AEP Review of S. 2877 Proposal

Policy Summary

- S. 2877 -- the Carbon Limits and Energy for America's Renewal (CLEAR) Act as introduced by Senators Cantwell and Collins would establish an economy-wide CO_2 cap and limited trade system.

- 100% of the allowances would be auctioned off to "capped" regulated entities (upstream fossil fuel providers) only.

- 75% of the revenues from the auction would be recycled to consumers thru a cash refund on a per capita basis with every man, woman and child receiving the same $ rebate.

- 25% of revenues would be used to fund GHG reductions in additional sectors, alternative energy, climate adaptation and industry compensation. However, the distribution of the revenues for such purposes would be authorized only to the extent available through the normal appropriation process.

- Allowance trading is restricted exclusively to entities with a compliance obligation. No third parties (i.e. utilities, industry or financial firms) can partake in allowance market.

- Emission cap is set at 2012 levels in 2012 and declines at an accelerating rate (starting at 0.25%) each year beginning in 2015. The overall GHG reduction goals start at 20% reduction from 2005 emissions in 2020 and decline over time until an 83% reduction is achieved in 2050.

- Price collar for allowances is established with a minimum price of $7 (escalates at inflation + 6.5%/yr) and a maximum price of $21 (escalates at inflation + 5.5%/yr).

- No use of offsets is allowed for compliance purposes.

Major Negative Feature of S.2877

- Bill would effectively **tax** all fossil based electricity consumption due to the 100% auction of allowances, which would dramatically raise customer rates.
    - **AEP customers would face about a $3 billion increase in electric rates in the first year alone. This amounts to an immediate 20% - 30% rate increase in 2012 in all of the 11 states that AEP serves.**

- Fossil-fuel producers probably will not be able to pass on these entire enormous auction costs to end use consumers. For example, the effective **tax** on coal producers is on the order of **$50 billion per year** at the beginning of the program**.**

- Proposal would create **major regional disparities** in cost impacts to the electric sector, particularly between states dependent on coal versus those more reliant on nuclear, hydro and gas, as described above.

- The auction program (which raises the money for the cash refunds to consumers) does NOT reflect the significant differences in carbon and energy intensity between the various states due to (1) mild versus severe weather patterns; (2) use of energy by heavy industry and commerce within the states; and (3) the degree to which states are powered by coal versus states powered by nuclear or hydro with zero carbon emissions from those sources. **As a result, there are significant inequities with regards to the costs that would be borne by the various states.**

- For example, West Virginia electricity is almost all powered by coal and would bear extremely high costs under the auction. But in this **inequitable redistribution of wealth**, West Virginians will unfairly receive the same per capita payment as residents of Idaho, who would receive a windfall payment out of proportion to what they really need, since Idaho has among the lowest CO_2 emissions with almost all of their power generated from hydro. West Virginia is hit hard by S.2877 because geography mandates that its energy needs must be powered by coal rather than hydro; while Idaho is rewarded because it is blessed with high mountains and hydro as an accident of geography.

- Another example would be Ohio that would be hit hard by the auction due to a large proportion of coal-fired generation and relatively high energy use due to a concentration of heavy industry, and hot summers and cold winters. Yet, Ohio residents would receive the same per capita payment as Californians, or residents of the Pacific Northwest, who benefit from a mild climate and low energy costs, lower concentration of heavy industry, and greater access to hydro power.

- **Climate legislation should provide transitional and economic assistance to those states which are hit the hardest. *S. 2877 does just the opposite*, and redistributes wealth by taking it from the states who will be hit the hardest under the auction, and then redistributes those auction revenues on a flat per capita formula, so that those affected the least and can most easily adjust to the cost of climate legislation receive the same payment. *Put simply, the states that are hit the hardest and must adjust to the severe impact of auctions under S.2877 would receive the same per capita payments as states that are affected the least and can most easily adjust to the bill's cost.*** See attached charts.

- Coal dependant states will pay much more in per capita terms when the emission costs passed thru to all sectors are considered. This will cause **major reductions in industrial and commercial employment** in these states as result of the increased cost of production / doing business.

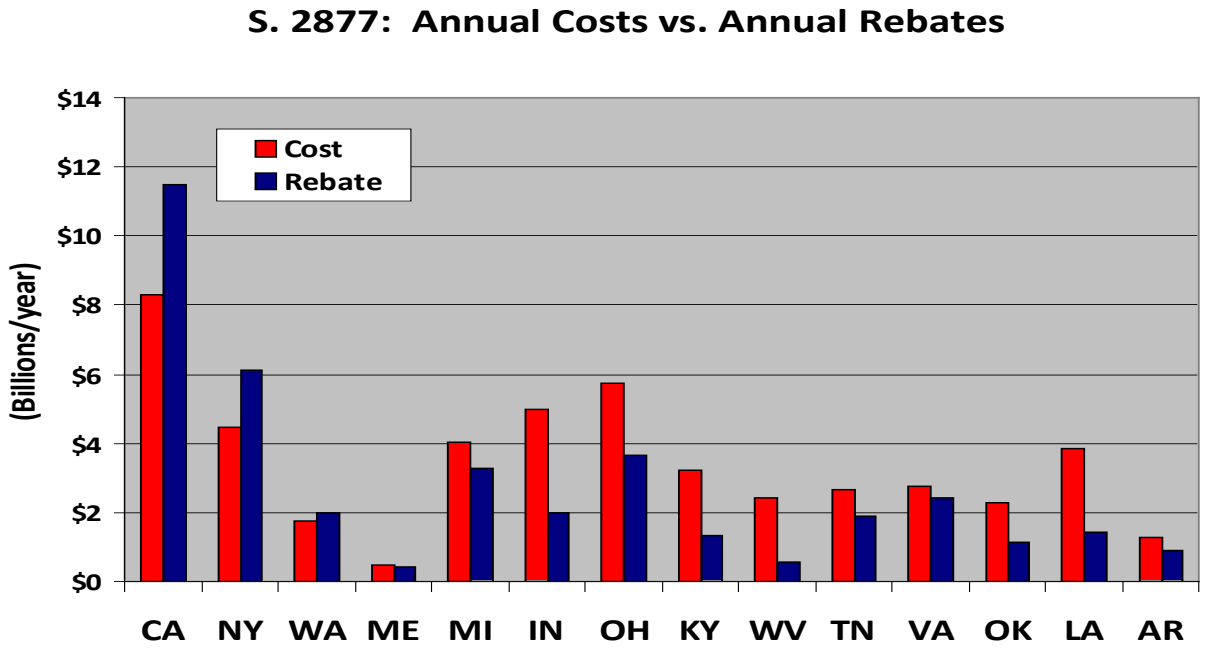
- 17% of US GHG emissions, many with low cost abatement potential, are not directly addressed as **offsets cannot be used for compliance**.

- **The elimination of all offsets significantly increases costs for AEP as well as all companies covered by the bill. A wide range of studies demonstrate that verified and monitored offsets will directly reduce the cost of compliance by an order of magnitude, approximately 30% at the low end to 50% at the upper end and provide real and additional GHG reductions outside of capped sectors. These studies are from US government agencies, the European Union, European governments, academic institutions, international organizations, non-governmental organizations, and think tanks. The importance of verified and monitored offsets has been confirmed across a wide spectrum of stakeholders. S. 2877 throws the baby out with the bathwater by banning offsets.**

- The bill greatly restricts the use and ability of emissions trading to keep overall compliance costs down. The bill **ONLY** allows those directly affected by the allowance cap (e.g. coal and gas producers, oil refiners) to buy, sell and use emission allowances. Electric power companies, gas utilities, banks, industrial and commercial companies are **not** allowed to participate in the markets. **This restriction on trading makes it difficult to hedge against the risks of high compliance costs or invest in capital and new technologies such as carbon capture in order to more cost effectively reduce CO_2 emissions.**

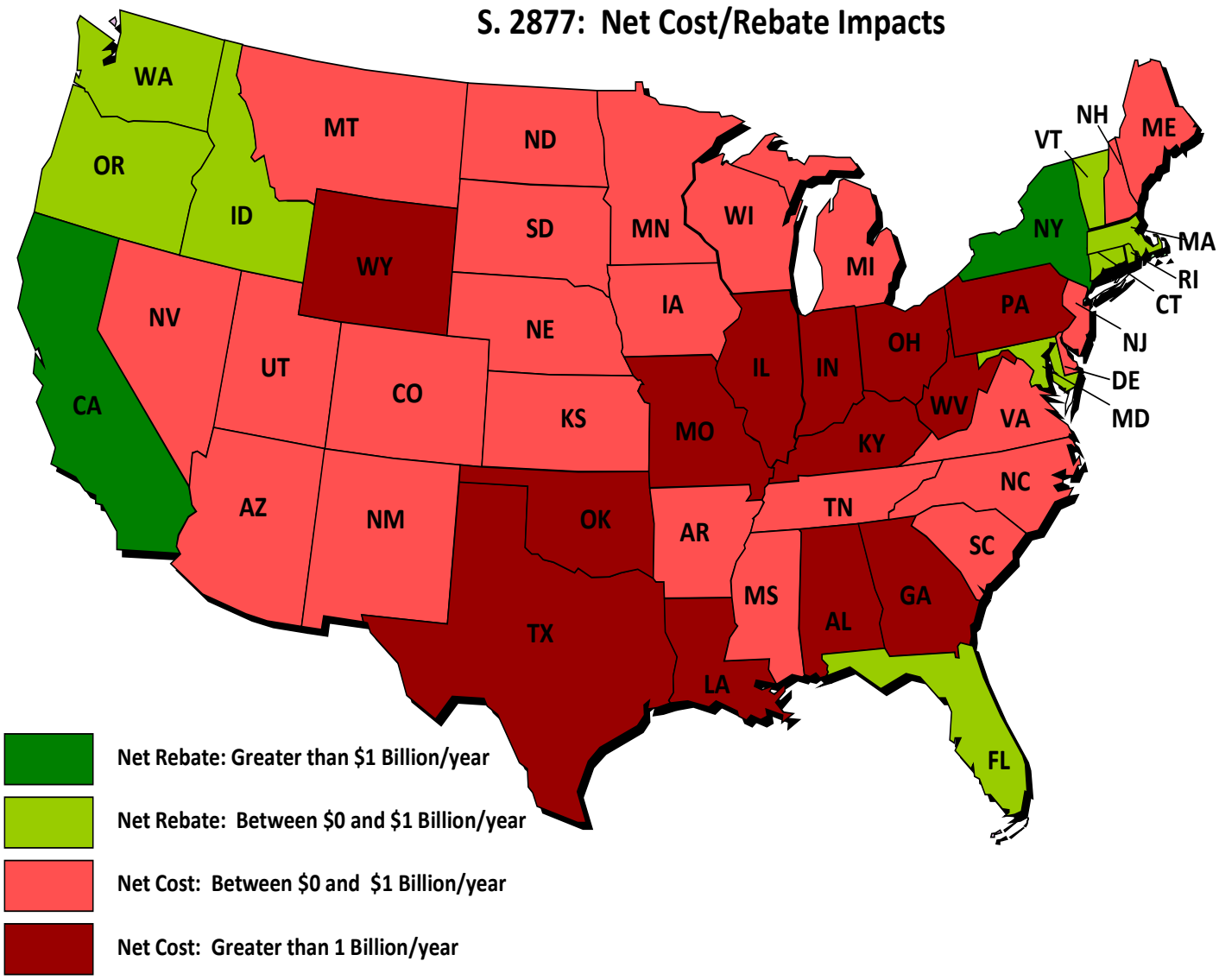
COST IMPACTS OF S.2877

*The analysis shown below represents early year annual costs associated with S. 2877. It assumes: (1) allowance price of $21 and (2) 2005 emission levels as representative of potential annual impacts in the early years of program. Costs were calculated based on upstream allowance purchases associated with direct in-state CO_2 emissions assuming all costs borne by energy producers are flowed thru to fossil fuel consumers. (**Note**: This is a simplifying assumption. To the extent these costs cannot be flowed through completely to fossil fuel consumers, energy producers and employment will be harmed and the regional cost disparities shown will be exacerbated further because most of the states harmed are also energy producing states). A general equilibrium macro economic analysis would be required to fully assess the full economic impacts on state output and employment. Total per capita rebates received by state residents based on current population data and 75% revenue rebate assumption in the bill.*



Shown: All AEP Service Territory States, plus California, New York, Washington (Cantwell) and Maine (Collins)
Source: EIA_2005 State Emissions Data: EIA_861 (2005 Data)
*** Assumes a $21/ton CO2 allowance price**

S. 2877: Net Cost/Rebate Impacts



Emissions Data: EIA_2005 State Emissions Data - by Sector
Electricity Rate & Sales Data: EIA_861 (2005 Data)

CO2 Price = $21/ton