

CLEAN
AIR



COOL
PLANET



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Senator Max Baucus
Chairman, Senate Finance Committee
511 Hart Senate Office Building
Washington, DC 20510

Senator Jeff Bingaman
Chairman, Senate Committee on Energy and Natural Resources
703 Hart Senate Office Building
Washington, DC 20510

Senator Barbara Boxer
Chairman, Senate Committee on Environment and Public Works
112 Hart Senate Office Building
Washington, DC 20510

Dear Senators Baucus, Bingaman and Boxer:

You are now stepping up to an historic opportunity for the United States to act on climate change, enhance our security, focus our economy on a needed energy transition, and lead internationally.

Action by the US Senate is urgently needed because scientists have now observed that catastrophic changes are underway including the rapid shrinkage of the Greenland Ice Sheet that will raise sea level globally by several feet in this century; the death of vast acreages of western forests because pests can now survive warmer winters; the death of coral reefs globally because of irreversible warming and acidification of the world's oceans from excess loading of carbon dioxide. Only a few years ago these impacts were only possibilities. They have become our reality.

The design of cap-and-trade is crucial to success. Different decisions on architecture can vastly raise or lower the cost of a cap-and-trade program to achieve the same level of emissions reductions. Ambitious emissions reduction goals can best be achieved, and the needed energy transitions advanced and strengthened, by maximizing environmental and economic returns on investment across the economy for all stakeholders -- a system that generates the greatest emission reductions at the lowest possible cost to society.

The architecture you and your colleagues agree on will be critical to passage, successful implementation, and long-term credibility and acceptance by the American people. The

legislation you embrace should be simple, efficient, transparent, and fair. We hope you will consider that cap-and-trade will be more successful if it:

- provides a price collar that limits volatility and moves upward on a predictable path to reach agreed emissions goals;
- regulates emissions most efficiently – at the well head for natural gas, the refinery for oil, and the point of combustion for coal;
- as much as is realistically possible, auctions permits and recycles revenues to taxpaying businesses and individuals and to low-income persons.

Cost containment and business investment. A well-designed cap-and-trade system should eliminate price spikes, upward and downward. Experience in the United States SO₂ market has shown that SO₂ allowance prices spiked 400% during Hurricane Katrina, have varied up and down ten-fold and more since 2004, and recently have almost collapsed. The European Union has seen similar spikes in carbon prices in its European Trading System. Consumers bear the brunt of the upward spikes and entrepreneurs bear the brunt of downward spikes. It is hard to finance long-term emissions reduction projects based on short-term upward spikes, and collapsing prices lead to cancellations of financing and investment. There is a simple fix -- a gradually escalating price collar that institutes maximum and minimum prices above and below the market price while maintaining a firm trajectory toward an emissions cap.

Because a price collar is transparent it allows regulated industries to plan for the future and make prudent decisions about capital investments, which is not doable under a pure cap-and-trade system. The price collar can be recalibrated at reasonable intervals to assure compliance with emissions targets and still give regulated industries price certainty.

The collar also avoids the reliance for cost containment on international offsets or borrowing which may drive up future prices. There are many questions about the reliability of such approaches as well as concern about the substantial transfer of American dollars abroad. If the necessary quantity of offsets is not available, costs are not contained. If the quality of offsets plummets, emissions reduction goals will go unrealized. Moreover, shortages of offset quantity and quality could occur simultaneously, short-circuiting both cost containment and environmental objectives, again possibly driving up future prices.

All major sources. To be most effective in achieving environmental and economic goals, cap-and-trade legislation should be economy wide and regulate all major sources efficiently. One example of an improvement we hope you will consider: the House-passed bill has a downstream point of regulation on natural gas and must of necessity exempt emitters of less than 25,000 metric tons annually in order to attempt to oversee the estimated 5,000 facilities. This exemption results in less emissions being subject to regulation, which imposes a higher cost on those who are regulated. This is unfair, unnecessarily inefficient and cumbersome, and it undermines environmental objectives as well. By regulating natural gas at the wellhead, sometimes referred to as “at the lease,”

the regulatory burden on producers can be minimized by allowing them to piggyback on the production report they are currently required to file with the Energy Information Administration, the EIA 914 report.

Returning revenues to businesses and households. There is also room for improvement on another important item. Providing rebates to electricity customers through electricity distribution companies does not recognize the reality that any climate change proposal affects carbon-related costs generally, not just electricity purchases. Instead of encouraging consumers to reduce electricity use, these rebates subsidize electricity consumption because the rebates come in the form of reductions in bills rather than direct payments to households and businesses. Concerns about volatility that could translate into high prices for electricity and other goods and services are legitimate, but these concerns are best addressed through the price collar and revenue recycling through lower taxes, not electricity rate rebates.

Because it is taxpaying businesses and individuals who will absorb most of the increased costs associated with a climate change policy, it makes sense to return the revenues as much as possible to all individuals and businesses – including payroll tax reductions that would benefit both employers and workers -- in a way that does not distort the price signals needed to reduce energy use. Such a tax reduction will lead to other benefits for the economy and thus provide an economic dividend and shrink the economic impact of the cap-and-trade program.

CBO recently cited two reports, one by the National Bureau of Economic Research (NBER) and the other by Resources for the Future (RFF), that adoption of an emissions reduction policy results in little disparity in the effects on households across regions of the country. Also, CBO, NBER and RFF all find that price increases will impose a larger burden on low-income households than on high-income households. For that reason, we support provisions that address this distributional concern. And we agree that some allowance value would wisely be allocated to fund research and development and address transition issues, including those of the energy-intensive, trade-sensitive industries.

The Washington Post wrote about the House bill:

“While in theory the bill relies on the market to find the most efficient alternatives to greenhouse-gas emitting energy sources, in practice its subsidies, regulations and exemptions could skew the outcome in costly ways...With... fierce battles to come in the Senate, the debate over how to design this fundamental shift in the American economy remains wide open. It's not too late to hope for a cleaner cap-and-trade bill -- such proposals are circulating on Capitol Hill -- or a properly designed carbon tax that would send the right market signal to spur green-energy innovation while also leading to vital changes in behavior. We're not ignorant of political realities, and we don't believe the perfect should become the enemy of the good. Congress should deliver a bill to Mr. Obama this year. But given that congressional action could set a template for years or decades, we think it's too soon to settle for something that falls so far short of ideal.” (June 25th, 2009)

We whole-heartedly agree. We believe the recommendations we have made above will result in a cleaner cap-and-trade bill that appropriately limits risks, spurs investment and innovation, and sends the right market signals to achieve emissions reduction targets.

We look forward to working with you to achieve these goals.

Sincerely yours,



Rafe Pomerance
President
Clean Air-Cool Planet



Carol Werner
Executive Director
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CC: Senator Charles Grassley
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