

Testimony of Ian Bowles
Secretary of Energy and Environmental Affairs
Commonwealth of Massachusetts
Select Committee on Energy Independence and Global Warming
U.S. House of Representatives
January 23, 2008

Thank you, Chairman Markey and members of the Committee. Thank you for your leadership on this tremendously important issue.

My comments today reflect the general context in New England – compared with the rest of the country, we have expensive electricity (due to a lack of indigenous coal or natural gas resources), lower GHG emissions, and a deregulated power market. In MA, we have also made considerable investment in energy efficiency and are currently in the process of “decoupling” our utility rate structure – a process designed to eliminate the economic incentive for utilities to maximize power sales. We already have in place GHG limitations on our largest power plants and have built GHG emission reductions into the state environmental review process – a policy that is leading to greater private investment in green buildings. In renewable energy, we are moving forward with three biomass power plants, the Cape Wind project, a sizeable solar program and new incentives for biofuels. And Governor Patrick has combined the six energy and environmental regulatory agencies under one Secretariat to focus on three main goals: tapping the economic potential of the rapidly growing clean energy technology sector in Massachusetts, curbing our GHG emissions and reducing energy costs.

Auction v. Allocate – Protecting the Public’s Interest

When Governor Patrick brought Massachusetts into the Regional Greenhouse Gas Initiative just over a year ago, one of the central questions we had to grapple with was how to distribute emissions allowances to power generators – by free allocation or auction. We came to the conclusion that auctioning allowances, and using the proceeds for the benefit of consumers, was the best way to meet our environmental objectives and cut electricity costs. By contrast, direct allocation could result in windfall profits for power generators, at the expense of business and residential customers.

The central point to understand – and it is not intuitive – is that, in our deregulated market for power generation, the impact of emissions allowances on electricity prices is exactly the same whether allowances are sold at auction or given away for free. As power generators determine the price at which it becomes economic for their plants to produce power, they have to decide whether to expend allowances in order to generate electricity, save those allowances for a time when electricity prices are

higher, or sell allowances to other power producers who need to meet their compliance obligations. In any of these three scenarios, the market price of allowances becomes a component of the price of electricity.

It is tempting to think that, if you make generators pay for the emissions they produce, it will drive electricity prices up, but if you give allowances away for free, it won't. But it's not true. The price impact is the same either way.

Auctioning is the right way to distribute allowances for other reasons as well. In "grandfathering" schemes, allowances are distributed according to past emission levels, or by share of the electricity market – in either case giving preferential treatment to low-cost, high-emitting power sources. An auction levels the playing field and lets the market decide where the allowances go, instead of government. This is a critical point for a Federal program – Congress should design a system that gives fair treatment to state and power generators who are already paying the price for clean energy and sends a clear market signal to all GHG emitters.

Use of Auction Proceeds – Maximizing Ratepayers Savings and Environmental Benefits

Auctions also generate revenue that can be used to further our energy and emissions reduction goals. In our case, we were looking to utilize these funds to reduce electricity costs and promote clean energy. On the state level, we determined that the best way to do both is to invest in energy efficiency – it locks in permanent savings for consumers and permanent reductions in GHG emissions for the environment.

In Massachusetts, our analysis of the ratepayer impacts of RGGI showed that spending auction proceeds on energy efficiency would result in small short-term costs but long-term savings. This is due to the large amount of cost-effective energy efficiency investments available in our state – and across the country. With allowance prices estimated at \$1 to \$5 per ton of CO₂, auctioning Massachusetts's share of the RGGI cap would raise between \$26 million and \$133 million. We currently spend about \$125M/year on energy efficiency programs, which save three-to-four dollars for every dollar invested. At \$5/ton, we could double our energy efficiency investments. Customers who get efficiency upgrades in lighting, air conditioning, production equipment, and appliances that use less electricity would save the most, but all consumers would save in the form of lower rates, as reduced demand takes pressure off capacity at times of peak usage.

While it is important that a federal program also give substantial new financial incentives to develop new clean energy technologies, energy efficiency gives the greatest near term return for the ratepayers. For the most part, energy efficiency

programs don't lend themselves to federal administration and auction proceeds should return to the states provided they meet objective standards for efficiency.

Lessons for a Federal Program

With the Regional Greenhouse Gas Initiative going into effect next year for the first time, we are just starting to learn how to operate an auction-based cap-and-trade program. I am sure we will learn as much from RGGI's early trials and adjustments as from its long-term achievements.

Speaking only for Massachusetts here – we hope to see a RGGI-wide auction process, but our regulations allow us to hold our own if necessary – we anticipate four auctions a year, each one selling portions of current and future years' allowances. At the start, auctions will be open to any qualified buyer, although if we see evidence of hoarding or gaming, we will adjust participation rules. We think it's best to establish a low reserve price and bring any unsold allowances back into market at a later date. And we will institute a sophisticated market monitoring system, so we can determine whether the market is functioning with the openness and transparency we are seeking. We also will use a three-year compliance period and unlimited forward banking rights for unused allowances, to allow maximum flexibility in achieving our environmental goals.

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Since the early 1990s, Congress, successive Administrations and many states have implemented a variety of market-based approaches to environmental protection. This is an American innovation and experience shows market-based approaches encourage technology innovation and spur economic growth. We look forward to working with you and your colleagues to assist in developing a national system for curbing carbon emissions, while also allowing the states to experiment with ways to take environmental policies further. We pledge to work with you to get the most effective national program in place as quickly as possible.