

Don't Let Cap-And-Trade Become Cap-and-Evade

COMMENTARY

BY LEW HAY

Recently, Jim Rogers of Duke Energy wrote a commentary on climate legislation in these pages. Jim is to be commended for all his efforts to bring attention to global warming, despite running the third largest CO₂-emitting company in the nation. I also commend him on calling for aggressive, mandatory, economy-wide CO₂ reduction targets, and for substantial and immediate investment in the RD&D to achieve them.

But he and I have a major difference of opinion on the climate change bill introduced by Sens. Joe Lieberman (I-Conn.) and John Warner (R-Va.). Jim thinks electric power companies should be permitted to emit carbon into the atmosphere for free. I think they should have to pay for every ton of carbon that goes up the smokestack. His approach—granting a disproportionate amount of free allowances to the biggest emitters—allows those who contribute the most to global warming to reap a massive financial windfall. Mine requires them to bear the cost.

I agree that we should not punish companies for taking actions consistent with past public policy. But coal plants built in the mid-1960s and earlier are now fully depreciated, paid for many times over, and beyond their intended lives. These facilities contribute a disproportionately high share of CO₂ emissions (even among other coal plants) and need to be retired soon. Regardless of the final form of allowance allocations, none of these facilities should receive allowances for free. Moreover, basing allocations on historical emissions creates a perverse incentive to continue operating old, inefficient, high-emitting plants long past their intended lives—all in the hope of one day receiving a windfall in the form of a long-term annuity of free allowances.

Make no mistake—coal is an abundant, strategic resource important to our energy security and needs to be included in our future national energy portfolio, even after the advent of stricter environmental regulations. We must develop advanced clean coal technologies, and the best way to fund this is with a real price on carbon. Even the coal industry itself has proposed a surcharge on coal to pay for R&D supporting clean-coal technologies.

Even so, a number of electric power companies such as FPL Group, PG&E

and others recognized the need to reduce CO₂ emissions years ago and began to clean up their act. They shuttered old, inefficient plants, repowered with newer, more efficient generation, built new plants with more efficient, lower-carbon technologies (like combined cycle natural gas), uprated their zero-carbon nuclear facilities, deployed aggressive energy conservation and load management programs, and added renewable sources such as wind, solar and geothermal. These aren't immature laboratory technologies. They are proven and in commercial use today.

As a result, the customers of these forward-thinking power providers have been paying higher rates than those of their coal-based brethren. For example, customers in the predominantly natural gas-fired states of Florida and California pay rates 30 percent to 135 percent higher than those in coal-based Kentucky, Ohio and Indiana. In other words, customers of cleaner electric companies such as FPL already have been paying and continue to pay their fair share for reducing carbon emissions.

That's worth remembering when you hear coal-based utilities decry the cost increases their customers would see under a cap-and-trade program that auctions allowances. It also sheds a completely different light on the argument of coal-based customers "paying twice." It is actually the clean energy customers who would take a double hit, once for paying the higher energy prices they pay already, and a second time to subsidize free allowances for the companies continuing to spew CO₂ into the atmosphere.

In fact, even with a 100 percent allowance auction that yields carbon prices as high as \$30 per ton, electricity consumers in the vast majority of coal-based states would still pay much less than those in cleaner states. To be sure, some low-income customers in all states would find the added costs onerous. For these consumers, a portion of the auction proceeds should be recycled to provide cost assistance.

If we're honest, though, we must acknowledge that most consumers and companies need to see the price of car-

bon reflected in their electricity prices, as well as the price of the goods and services they purchase. This is what will ultimately drive true behavioral change. As such, the right way to target free allowances, to the extent they are needed at all, is with a rifle and not a shotgun. The companies that truly need free allowances are those in key industries that will become cost-disadvantaged because they face international competitors who operate without parallel climate regulation.

The best way to minimize disruption to the economy is not with free allowances into the distant future. It is with a safety valve that would kick in when the price of allowances reaches a level that threatens economic harm. To protect the economy, we need a ceiling on the price of allowances to ensure they don't rise too high. And to protect the environment and to provide certainty to those investors funding clean technology developments, we need a floor on the price of allowances to ensure they don't fall too low.

It is ironic that I find myself in the role of defender of cap-and-trade. After all, my personal preference—and that of most economists—is that we address the challenge of climate change with a simple fee on carbon that starts at a modest level and increases over time. But the approach before Congress at the moment is cap-and-trade, and the Lieberman-Warner bill is at the center of an intense tug of war between clean energy companies who are willing to pay for their emissions allowances and big-emitting companies who want them for free.

My view is this: the whole idea of cap-and-trade is to let the market put a price on carbon so that companies have a powerful incentive to emit less of it. Saying you favor free allowances is the same as saying companies should be allowed to pollute for free. The right response to the challenge of global climate change is cap-and-trade, not cap-and-evade.

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