

June 19, 2009

The Honorable James Oberstar
U.S. House of Representatives
Washington, DC 20515

Dear Representative Oberstar:

The following organizations, which represent cooperative, investor-owned and municipal electric utilities serving customers in Minnesota, have major concerns with H.R. 2454, the American Clean Energy and Security Act of 2009. As drafted, this legislation will result in significant increases in electricity rates.

While there are many areas of H.R. 2454 that will impact Minnesota electric customers' rates and should be solved before this bill becomes law, we want to focus our comments on Title III of the bill.

Title III of H.R. 2454 creates a new greenhouse gas commodity market that will be open to any investor as well as a complex "cap and trade" program. The "cap" creates absolute restrictions on greenhouse gas emissions like carbon dioxide, while the "trade" program creates new, tradable commodities; emission allowances and allowance offset credits. An emission allowance must be held for each unit of greenhouse gas emissions. The emission allowances and offset credits are the means that put a price on these emissions.

According to economic theory the emission allowance and offset credit prices will reflect the marginal cost of control and should be an economically efficient way of reducing greenhouse gas emissions from our expected future emissions down to the cap created by the bill. The Commodity Futures Trading Commission has stated this market could be in excess of \$2 trillion in five years and become the largest commodity market in the world.

Beginning in 2012, each electric utility generator must acquire an emission allowance to offset each ton of its carbon dioxide emissions. Allowance prices, which the Environmental Protection Agency predicts will be approximately \$15 per ton in 2012 and rising thereafter, will lead to substantial increases in electric prices. Many other allowance price estimates are significantly higher than EPA's.

H.R. 2454 attempts to mitigate the increase in electricity prices through the allocation of emission allowances to utility local distribution companies. These are the companies, or parts of companies, that sell electricity directly to the consumer. We all support the allocation of emission allowances to local distribution companies in order to mitigate costs to electricity consumers. We would also note that the decision to allocate allowances will have no impact on the environmental benefits that are obtained through the emission caps set by the bill.

The bill's impact on electricity consumers is made worse by a defective allowance allocation formula. The emission allowance formula used in H.R. 2454 is based partly on electricity sales and not emissions. This formula causes customers of local distribution companies with a high percentage of coal-based generation to pay higher electricity bills than would be the case if the formula were based solely on emissions. Thus, this formula acts to subsidize the

customers of some utilities at the expense of customers of others. The flawed allocation formula particularly hits Midwest electric customers hard. An emission allowance formula that is not based on emissions is not equitable, not logical and not good public policy. Further, the bill phases out the allowances between 2025 and 2030, which will force consumers to pay even higher prices beginning in those years.

Finally, Title III creates a program to encourage and certify allowance offset credits. The rules for this program need to be significantly streamlined so that these offsets, which will be critically important to holding the costs to consumers down in the early years of the program, are available. The EPA and other entities that have analyzed the bill have estimated that if offsets are not available, the price of emission allowances would increase between 70 and 100 percent, further impacting consumers.

We believe these problems must be addressed before you are required to vote for or against it on the House floor, and would urge you to vote no if the bill is brought up on the House floor unless the following issues are fully addressed.

- The utility sector’s allowance credit formula must be changed to be based on emissions, not sales;
- The allocation of allowances to utility local distribution companies must not be phased out after 2025 to keep the allowances harmonized with their emission reduction requirements;
- The allowance and offset credit market must be restricted to those entities that either need allowance credits or create allowance offset credits, and;
- The allowance offset credit program must be streamlined.

Attached is additional information on the above four issues. If you should have any questions please feel free to contact any or all of our organizations.

Thank you for your time and consideration. We look forward to working with you to improve this important piece of legislation.

Sincerely,

ALLETE/Minnesota Power

Great River Energy

Alliant Energy

Minnesota Rural Electric Association

Central Minnesota Municipal Power Agency

Minnkota Power Cooperative

Cooperative Network

Otter Tail Power Company

Dairyland Power Cooperative

Southern Minnesota Municipal Power Agency

Attachment

June 19, 2009

Joint Minnesota Utility Letter

H.R. 2454

Allowance Allocation Formula

- The rationale for distributing emission allowances is to help defray some of the compliance costs incurred by customers of electric distribution companies that receive a high percentage of electricity generated by fossil fuels.
- Under H.R. 2454, the allocation of allowances does not go to electric generators. Rather, they are distributed to utility local distribution companies based on a formula which includes both historic emissions and historic sales.
- Most consumers of local distribution companies in Minnesota will be disadvantaged by the allowance allocation formula in H.R. 2454.
- Basing the allocation formula partially on sales rather than historic emissions will result in the distribution of emission allowances to some entities in excess of their allowance needs. This would seem to obviate the primary purpose of an emission allowance allocation program and causes significant inequities among electric energy suppliers.
- **Because of the equity issues the allowance allocation formula must be based on historic emissions and not sales of electricity.**

Program and Electric Utility Caps

- H.R. 2454 sets overall cap levels as follows: 3 percent below 2005 levels by 2012; 17 percent below 2005 levels by 2020; 42 percent below 2005 levels by 2030 and 83 percent below 2005 levels by 2050.
- Allowance allocations to local distribution companies (LDCs) are far under their compliance obligations. In aggregate, the utility LDCs will receive allowances that are 25 percent below their baseline in 2012; 54 percent below their baseline by 2025, and; 100 percent below their baseline by 2030. Most Minnesota LDCs will receive far less allocations than these average numbers because of the flawed allowance distribution formula.
- This shortfall of allowance allocations coupled with their complete phase-out in 2030 drives up electric prices and in effect makes electric customers pay twice. Once to cover the costs of making investments in renewable energy, energy efficiency and conservation measures to reduce greenhouse gas emissions and again simply to buy allowances that are in fact "under their cap".
- Unlike the successful Acid Rain Program, there are no commercially available technologies to remove carbon dioxide from fossil-fueled power plants.

- Money spent by utility customers on allowances that have nothing to do with actually lowering emissions is simply an additional cost to electric consumers with no commensurate environmental benefit.
- **The allowance allocations and emission reduction requirements for electric utility LDC's should be harmonized.**

Allowance Program Participants

- Under Part C of Title III, any entity, even those that have no need to buy or sell allowances, may buy, hold and sell allowances in the allowance trading program.
- Electric utility generators and LDCs need to be market participants.
- Entities in the business of creating offset allowances need to be market participants in order to sell their allowances to the market.
- Entities that do not need to purchase or sell allowances as part of their business requirements should not be allowed to be market participants.
- There are plenty of commodity markets that purely financial investors may participate in. We do not believe that the price of electricity should be subject to the vagaries and volatility that would be created by allowing pure financial speculators to participate in a commodity that most Americans regard as a necessity.
- **Market participants should be limited to those entities that have direct business needs in the use and creation of allowance credits.**

Allowance Offset Provisions

- Title III contains what, at first blush, appear to be very generous allowance offset credit provisions. Offset credits will be the primary cost containment mechanism to keep the cost of allowances from skyrocketing, especially in the program's early years.
- Several independent reports suggest that there may be approximately 300 million domestic and perhaps 400 million international offset allowances available in the early years of the program. Actual offset numbers, especially in the program's early years, could be significantly lower.
- In 2012, electric utility LDC's, on average, will be 25 percent short of their needed allowances in 2012. This represents a shortfall of approximately 600 million allowances.
- This allowance shortfall becomes even more problematic as we step-down the limitations imposed by the cap on electric utility LDCs. It is possible that there will not be enough emission allowance credits available to keep the cost of allowances at a reasonable price.

- The complexity of accrediting both domestic and international offsets, combined with the limitations on the number of offset allowances that can be used to meet compliance goals, will unnecessarily drive up the overall program's cost to consumers.
- **The allowance offset credit program rules must be transparent and verifiable, but must be streamlined to maximize the number of allowance credits available.**