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Incentivizing Natural Gas As A Bridge Fuel Under Climate Change Legislation

The Bridge Fuel Credit (BFC) program described below is designed to deliver up to three billion tons of additional greenhouse gas (GHG) reductions in the first 15 years of any cap-and-trade plan. It is based on providing incentives for capped entities to use more natural gas, a relatively low-carbon fuel. Incentives are provided in the form of an additional emission allowance or BFC for each ton of net emissions reduction attributable to the substitution of natural gas for a higher carbon fossil fuel.

Most cap-and-trade plans prepare to award millions of free allowances to large emitters, only to ease the cost of maintaining business as usual. The BFC plan would provide allowances to emitters that change their expected emissions profile.

Eligible Entities

Credits are issued to eligible parties (e.g., electricity generators, owners of combined heat and power (CHP) plants, natural gas local distribution companies (LDCs), etc.) annually for a temporary or bridge period (2012-2025). The annual quantity of BFCs would begin at 150 million tons (for 2012-2017) and be capped at 250 million tons thereafter. All credits would be funded on a one-for-one basis out of the existing pool of emission allowances, so as not to “bust the cap.”

The following activities would be presumptively eligible for BFCs: (1) retiring an older coal-fired power plant and replacing the output with gas-fired generation; (2) co-firing a coal plant with natural gas; (3) fuel-switching to natural gas at an industrial facility; and (4) building a new combined heat and power (CHP) plant.

In addition, LDCs should be allowed to “bundle” BFC-eligible projects undertaken by smaller customers who modify boilers or change their process heating or other energy uses, including switching to natural gas for transportation – such additional natural gas use would offset CO₂ emissions from more carbon intensive fuel sources. For some examples of the activities that would earn BFCs, [see Appendix A](#).

The EPA’s rules could also require eligible entities to share any financial benefits from BFCs with utility rate payers and consumers (where credits go to unregulated entities). In addition, cost containment measures might be added as well, including a trigger price mechanism that would suspend the program (i.e. provide an “off ramp”) if natural gas prices were to spike.

Public Policy Rationale

Along with greater reductions of CO₂ from capped entities, the public benefits of the BFC program include:

- **Less conventional air pollution** – ensuring that more capped emissions come from natural gas which, upon combustion, emits few conventional (non-CO2) pollutants, like SO2, NOx and mercury. When it comes to capping emissions, most other sources of CO2 pose a graver threat to human health than natural gas.
- **Greater Energy Independence** – based on expanded use of domestic natural gas, which will stimulate more jobs at home and reduce the need for imported energy.
- **Quick Implementation** – because no new infrastructure is needed to produce immediate GHG reductions from fuel switching. America’s 440 GW of gas-fired generation is now utilized at less than one third of its capacity, and over 2 million miles of gas pipelines already exist.
- **A level international playing field** – given that the Kyoto Protocol already allows foreign companies to earn carbon offsets from fuel switching. The BFC program would allow U.S. companies to reduce their cap & trade compliance costs by doing the same thing – fuel-switching – instead of importing an offset derived from this activity.

Why Are New Incentives Needed?

A Bridge Fuel Credit is necessary to spur natural gas usage for two main reasons. First, an analysis of [S. 1733](#) and [H.R. 2454](#) indicates that the prices expected for emission allowances will remain well under \$25 per ton for a decade or more – too low to trigger expanded use of natural gas. The Obama Administration’s senior energy analyst – Dr. Richard Newell, head of the Energy Information Administration (EIA) – told Congress on October 28, 2009 that fuel switching only becomes attractive once allowance prices reach approximately \$30 per ton, assuming a modest gas price of \$5 per thousand cubic feet.

Second, the current cap & trade bills systematically dilute the comparative advantage of natural gas as a low-carbon fuel. Capped parties are given billions of free emission allowances based on historic emissions (which favors heavy-carbon fuels); bonus allowances are awarded for “clean coal”; and rising levels of renewable energy are expressly mandated.

Taking into the above, absent an off-setting incentive program, natural gas is likely to be squeezed out of the market.

Conclusion

The BFC plan outlined here would be an effective complement to any general cap & trade program. It would accelerate emission reductions from capped entities and make the most of America’s abundant base of low-carbon natural gas.