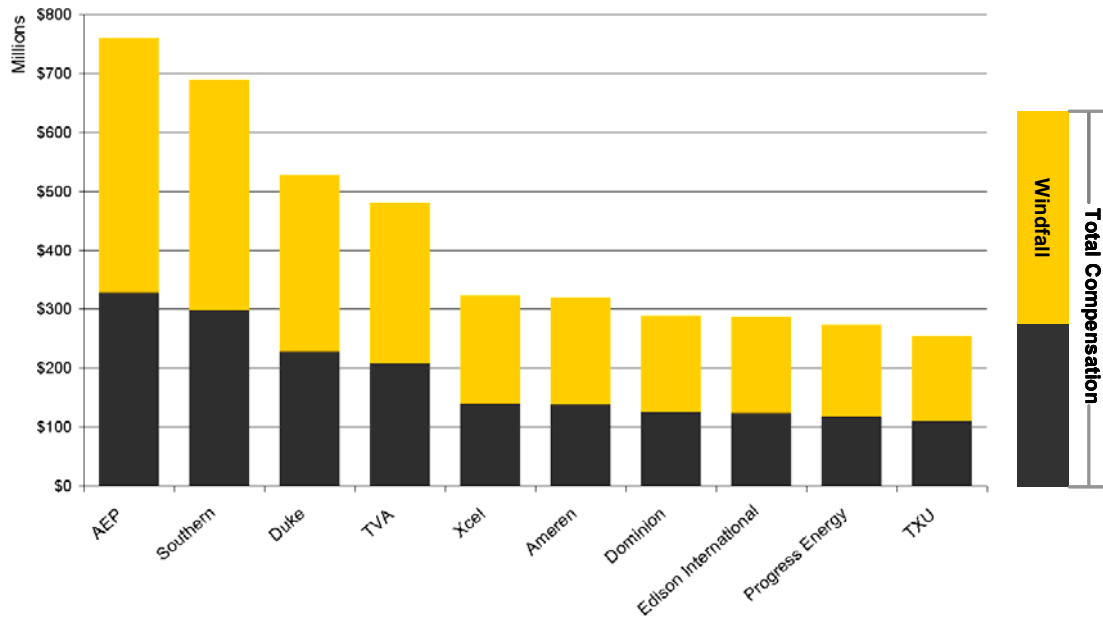
³ The Lieberman-Warner proposal diverts a portion of the consumer allocation to rural electric cooperatives that rely almost exclusively on coal for their electricity production.

⁴ Report available at:

http://www.cleanairwatch.org/Documents%20&%20Reports/should_big_polluters_own_the_sky_final.pdf.

⁵ Consistent with the assumption made by BernsteinResearch in evaluating the impact of CO₂ emissions limits on utility profits. Hugh Wynn, et al. *U.S. Utilities: The Impact of CO₂ Emissions Limits on Power Prices and Profits Under Four Legislative Scenarios*, BernsteinResearch (July 19, 2007).

Compensation to the Top Ten Emitters Under the Lieberman-Warner Proposal in 2012



Company	CO ₂ Emissions ⁶ (tons/year)	Allowance allocation value (Lieberman/Warner proposal at \$10/ton)	CO ₂ emissions costs not recovered in the market (20%)	Windfall - Value of over-allocation ⁷
AEP	163,934,554	\$759,764,096	\$327,869,109	\$431,894,988
Southern	148,647,755	\$688,916,549	\$297,295,511	\$391,621,039
Duke	113,602,312	\$526,496,434	\$227,204,625	\$299,291,809
TVA	103,602,929	\$480,153,717	\$207,205,858	\$272,947,859
Xcel	69,809,043	\$323,534,015	\$139,618,086	\$183,915,929
Ameren	69,029,540	\$319,921,361	\$138,059,079	\$181,862,282
Dominion	62,071,888	\$287,675,724	\$124,143,775	\$163,531,949
Edison International	61,810,500	\$286,464,307	\$123,620,999	\$162,843,307
Progress Energy	58,930,512	\$273,116,839	\$117,861,024	\$155,255,815
TXU	54,946,087	\$254,650,794	\$109,892,175	\$144,758,619

In addition to the 20 percent of allowances allocated to power plant operators, Senators Lieberman and Warner have proposed allocating 10 percent of the economy-wide cap to electric distribution companies to defray energy-cost impacts on low- and middle-income consumers and to promote demand-side energy efficiency. Thus, if the Senators draft the bill accordingly, the value of the

⁶ Source: Ceres, Natural Resource Defense Council, and Public Service Enterprise Group, Benchmarking Air Emissions of the 100 Largest Electric Power Producers in the United States – 2004, (April 2006) (available at: <http://www.nrdc.org/air/pollution/benchmarking/2004/benchmark2004.pdf> and <http://www.nrdc.org/air/pollution/benchmarking/default.asp>).

⁷ This calculation assumes that: the Lieberman and Warner bill will cover 80% of economy-wide emissions; the electric power sector will receive 20% of the allowances; companies in the electric power sector will be able to recover 80% of the cost of emissions through the increased marginal cost of electricity; and allowances will initially be \$10 per ton of CO₂.

allowances should be passed on to the consumer in full – a very good idea. As the saying goes, however, the devil is in the details. And here the details are sketchy. If the value of these allowances is not returned to consumers, hundreds of millions of dollars in additional windfall profits will be distributed – AEP alone would receive a windfall of over \$700 million in first year of the program (assuming an allowance price of \$10 per ton).

Company	Electric distribution company allocation value (Lieberman/Warner proposal at \$10/ton)	Windfall - Value of over-allocation including the 10% allocation to electric distribution companies⁸
AEP	\$339,522,308	\$771,417,296
Southern	\$255,910,973	\$647,532,012
Duke	\$204,382,312	\$503,674,121
TVA	\$51,353,980	\$324,301,839
Xcel	\$125,215,477	\$309,131,405
Ameren	\$110,275,962	\$292,138,244
Dominion	\$126,606,917	\$290,138,865
Edison International	\$119,469,937	\$282,313,245
Progress Energy	\$132,199,187	\$287,455,002
TXU	\$82,580,075	\$227,338,695

Additional Value to the Coal Industry

In addition to the windfalls provided to large coal-based utilities, the Senators’ proposal directs a disproportionate share of the revenue from the federal auction in a manner that significantly benefits coal-related industries and companies at the expense of consumers and renewable energy technologies. Auction proceeds would be used to fund: (1) low- or zero-greenhouse gas emitting electric power sector technologies, including technologies for capturing CO₂ in the generating of electricity from coal; (2) geological sequestration of CO₂ emissions from coal-fired power plants; and (3) reducing SO₂, NO_x, and mercury emissions from coal-fired power plants. This additional funding amounts to more than \$5 billion in 2010 (assuming an allowance price of \$10 per ton) and more than \$20 billion in 2030 (assuming an allowance price of \$30/ton).

Conclusion

Senators Lieberman and Warner’s efforts to develop an effective climate change policy for the United States is a welcome development, and their bill will play an important role in shaping the debate. However, as the Senators finalize the details for their bill, we hope they’ll take a closer look at the need to balance the interests of consumers with the interests of the biggest polluters, while at the same time promoting investment in clean energy technologies. The Senators’ current draft proposal fails to strike that balance and provides a massive windfall to the biggest polluters. There is still time to fix this important legislation.

⁸ This calculation assumes that 100% of the value of the allowances allocated to load-serving entities is not returned to the consumer.