



N A R U C
National Association of Regulatory Utility Commissioners

March 17, 2009

The Honorable Peter R. Orszag
Director
The Office of Management and Budget
725 17th Street, NW
Washington, D.C. 20503

Re: Climate Policy and Obama Administration's FY2010 Budget

Dear Mr. Orszag:

We are writing to you on behalf of the National Association of Regulatory Utility Commissioners (NARUC). As regulators of the nation's electric and natural gas utilities, we read with interest the Obama Administration's proposed budget for Fiscal Year 2010, entitled *A New Era of Responsibility: Renewing America's Promise*. We are familiar with your background in emissions trading, which is reflected in the Administration's proposal to limit greenhouse gas emissions through a cap and trade mechanism involving the auctioning of emissions allowances.

The Administration's proposal is consistent in many respects with NARUC's climate policy, which supports the auctioning of allowances as "the most efficient mechanism for achieving emission reduction goals from electric generation" assuming a cap and trade approach. However, NARUC has also concluded that allocation of no-cost emissions allowances to regulated local distribution companies (LDCs) within the electric sector "is an appropriate transitional measure" to ensure reliability and technology development while minimizing economic dislocation associated with limiting such emissions as the nation moves toward the auctioning of all allowances.¹

NARUC shares your stated concerns that no-cost allowances allocated to private companies could produce windfall profits for their shareholders. For precisely this reason, NARUC does not support the allocation of no-cost emissions allowances to electricity *generators*, which may operate as unregulated entities in competitive electricity markets where they have no obligation to share the value of such allowances with consumers.

Allowances allocated to *regulated* local distribution utilities, however, are another matter. State public utility commissions are obligated to account for the receipt of valuable allowances as utility income.² Thus, such an allocation ensures that allowance value will be used for public purposes rather than to enhance the profits of private investors. Under State regulation, this value would be passed along to the utility's consumers in the form of lower prices or through additional expenditures for energy efficiency or low-income assistance programs.³

¹ National Association of Regulatory Utility Commissioners, *Resolution on Federal Climate Legislation and Cap-and-Trade Design Principles*, November 2007 (attached).

² Local distribution companies (LDCs) remain subject to regulation in every jurisdiction, whether or not a state's electricity market has been restructured.

³ NARUC's climate policy is summarized at <http://www.naruc.org/Publications/NARUC%20Climate%20Issue%20Brief.pdf>

The allocation of transitional no-cost allowances to regulated LDCs therefore offers a potential mechanism for returning some of the revenues associated with pricing greenhouse gases directly to the very consumers who will be required to pay resulting higher energy prices. This approach could help minimize any potential economic dislocation for consumers during the transition to 100-percent auctioning of allowances, while emitters would still feel the full effect of pricing GHG emissions.

NARUC also supports the use of some allowance proceeds to fund public policy goals such as energy efficiency and low-income assistance programs at the State level. In fact, NARUC believes that a nationwide commitment to energy efficiency will provide an essential foundation for any national program to limit carbon dioxide emissions from the energy sector, thereby helping to minimize the cost of curbing those emissions.⁴

NARUC looks forward to working with the Administration and the Congress toward policies to limit greenhouse gas emissions in a manner that protects consumers while preserving reliable and affordable energy services.

Sincerely,



Frederick F. Butler
President, NARUC
(Commissioner, New Jersey
Board of Public Utilities)



Richard E. Morgan
Leader, NARUC Task Force on Climate Policy
(Commissioner, Public Service Commission
of the District of Columbia)

Attachment

cc: The Honorable Barack Obama, President
The Honorable Carol Browner, Assistant to the President for Energy and Climate Change
The Honorable Lisa Jackson, Administrator, Environmental Protection Agency
The Honorable Harry Reid, Senate Majority Leader
The Honorable Mitch McConnell, Senate Minority Leader
The Honorable Nancy Pelosi, Speaker of the House
The Honorable John Boehner, House Minority Leader
The Honorable Barbara Boxer, Chairman, Senate Environment and Public Works Committee
The Honorable James Inhofe, Ranking Member
The Honorable Jeff Bingaman, Chairman, Senate Energy and Natural Resources Committee
The Honorable Lisa Murkowski, Ranking Member
The Honorable Henry Waxman, Chairman, House Energy and Commerce Committee
The Honorable Joe Barton, Ranking Member
The Honorable Ed Markey, Chairman, House Energy and Commerce Committee
Subcommittee on Energy and Environment
The Honorable Fred Upton, Ranking Member
Charles D. Gray, Executive Director, NARUC

⁴ For further information, see NARUC, *State Clean Energy Policies: The Foundation Stones for an Electric-Sector Cap-and-Trade Program* (forthcoming, spring 2009).

Attachment

Resolution on Federal Climate Legislation and Cap-and-Trade Design Principles

WHEREAS, The National Association of Regulatory Utility Commissioners (NARUC) formed a Task Force on Climate Policy in March 2007 in order to educate NARUC members concerning climate policy issues and to develop policy proposals for consideration by the NARUC membership; *and*

WHEREAS, The NARUC Board of Directors adopted a resolution sponsored by the Task Force on Climate Policy at the 2007 NARUC Summer Meetings held in New York, New York, on July 18, 2007, that enunciated ten policy principles that NARUC believes should inform federal climate policy; *and*

WHEREAS, The relative merits of a market mechanism proposed for inclusion in any federal climate change legislation, including, but not limited to, a cap-and-trade mechanism, a carbon tax, and a loadside cap, should be carefully evaluated in determining how to achieve the desired emissions reductions consistent with the ten principles previously adopted by NARUC; *and*

WHEREAS, Congress has continued to debate various policy proposals for addressing the environmental and economic consequences of alternative climate change policies since the 2007 NARUC Summer Meetings; *and*

WHEREAS, Since the 2007 NARUC Summer Meetings, the Task Force on Climate Policy has also continued to examine various policy proposals relating to climate change issues; *and*

WHEREAS, The momentum for enactment of federal legislation regulating the emission of greenhouse gases (GHG) appears to have further increased, making the enactment of such legislation within the foreseeable future likely; *and*

WHEREAS, The existence of uncertainty about the nature and extent to which GHG emissions will be subject to future federal regulation makes it difficult for State regulators, regulated utilities, and others to appropriately plan for needed investments in electric transmission and generation infrastructure; *and*

WHEREAS, Despite a diversity of opinion within NARUC's membership regarding the need for national limitations on the emission of GHGs for the purpose of addressing concerns over warming of the Earth's climate, NARUC's members are in general agreement that the enactment of federal legislation limiting such emissions in would be appropriate in order to remove existing uncertainties that are hampering the making of transmission and generation investment decisions; *and*

WHEREAS, NARUC's members are also in general agreement that appropriate federal climate change legislation should be enacted in order to enhance the likelihood that appropriate technologies will be developed and other solutions implemented so as to achieve desired reductions in GHG emissions in the most economical manner possible; *now, therefore, be it*

RESOLVED, That the National Association of Regulatory Utility Commissioners, convened in its November 2007 Annual Convention in Anaheim, California, supports the enactment of federal legislation intended to reduce GHG emissions so long as such legislation relies, to the extent practicable, on an appropriate market mechanism or mechanisms as part of an economy-wide approach

to GHG regulation; provides for an appropriate transition period prior to the implementation of full regulation of GHG emissions; creates sufficient certainty to ensure the financing of needed energy infrastructure consistent with the achievement of the environmental objectives intended to be accomplished by such legislation; and is otherwise consistent with the policy principles developed by the Task Force on Climate Policy and approved by the NARUC Board of Directors at the 2007 NARUC Summer Meetings held in New York, New York, on July 18, 2007; *and be it further*

RESOLVED, That the Task Force on Climate Policy should consider and develop, as appropriate, proposed resolutions for NARUC's consideration addressing additional market mechanisms including, but not limited to, a carbon tax and a load-side cap; *and be it further*

RESOLVED, That, in the event that Congress chooses to implement a cap and trade mechanism for the purpose of limiting electric sector GHG emissions, any such federal climate change legislation should rest upon the following cap-and-trade design principles in order to appropriately balance competing criteria, including, but not limited to, equity, economic efficiency, and ease of administration:

1. Auctioning of all allowances is ultimately the most economically efficient mechanism for achieving emission reduction goals from electric generation. However, the allocation of emission allowances within the electricity sector at no cost is an appropriate transitional measure in order to ensure continued reliability, minimize economic dislocation resulting from the carbon intensity of the existing electricity generation infrastructure, and allow for the development of appropriate new technology.

2 Any emissions allowance allocation program, consistent with an economy-wide approach, should involve a reduction in the number of allowances allocated within the electricity sector over time to ensure that needed reductions in GHG emissions are encouraged through a gradual increase in the cost of carbon-intensive generation sources as compared to the cost of other generation sources.

3. The primary purpose of any transitional emissions allowance allocation process applicable to the electricity sector should be to minimize the initial economic impact of GHG-emissions regulation to end-user customers by phasing in the impact of such regulation over a reasonable period of time.

4. Any emissions allowance allocation program should produce reasonable outcomes, consistent with these cap-and-trade design principles, regardless of applicable electricity market or regulatory structures.

5. Any emissions allowance allocation program should assign all allocated allowances available to the electricity sector to local distribution companies providing a regulated local distribution function for end-user customers (including vertically-integrated utilities, distribution utilities, rural-electric cooperatives, municipal distribution systems, and all other entities providing distribution service directly to end-user customers subject to State regulation or its equivalent). This approach will allow State PUCs or other authorities to ensure that the value of these no-cost allowances will inure to the benefit of end-use consumers. Alternatively, States should be able to adopt other methods for distributing benefits to end-use consumers.

6. The assignment of no-cost allocated allowances to local distribution companies as defined above should be based primarily on the level of GHG-emissions from the resources used to provide service to the local distribution company's load during an appropriate baseline period.

7. Any emissions allowance allocation program should not inappropriately advantage or disadvantage particular regions, local distribution companies (as defined above), or generators, and should ensure that end-user customers receive the benefit of allocated emissions allowances for the purpose of offsetting the increased costs resulting from the institution of GHG-emissions regulation.

8. Any assignment of allocated emissions allowances should seek to accommodate any efforts made in particular regions or States to reduce GHG-emissions in anticipation of the enactment of federal legislation regulating GHG-emissions.

9. In defining the baseline period, proper precautions should be taken to ensure that counterproductive behavior by any allowance market participants is discouraged and that gaming does not occur.

10. Cost-containment measures should be included in any cap-and-trade mechanism in order to minimize abrupt changes in the cost of compliance, including during the initial phases of implementation, which could adversely affect electricity consumers or allowance markets. Such measures should be designed to achieve effective and appropriate environmental benefits while ensuring price stability and predictability, promoting investment in appropriate technologies, and minimizing adverse consumer impacts, including price volatility; *and be it further*

RESOLVED, That any federal climate change legislation should be consistent with existing NARUC policies regarding non-discriminatory wholesale competition; demand response; energy efficiency; renewable generation; generation resource adequacy; fuel diversity; the development of clean coal and improved nuclear technologies; and the development of a comprehensive solution for the existing nuclear waste disposal problem.

*Sponsored by the Committees on Electricity, Energy Resources and the Environment, and Gas
Recommended by the NARUC Board of Directors, November 13, 2007
Adopted by the Committee of the Whole, November 14, 2007*