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Energy and Clean Technology Alert: Electricity Prices in Northeast Not Likely to Increase from Carbon Costs

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The initial price for power plants in the northeast to purchase allowances to emit carbon, if sustained over time, is not likely to produce an appreciable increase in the price of electricity to businesses and residential customers. That seemed to be the consensus of several experts at a recent Environmental Business Council of New England ("EBC") forum co-sponsored by Mintz Levin and ML Strategies. The experts cited at least two reasons in reaching this consensus. First, the allowance cost would be less than 2% of the current average cost to operate the gas-fired power plants that set regional wholesale electricity prices. Second, most of the revenue from allowance auctions will be reinvested in electric efficiency programs that should decrease overall electricity demand and thereby reduce prices.

The first-ever, public sale of carbon allowances in the United States took place in an auction on September 25, 2008. This was a result of ten northeastern states deciding to require all electric generating plants within their boundaries to own allowances sufficient to cover their carbon emissions starting in 2009. The auction price of $3.07 for an allowance to emit a ton of carbon is only slightly above the floor price of $1.87 established by the Regional Greenhouse Gas Initiative (RGGI), a consortium of the ten participating states.[1] (See RGGI press release describing the auction and its results.)

At the Mintz/EBC forum on October 3, 2008, Laurie Burt, Commissioner of the Massachusetts Department of Environmental Protection and Phil Giudice, Commissioner of the Massachusetts Department of Energy Resources, described the results of the recent auction. Industry experts Jeremy McDiarmid from Environment Northeast, Christopher Sherman from the New England Power Generators Association, Patricia Stanton from Conservation Services Group, and Dr. Jurgen Weiss from Point Carbon provided a diverse set of perspectives on the implications of the auction for regional electricity and carbon markets, as well as for a future U.S. market for carbon allowances. David O'Connor of ML Strategies moderated the dialogue.

Commissioner Giudice reported that most of the almost 60 participants in the first auction are power-plant owners. They submitted bids, at varying prices, for almost 51 million allowances, more than four times the number of allowances available. Speaking about the future demand for allowances, Giudice said, "We expect that there will be even more participation in the next auction, since some people probably wanted to wait and see how the auction worked and how the market was monitored."

Jeremy McDiarmid predicted that the supply of allowances would "remain generous for the foreseeable future." He noted that a recent Environment Northeast report found that the current emissions levels are as much as 9% below the regional cap, a trend that is likely to continue in the short term. Commissioner Burt noted that "our first goal was stabilization [of carbon emissions], with the eventual next step being significant carbon reductions. But that will take some time."[2]

Jurgen Weiss, based on his experience with the European carbon market where prices have been as high as $40 or more per allowance, observed that the RGGI auction price was "well below the level needed to induce significant changes in emissions behavior or investments in carbon reducing technologies." Patricia Stanton agreed, reporting that the price was "much too low" to enable her firm to invest in energy efficiency "offsets" that RGGI rules allow as substitutes for allowances.

David O'Connor, former Massachusetts Energy Commissioner, predicted that the allowance price would have a minimal impact on electricity prices in the northeast. He estimated that a straight pass-through of the cost by the owner of a gas-fired power plant would add about $1.23 per megawatt hour to the 2007 regional annual average wholesale electricity price of about $70 per megawatt hour, or about 1.7%. Chris Sherman acknowledged this result. "The benefits of electric reliability cannot be compromised, and any price increases must also be manageable for consumers," he said.

Jeremy McDiarmid pointed to another reason the price impact may be negligible. He noted that most of the proceeds from the auction will be invested by the states in electric efficiency programs. McDiarmid said "reinvesting auction proceeds into energy efficiency programs will offset costs to consumers by reducing overall demand for electricity."

Commissioner Giudice reported that Massachusetts, which received approximately $13.3 million for its share of allowances sold in the auction, will begin its efforts to achieve this goal by investing $3.5 million in new energy-efficiency programs approved by the Department of Public Utilities. Another $4.3 million has been allocated for residential heating assistance this winter and approximately $5 million will be invested in the Green Communities Program in order to help municipalities invest in energy efficiency and renewable energy. (See Governor Deval Patrick's press release on the use of the RGGI auction proceeds.)

David O'Connor observed that the recent cataclysmic events in capital markets and the anticipated slowdown of the regional economy can be expected to reduce or even eliminate growth in electricity consumption over the first compliance period. But as the regional economy regains momentum, and the cap begins to tighten after 2014, carbon allowance prices would be expected to rise.

Overshadowing these projections, however, is the prospect for development of a national framework for regulating carbon emissions. Commissioner Burt said that the RGGI Model Rule "anticipates that federal cap and trade legislation will eventually replace or complement the RGGI system."

What a national system for regulating carbon would mean for RGGI allowances remains unclear, though many expect regional compliance programs to be "grandfathered" into a federal system. In any event, the RGGI program, and its successful auction process, would seem to provide policymakers, and participants in future carbon markets, with useful indications of how a national carbon "cap and trade system" might be designed and what its economic impact might be.

Endnotes

[1] Ten northeastern states have joined together to create RGGI, including all of the New England states, New York, New Jersey, Delaware, and Maryland. They have established limits on carbon emissions for all electric generating plants within their boundaries with a generating capacity of 25 megawatts or greater. Through the enforcement of a "cap and trade" mechanism, power plants must purchase sufficient "allowances" (measured as one ton of emissions per allowance) to equal their carbon emissions by the end of each three-year compliance period. The first compliance period begins in January of next year.

[2] For the ten participating states, the regional "cap" on emissions is 188 million tons per year through 2014. From 2015 through 2018, that cap is reduced each year by 2.5%. Only six of the ten states (Massachusetts, Connecticut, Maine, Vermont, Rhode Island, and Maryland) sold allowances on September 25, 2008. The allowances sold then represent approximately 6.7% of the regional emissions cap for 2009. The remaining four states will join the others in making their allowances available for sale at the second auction on December 17, 2008. Auctions will take place quarterly throughout the first three-year compliance period until all 188 million allowances have been sold.

For additional information, please contact a member of the Mintz Levin Energy and Clean Technology *practice group.*

David L. O'Connor
Senior Vice President for
Energy and Clean Technology,
ML Strategies (Boston)
(617) 348-4418
DOConnor@mlstrategies.com

Thomas R. Burton
Chair, Energy and Clean Technology (Boston)
(617) 348-3097
TRBurton@mintz.com

Evan M. Bienstock
Corporate (Boston)
(617) 348-3090
EMBienstock@mintz.com

Ralph A. Child
Member, Environmental (Boston)
(617) 348-3021
RChild@mintz.com

Richard A. Kanoff
Of Counsel, Energy Regulatory and
Project Development (Boston)
(617) 348-3070
RAKanoff@mintz.com

Patrick J. Kealy
Corporate (Boston)
(617) 348-1679
PJKealy@mintz.com

Paul J. Scapicchio
Senior Vice President
of Government Relations,
ML Strategies (Boston)
(617) 348-3031
PJScapicchio@mlstrategies.com

Sahir C. Surmeli
Member, Corporate (Boston)
(617) 348-3013
SSurmeli@mintz.com

Stanley A. Twarog
Member, Corporate (Boston)
(617) 348-1749
STwarog@mintz.com

David P. Dutil
Member, Corporate (Washington)
(202) 434-7425
DDutil@mintz.com

David J. Leiter
Senior Executive Vice President
of Government Relations,
ML Strategies (Washington)
(202) 434-7346
DJLeiter@mlstrategies.com

Chuck A. Samuels
Member, Federal/Energy Efficiency (Washington)
(202) 434-7311
CASamuels@mintz.com

Faith L. Charles
Member, Corporate (New York)
(212) 692-6770
FLCharles@mintz.com

Daniel I. DeWolf
Member, Co-Chair, Ventures and
Emerging Company Group,
Corporate (New York)
(212) 692-6223
DDeWolf@mintz.com

Peter Zlotnick
Member, Litigation (New York)
(212) 692-6887
PBZlotnick@mintz.com

Jason Altieri
Member, Corporate (Palo Alto)
(650) 251-7730
JAltieri@mintz.com

Brady Berg
Member, Corporate (Palo Alto)
(650) 251-7758
BBerg@mintz.com

Gabriel Schnitzler
Real Estate (Palo Alto)
(650) 251-7720
GSchnitzler@mintz.com

Jeremy B. Hayden
Of Counsel, Corporate (San Diego)
(858) 320-3024
JBHayden@mintz.com

Carl A. Kukkonen III
Member, Intellectual Property (San Diego)
(858) 320-3035
CAKukkonen@mintz.com

Michael D. Van Loy
Intellectual Property (San Diego)
(858) 320-3059
MDVanLoy@mintz.com

Susan L. Foster
Corporate (London)
+44 (0) 20 7776 7330
SFoster@mintz.com
