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Cap-and-Trade Provisions Find Utility Support

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The debate that will decide the next round of changes in emissions limits has started. All sides are tossing around figures that purport to define the ramifications of such public policy. But, setting aside those predictions, the concept of cap-and-trade would apply to all emissions regulated under the Clean Air Act of 1990.

That policy, known as “Clear Skies,” would allow utilities to sell or bank credits if they operate below allowable emissions limits and buy them if they pollute more than they are permitted. While some say big polluters would be rewarded, most say the market-based approach is at least a decent supplement to strict government oversight. Still, within the camp that supports cap-and-trade provisions, utilities are divided between those that own cleaner generation facilities and those that rely on older plants to produce electricity.

The Bush proposal would curb emissions by allowing utilities the right to buy and to trade “pollution credits” for three sources of emission: nitrogen oxide, which produces smog, and sulfur dioxide, which causes acid rain. It would also require cuts in mercury but it would not touch carbon dioxide, thought by many to be the main contributor to global warming. Companies that have exceeded their pollution reduction targets could sell their “surplus” to those utilities that have failed to meet the minimum requirements.

“Public policy should recognize that generating the amount of electricity needed by our economy can be done with fewer emissions per unit of electricity generated,” says FPL Group in a personal interview. The way to remedy that, it says, is to measure emissions

by megawatt hour produced and not through total emissions. Doing so, it adds, would increase investment in research and development and lead to even greater investment in cleaner generation technologies.

The initiative is modeled after the acid-rain program that uses a market-based approach. The emission caps would go into effect in 2010, which the administration says will have an immediate effect. Because of the nature of cap-and-trade systems, it says, companies will act quickly to generate the credits necessary to come into compliance. Clear Skies would eliminate 35 million more tons of nitrogen oxide, sulfur dioxide and mercury in the next decade than the current provisions of the Clean Air Act, Bush says.

Utility Divide

Utilities generally like the idea of “Clear Skies” because it slows down the timetable to reduce emissions and allows them to implement technologies as they become commercially available. The split between utilities occurs over the cap-and-trade allowances. In essence, those that burn mostly natural gas and use wind energy want a system that rewards efficiency and would therefore like to see such measurements in terms of how much fuel must be burned to generate a megawatt of electricity.

Right now, the tilt is toward granting most of the credits to companies that operate less efficiently and pollute more, all to give them the incentive to install modern technologies. Coal operators, for example, would be eligible for most of the credits. But those that operate natural gas combined cycle plants say that they should be able to buy more credits, which are worth lots of money.

"Credits are allocated on the basis of historical fuel use," says an FPL source. "Those who used more fuel in the past (in the base year) receive more credits in the future. Rather than focus on heat input of fuels as a measure of emissions, the output approach actually focuses on emissions, measuring the rate of emissions for generators or a fleet of generators. Rather than pitting fuel against fuel—coal vs gas vs hydro vs nuclear, the output approach is a contest between the efficient vs inefficient. It is more a question of age and technology than it is a question of fuel choice."

Utilities, which release 22 percent of the nation's nitrogen oxide and 68 percent of the sulfur dioxide, do support the president's plan that they say would reduce those emissions by 70 percent by 2018. But unlike the Clean Air Act of 1990 already on the books, the approach to achieving those cuts would employ free market principles. Not only would costs be more predictable, they say, but the results would be achieved more quickly as disputes would avoid litigation.

Others, however, say that greater reductions in pollution would occur if the administration just enforced the Clean Air Act. The president's policy, they say, will allow at least 36 percent more nitrogen oxide, 50 percent more sulfur dioxide, and more than double the amount of mercury to be legally emitted by power plants, mainly because the lives of older coal-fired plants would be extended. They want even tougher laws. For those reasons, they back strict legislation submitted by Sen. Jim Jeffords, I-Vt., that would also cut carbon dioxide pollutants by 23 percent by 2008.

"There are, of course, a lot of things we dislike about the 'clear skies' plan—chiefly the fact that it postpones deadlines for meeting clean air standards and takes away key tools that are in the current Clean Air Act," says Frank O'Donnell, head of Clean Air Watch in Washington, D.C.

"We believe current law would mean cleaner air more quickly. However, in the future we are likely to see more emphasis on 'cap and trade' plans—hopefully plans that provide clean air more quickly than the Bush administration proposal," adds O'Donnell. "Historically (as in the acid rain program), emission credits have been allocated based on past overall emissions—giving the most credits to the facilities that have polluted the most. If you think about it, it's really not common sense to do this, since that rewards the companies that pollute most and penalizes those that use the cleanest fuels. The system doesn't encourage efficiency or energy diversity."

Indeed, some common ground does exist between industry and environmentalists. Utilities say that a cap-and-trade program would allow them to spend more time complying with environmental laws and less time fighting in court. Because of the nature of "cap-and-trade" systems, proponents say that companies will act quickly to generate the credits necessary to come into compliance.

But who should be rewarded with the allowances? If two companies produce a single unit of energy but one of them pollutes nearly twice as much, then which of them should receive the right to buy more "credits" from the marketplace? That's the analogy used by 40 to 50 percent of the utility sector—those that run primarily on natural gas, nuclear and green alternatives as fuel sources.

"These credits have value in the market," says FPL Group. "By pricing in those allowances into the cost of production, generators can quantify their emissions." This output-based system should be calculated as a ratio between targeted emissions in tons compared to the national electric generation total, or tons per megawatt hour.

Bush's "Clear Skies" legislation has languished in Congress for three years. And conciliation on some of the more contentious points is unlikely anytime soon. Simply, the Democrats and others have enough votes to stall any movement. But nothing in the current Clean Air Act precludes additional cap-and-trade activity, which is the free market approach to cutting emissions. It's possible that the provision could be expanded beyond the acid rain program to include other pollutants.

Even then, that won't be easy. A divide is clearly evident between those utilities that run on cleaner burning fuels and use modern technologies and those power companies that generate most of their electricity with older equipment.

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