

ORAL TESTIMONY OF LEWIS HAY, III
SENATE COMMITTEE ON ENVIRONMENT AND PUBLIC WORKS
"EXAMINING GLOBAL WARMING ISSUES IN THE POWER PLANT SECTOR"
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Madam Chairman, Ranking Member Inhofe, Members of the Committee, thank you for the opportunity to be here today. My name is Lew Hay, and I am the Chairman and CEO of FPL Group. We provide electric service to over 8 million people in Florida, and we are one of the top four generators in the country. Our generation fleet is one of the lowest emitters of carbon dioxide in the country, and we are by far the largest wind energy and solar energy producer in the country.

If the rest of the industry were emitting CO₂ at the same rate as we do, U.S. CO₂ emissions would drop by 1.6 billion tons per year or 65% of our sector's emissions. This alone would allow the U.S. to meet its Kyoto target for total carbon emissions – even without any emissions reductions from other sectors.

We are also ranked first in the nation in energy conservation. In fact, if the rest of the industry had conservation efforts roughly as effective as Florida Power & Light's, CO₂ emissions would be reduced by about 240 million tons per year, or nearly 10 percent of the emissions of the entire electric utility sector.

Our exceptional environmental performance has not come without a cost. Our customers in Florida clearly pay more today for electricity than they would if we had a higher percentage of coal in our fuel mix.

Let me summarize our views on global climate change. We believe man-made global climate change is real and requires prompt policy attention, but that it is not yet a crisis. We must take action, but the wrong actions can be worse than doing nothing at all.

To be effective, any program must

- set a clear market price on carbon;
- apply throughout the economy
- protect export- and import-sensitive industries, or production will simply flee offshore;
- recycle the dollars that consumers will pay in higher prices back into their pockets, or we will do serious damage to the economy;
- Fund needed new technologies.

The simplest, most effective way to do this is through a carbon fee. We are not alone in this view. Most economists, the *LA Times*, *The Washington Post*, *Economist* magazine, former Fed Chairman Alan Greenspan and many others endorse the concept of a fee. A carbon fee is administratively simple; it can be implemented quickly across our economy; it is immune from market manipulation; it rewards those who have taken prior action; its costs are certain and, crucially, it provides us in industry with clear price signals, which we need to make appropriate long term capital decisions. We suggest that the price start out at a modest level – say \$10 per ton of CO₂ emitted – and rise predictably each year by, say, \$2 per ton.¹

To be effective, a carbon fee must be recycled, and we believe it should be recycled three ways. First, return the

¹ These values can be adjusted upwards each year for general inflation, in order to maintain the desired level of increasing real burden.

bulk of it to consumers directly. Second, protect those few industries that are genuinely exposed to direct competition from foreign firms located in countries without a carbon program. Third, fund research into carbon reduction, capture and storage technologies, as well as conservation and other low-to-no carbon power sources such as nuclear and renewables.

Many people will tell you that a fee is just a tax, and a tax is politically infeasible. Senators, let me be quite clear – any action you take to constrain carbon will effectively impose a tax on our economy. [With a fee, we have cost certainty, however with unconstrained cap and trade, we don't.] There are important differences between a carbon fee and a tax. These are explained in my written testimony.

However, if a fee really is politically infeasible, then the next best alternative is the right type of cap and trade program. But not all cap-and-trade programs are created equal.

One simple example of the practical issues you must address in cap-and-trade involves the allocation of free allowances. Allowances represent a valuable financial asset – worth between \$70 billion and \$300 billion per year. The specific method by which free allowances are allocated is very important and is likely to be highly politicized and highly susceptible to rent seeking influence in Washington.

Consider two different ways of allocating allowances to electric generation sources: In the first, every megawatt hour produced receives the same number of allowances; while in the second allowances are allocated based on historical emissions. The first approach rewards efficient, low emitting generators, as they will have to buy fewer credits than inefficient, high emitting generators. The

second approach rewards those who have taken no action and who have old, inefficient and, for the most part, fully depreciated plants. Which would you rather reward: companies that have planned ahead and sought to anticipate policy trends and who have low emissions profiles today? Or firms that have sat back and done little? We believe the answer should be obvious.

This is just one of many practical issues with cap-and-trade. Close study of the problems encountered in the early days of the European carbon trading scheme reveal many others, including volatility of carbon prices, market manipulation, regressive impacts on the poor and windfall profits.

For every problem, there is a proposed “fix,” however each proposed “fix” adds complexity and possibly other unintended consequences, and, in effect, makes a cap and trade system work more and more like a carbon fee, albeit without all the benefits that a carbon fee brings.

That said, our analysis suggests that the best cap and trade approach is to auction the majority of allowances and give away the remainder for a short transition period. These free allowances should be allocated based on electricity production (output) not the amount of BTU’s consumed. Moreover, it is critical that a “safety valve” be included.

Senators, I know that there are some who do not believe that the science of climate change is conclusive, or that the consequences are certain. We agree. But we know enough to warrant taking action today. We know enough to know there is risk of severe consequences, and just as we buy insurance, we need to address that risk. However, we need to be balanced in our approach to addressing that risk. A

moderate escalating carbon fee as we have proposed strikes the right balance.

Thank you for the opportunity to contribute to this critical public dialog.