U.S. Senate Committee of Environment and Public Works
Hearing on S. 1733 (Clean Energy Jobs and American Power Act)
Written Testimony of the Honorable Dustin "Dusty" Johnson
Chairman, South Dakota Public Utilities Commission
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Good morning Chairman Boxer, Ranking Member Inhofe, Members of this Committee, and distinguished panelists. I appreciate the opportunity to appear before you this afternoon. I am Dustin "Dusty" Johnson, and I currently serve as the chairman of the South Dakota Public Utilities Commission (SDPUC). The SDPUC has been protecting consumers since 1886. Today we regulate companies in the electricity, natural gas, telecommunications, and grain storage industries. We understand how important it is to be a strong, fair, and proactive regulatory presence dedicated to the public interest.

I was elected to the Commission in 2004 and serve on the Board of Directors for the National Association of Regulatory Utility Commissioners (NARUC) and on the NARUC Electricity Committee. I have had leadership roles in a number of national, regional, and state energy committees and work groups and understand energy and regulatory policy and how it affects consumers. I am honored to serve on the SDPUC alongside my colleagues Steve Kolbeck and Gary Hanson. We are a bipartisan commission that has never let politics get in the way of working for the public interest. Our job is to fight for consumers, and we love doing it. Those consumers have earned their money and they shouldn't have to pay any more than necessary for their utilities.

That's what brings me here today. It seems like so often when people talk about the impacts of federal energy legislation, they talk about utility companies. Well, South Dakota is a traditionally-regulated environment with vertically-integrated utilities, so the utility companies don't pay for much of anything – their customers do. Those customers elected me, they're my bosses, and I'm here today on behalf of them, the people who pay the bills.

I understand the desire to reduce our carbon footprint, and I think we should. But I don't think the climate change legislation pending before you is the right approach. It will harm consumers, especially Midwestern consumers, far more than it needs to.

Direct Impact on Ratepayers

This bill will hurt Midwestern consumers because it substantially raises their monthly utility bills. Analysis done on Waxman-Markey shows South Dakota consumers will be paying as much as 25 percent more for their electricity as soon as 2012. It could be even more for customers of some companies.

- Black Hills Power estimates cost increases to be 47 percent in 2012 and 82 percent in 2030, assuming a $50/ton price on carbon emissions.
- MidAmerican Energy predicts an increase of as much as 25 percent in 2012.
- Missouri River Energy Services would see a 65 percent increase if the President's proposal of 100 percent auction were passed, but expects to see increases of 25 percent at $35/ton or 15 percent at $20/ton.
- Montana-Dakota Utilities estimates a 15 percent increase in 2012, up to a 30 percent increase by 2035, assuming emissions trading at $20/ton. At a higher price of $50/ton, they would see increases of more than 30 percent as early as 2012.
- NorthWestern Energy is expecting the average residential customer to pay an extra $250 annually with the average commercial customer paying more than $1,000 annually if the Waxman-Markey bill is signed into law.
- Assuming 35 percent free allowances, as given in the Waxman-Markey bill, Otter Tail Power Company expects to see emissions sell for $25/ton in 2012, $37/ton in 2015 and $40/ton in 2020, corresponding to rate increases of 23 percent in 2012, 37 percent in 2015, and 45 percent in 2020.

Although the chairman's mark of the Senate bill was just released late Friday night, I have taken some time to look at the 900+ page draft, and it is worse for consumers than the Waxman-Markey bill. The Kerry-Boxer bill has a more aggressive near-term target of 20 percent in 2020 and starts with fewer allowances available for allocation. The end result is a much more severe impact to ratepayers than what is outlined above.

The SDPUC has been interested in the impacts of a cap-and-trade proposal for quite some time. Last spring we hosted a Carbon Cap and Trade Forum. Prior to the event, we gathered some analyses of impacts to utility customers of recent cap-and-trade proposals. At the forum, we held panel discussions on cap-and-trade legislation, in an attempt to gather as much information as possible. After the event we wrote a report entitled, "Carbon Cap & Trade: National Policy, Local Impact." [1]

Not only did we learn how a cap-and-trade program should be structured to have the least impact on South Dakota's ratepayers, our conclusion estimated what that impact would be. Given a $30/ton price of emissions, and without no-cost allowances, we found the average South Dakotan was likely to see a near-term electricity price increase of 48 percent. That was only the direct cost of such legislation. I am glad the Kerry-Boxer and Waxman-Markey bills have included a number of the consumer-friendly provisions the SDPUC identified, but there are others I hope could still be added to minimize the substantial negative impacts to American families and businesses.

Because there is no hard price collar in the Senate bill, it is tough to say what the true limit of what the impact to consumers could be. The actual auction price will be

[1] http://puc.sd.gov/commission/Events/carbonforum/CarbonCapandTradeSummaryReport.pdf.

determined by what miracle technology sprouts from the small allocation of this bill going into research and development. It will be determined by the price of natural gas, and how much we can find and easily extract in the coming decades. It will eventually probably be determined by the price of new nuclear plants. As a result, many have suggested that climate change legislation include a price collar to minimize allowance price volatility. I agree with that. This is especially important to Midwestern states like South Dakota that will receive fewer allowances than needed under either version of the bill (House or Senate).

As I understand the current version of this bill, a minimum ceiling price is set at $28 in 2012 and increases thereafter. This minimum ceiling price fund is essentially a floor. The chairman's mark includes a reserve fund with a soft collar, but this mechanism will not do enough to protect customers. With emissions trading creating a commodity market expected to be in the trillions of dollars, I am not confident that such a mechanism would do much to limit speculation or control the price impacts to Midwestern ratepayers.

In South Dakota, we spend a little more than a billion dollars a year on electricity and natural gas. A 25 percent increase in those bills, just for an allowance cost, takes $250 million a year out of our state. Consider this: $250 million dollars across a state of slightly more than 800,000 people pencils out to more than $850 per household. South Dakotans also spend about a billion dollars a year on state taxes. Thus, the effects of this bill would be similar to a 25 percent increase in state taxes. This tax would be different, however, in that it would not provide the essential services that our state taxes do. Much of this tax would be shipped to other states, to special interest groups, to merchant generators, and to the federal government. You can't pull a quarter billion dollars out of a state like South Dakota and not cause serious damage to families and businesses.

Already Rising Energy Costs

This bill would hurt Midwestern consumers because it would raise rates at a time when prices are already expected to be rapidly increasing. A massive new capital expenditure cycle, environmental compliance, and worldwide demand for resources are all going to push prices significantly higher. We are already seeing it in South Dakota. Black Hills Power just requested a 27 percent increase. Xcel Energy has requested an 11 percent increase, much of which is being driven by their effort to get greener. Adding wind generation, building transmission lines to carry wind, changing coal plants over to natural gas – all of those things cost serious money. We recently approved a 12 percent increase for Otter Tail Power, and 60 percent of that rate increase was related to wind power. We are getting greener in South Dakota and it is already costing us serious dollars. Adding an additional 25 percent to the already rising costs is asking too much of consumers. As energy prices rise, consumers are already in the middle of an economic crunch. Increasing the price of energy even more will be devastating to many. How much more can they bear?

The costs ratepayers will carry just to add renewables to the system are now beginning to set in. The initial plans to export wind generation out of the Midwest and into areas of the country without renewable resources are being laid out and the costs are extensive. The Green Power Express is one example. This proposed network of high-voltage transmission lines spanning from the Dakotas to Illinois is estimated to cost between $10 and $12 billion, effectively doubling the value of the transmission in the region. This estimate does not include the generators being connected to the new grid. Coal plants that are in some cases less than halfway through their depreciable life will be replaced with more a more expensive mix of generators. These generation and transmission costs are in addition to compliance costs utilities will pay and be forced to pass along to ratepayers. The combination of transition and compliance costs will be massive, especially in areas like the Midwest, where three-quarters of our generation comes from coal.

For the last 100 years the real price of electricity in this country has been dropping with surprising consistency. It was among the most important developments of the 20th century and allowed electricity to become the "the lifeblood of modern society & economic growth," as noted by the Institute for Energy Research.[2] Today, as increasing world demand for resources transforms that long-standing cost curve, we may be nearing the end of the era of affordable energy. Is now the right time to implement a mechanism that would place significant additional upward price pressure on energy?

Effect on International Competitiveness

This bill would hurt Midwestern consumers because it lowers productivity and doesn't protect our international competitiveness. Of course, it's not just me who says that. CBO Director Douglas W. Elmendorf has testified that the cap-and-trade provisions of the House bill would cut the nation's gross domestic product by 1 to 3.5 percent in 2050.[3] Energy Secretary Steven Chu said that "[i]f other countries don't impose a cost on carbon, then we will be at a disadvantage."[4] The Tax Foundation has estimated similar legislation to reduce economic output by $136 billion annually and export 965,000 jobs.[5] Unfortunately, many South Dakota

[2] http://www.instituteforenergyresearch.org/energy-overview/

[3] U.S. Senate Committee on Energy & Natural Resources, Oct. 14, 2009, Testimony of Dr. Douglas W. Elmendorf

[4] "Energy Chief Says U.S. Is Open To Carbon Tariff," *Wall Street Journal*, March, 18, 2009, p. A4

[5] Andrew Chamberlain, *Who Pays for Climate Policy? New Estimates of the Household Burden and Economic Impact of a U.S. Cap-and-Trade System*, http://www.taxfoundation.org/publications/show/24472.html

businesses rely on the low cost of energy we enjoy today, and would likely be the first to go under or relocate as a result of higher energy prices. Since 2001, the price of electricity in South Dakota has risen at less than half the rate of electricity prices in the United States, and South Dakota has seen robust economic growth during that time.[6] In fact, during that time South Dakota's economy has grown at 129 percent the national average. I believe affordable energy is a powerful engine of economic growth and South Dakota is a clear example of that.

This bill does not require or even ask other nations to reduce their CO_2 emissions. The legislation doesn't include "off ramps" if other countries fail to participate. The two largest up-and-coming carbon emitters, China and India, have both indicated they place more importance on their economic wellbeing than on the concentration of CO_2 in the atmosphere. If carbon emissions and business opportunities simply transfer to other countries as a result, what is the point of capping carbon in this country in the first place? Does Congress intend to pass such an economic burden to American consumers when the results will be negligible? This one-sided approach to carbon reduction has the potential to cost South Dakota and the Midwest a substantial amount of jobs and economic prosperity.

Wealth Transfer to Coasts

This bill would hurt Midwestern consumers because it takes their money and uses it to provide a windfall to other regions of the country. Kerry-Boxer allocates free allowances 50 percent of emissions attributable to retail electricity and 50 percent to retail electricity deliveries. This methodology ensures customers of utilities that generate or purchase significant amounts of coal-fueled energy, such as many utilities do in South Dakota, will receive fewer allowances than required to offset increased customer costs when compared to nuclear and hydro-dependent utilities whose actual emissions attributable to their retail electricity sales are minimal. The recent EPA analysis on the Waxman-Markey bill allowance allocation methodology shows California is given 12 million more allowances than it needs for compliance and South Dakota would only receive two-thirds of what it needs for compliance, leaving it three million allowances short.

South Dakota is not the only state shorted by the allowance allocation. Other Midwestern states are left in a similar situation, meaning the bill transfers jobs and billions of dollars from our nation's heartland to the coasts. That isn't right and it isn't fair. It's not just me that believes that. It's also my colleagues across the country. A 2007 NARUC resolution stated, "[t]he assignment of no-cost allocated allowances to local distribution companies . . . should be based primarily on the level of GHG-emissions."[7] In the end, improper allocation of these allowances will cause

[6] According to data from the U.S. Department of Energy's Energy Information Administration

[7] *Summary of NARUC Climate Policy*, http://www.naruc.org/Publications/ClimateIssueBrief1_Apr2008.pdf

an outflow of dollars from Midwestern states, such as South Dakota, to the coastal states. These dollars, which will increase electric costs tremendously, will result in no reductions to greenhouse gas emissions. The solution to this issue is to allocate 100 percent on emissions.

Not only are the free allowances unfairly allocated, but this bill actually allocates fewer no cost allowances to utilities than Waxman-Markey. To states such as South Dakota, this can only mean costs under this version of the bill will be even higher than those under Waxman-Markey. I encourage the Senate to restore what was lost under this version and to increase the overall allowance allocation to the electricity sector from 35 to at least 40 percent to be equivalent to the sector's share of emissions.

The Kerry-Boxer bill also allocates 14.3 percent of the allocated utility sector allowances to merchant generators. Merchant generators are not rate-regulated by state PUC's (or anyone) and so there is no mechanism to ensure consumers gain the benefit of no-cost allowances. The result would be an enormous windfall of profits to merchant generators with no likely environmental or consumer benefit. It's not just me that believes that. It's also my colleagues across the country. The NARUC Climate Change Task Force has stated that, "[b]ecause merchant generators are not rate-regulated, they have no obligation to pass through benefits to consumers. Operating in a competitive market, merchant generators will likely retain the value of free allowances as profits, just as European merchant generators did."[8] This problem can be resolved by eliminating the allocation to merchant generators and instead providing those allowances to local distribution companies, which will be required to pass that benefit on to consumers.

Improper Allocation of Allowance Revenue

This bill would hurt Midwestern consumers because it gives them a fish, when they really need a fishing pole. These bills all envision softening the impact to consumers by providing some of them – the low- and middle-income – rebates to pay their utility bills. But I don't want more Americans more dependent on the federal government to pay their utility bills. If we need to reduce carbon, then let's do it. Let's put that money toward energy efficiency and toward research and development. Let's solve this problem, rather than making consumers reliant on yet another check from the federal government. We will not solve our carbon problem by under-investing in research and development, and unfortunately, the Kerry-Boxer and Waxman-Markey bills do just that.

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[8] *NARUC FAQ: Consumer Benefits of Free CO Allowances for Utilities*, http://www.naruc.org/Publications/FAQ1_Consumer_Benefits.pdf

Technology is key because we don't have the tools we need to reduce our carbon footprint by 80 percent. Without technology to reduce our carbon intensity, a cap-and-trade mechanism is really just a tax. With 70 percent of our nation's electricity generated from fossil fuels, buying allowances or offsets is the short-term answer. I strongly believe any climate change legislation should include provisions that result in additional renewable and nuclear energy, energy efficiency programs, carbon storage development, and other new technologies. It's not just me that believes that. It's also my colleagues across the country. Resolutions passed by NARUC have made it clear that an effective climate change bill must, "[i]nclude support for the development of more efficient generation, transmission and distribution technologies, energy efficiency, and GHG-emission control and sequestration technologies through various means . . . "[9]

I'm not only concerned that this bill under invests in technology; I also feel that way about energy efficiency. I think efficiency will have to be a central component of meeting these goals, and I'd like Kerry-Boxer to invest more resources into efficiency, rather than into rebates. Of course, in some parts of the country or for some classes of customers rebates may be necessary. That's why a large portion of the compliance revenue should be provided to state utility commissions with appropriate discretion to design the proper mix of rebates and efficiency improvements. Some states are farther along the efficiency path and may not have as much low-hanging fruit, so they might favor a higher proportion of rebates. Other states, particularly those cold-weather states like South Dakota, may make weatherization the top priority. Each state's utilities commission is uniquely qualified to determine how best to spend that compliance revenue. It's not just me that believes that. It's also my colleagues across the country. The NARUC Climate Change Task Force has stated that, "Congress should allow flexibility to State regulators in order to encourage creative solutions that address each jurisdiction's individual circumstances."[10]

Those familiar with both logic and the electric utility industry know that those who use the SO_2 trading program as a template for a successful CO_2 cap-and-trade program are guilty of the fallacy of false comparison. Although both programs cap emissions at a specific level and allow the trading of emissions allowances to set the market price of those allowances, the two programs are different in every other way. First and foremost, when the Clean Air Act acid rain SO_2 trading program was passed, the technology was available to capture SO_2. No such feasible technology is available for capturing CO_2, meaning most generators will be looking at fuel switching or abandonment rather than simply retrofitting. The goal of the SO_2 trading program was to reduce emissions by 50 percent, not 83 percent. In addition

[9] *Summary of NARUC Climate Policy*, http://www.naruc.org/Publications/ClimateIssueBrief1_Apr2008.pdf

[10] *NARUC FAQ: Consumer Benefits of Free CO Allowances for Utilities*, http://www.naruc.org/Publications/FAQ1_Consumer_Benefits.pdf

to less aggressive goals, allowances were allocated fairly. Ninety-seven percent of the SO_2 allowances went to utilities, but not all utilities, just those that needed them. Finally, allowances are freely distributed over the life of the program, and auction proceeds are redistributed to utilities with compliance obligations. It should be obvious, then, that the success of the acid rain program provides little help in evaluating current CO_2 cap-and-trade proposals. If anything, drafters of these bills should attempt to learn something from the successful SO_2 trading program.

As I understand this bill, free allowances are to be phased out between 2026 and 2030, similar to the Waxman-Markey bill. However, because this bill does not focus sufficient resources into the research and expansion of nuclear generation and because it will take time to research and develop the energy storage, carbon sequestration, and other technologies needed in its absence, there is real potential that allowances prices could increase dramatically as our country struggles to meet the carbon reduction timelines. To soften the impact to consumers, I urge the Senate to extend the phase-out over the entire emission reduction period to 2050.

State Commission Flexibility

This bill would hurt Midwestern consumers because it doesn't allow their state regulators the flexibility to design programs best suited for their needs. State utility commissions do a very good job of setting rates and a very good job of protecting consumers – those are our areas of expertise. I'm not sure this bill acknowledges that, and so I have great concerns about the workability of the legislation, as does NARUC.[11] This bill and the Waxman-Markey bill both include language that significantly limits how state commissions can distribute local distribution company allowance proceeds. Both bills require the benefits to be shared "ratably" and "equitably" within and among consumer classes. They also appear to require industrial and residential consumers receive a direct cash rebate from allowance proceeds if it is proven the cap-and-trade system caused their energy bills to increase.

These provisions are problematic because they foster uncertainty and potential litigation. Just who will determine what "ratably" and "equitably" mean, and how will that impact the decision to issue flat rebates when the industrial and residential consumers demonstrate their power bills have increased? In addition, if Congress wants to encourage and help fund energy efficiency and clean energy projects, this language unnecessarily prohibits what would otherwise be a strong revenue stream that could be dedicated for these investments. State commissions have historically encouraged significant amounts of clean energy investment, and as we have seen with the Regional Greenhouse Gas Initiative States, proceeds from the nation's only

[11] *NARUC FAQ: Consumer Benefits of Free CO Allowances for Utilities*, http://www.naruc.org/Publications/FAQ1_Consumer_Benefits.pdf

functioning cap-and-trade market are being used for energy efficiency investment. Allowing the Environmental Protection Agency (EPA) and other federal agencies to micromanage state ratemaking isn't a good idea and I urge you to remove such wording.

Additionally, I believe some utilities could achieve the emission reductions sought in this bill without participation in the allowance trading system, and if there are some that want to, I think they should be given options on how to proceed to accomplish the goals. Companies like MidAmerican Energy don't oppose reducing emissions but are skeptical of whether a trading mechanism will result in the lowest cost emission reductions for their customers. I understand their concerns and am also opposed to sending money out of state when we could use those dollars to either reduce emissions at existing power plants or replace those plants with low-carbon alternatives.

I believe some opt-out provision should be included in this legislation. States and utilities could decide whether to participate in the allowance trading system, or instead approach the reductions directly. The emission reduction targets would remain, but the state regulators would make the decisions on the energy policy within the state and how the reductions would be achieved at the lowest possible cost. Such an approach would let states and local distribution companies focus on pursuing the most effective means of reducing greenhouse gas emissions to meet the federal caps, and give consumers a voice in the process.

Conclusion

I don't want anyone to think that these comments are coming from a caveman or Neanderthal. I believe the globe is warming, and I believe we should reduce our carbon footprint. One hundred percent of the generation that has come on-line in South Dakota in my five years as an energy regulator has been renewable or low-carbon. In the last five years, more than a billion dollars has been invested in renewable energy in my state, new transmission lines have been built, and we're home to a thousand green jobs. Just last week, the American Council for an Energy-Efficient Economy (ACEEE) rated South Dakota as one of the "most improved" states for our energy improvement efforts[12]. Clearly South Dakota is a state that is embracing the new energy economy and the need to reduce our carbon footprint. You can see similar robust green efforts in almost every state in the Midwest and Great Plains. Tremendous progress has been made, much of it in just the last few years.

I believe in a low-carbon future. I just think the bill before you is the wrong way to get our country from where we are to where we need to be. I think it places far too

[12] *The 2009 State Energy Efficiency Scorecard*, http://aceee.org/press/e097pr.htm

much of the burden on consumers and on American business and I think it will make families more dependent on the government to pay their monthly utility bills. I know we can do better. With that, I will be pleased to answer any questions.