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By Electronic Delivery
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Mr. Christopher Sherry
Research Scientist
New Jersey Department of Environmental Protection
Division of Science Research and Technology
P.O. Box 409
Trenton, New Jersey 08625

Re: Comments of Dominion on the Proposed Regional Greenhouse Gas Initiative Key Draft Offsets Provisions of the Model Rule

Dear Mr. Sherry:

Dominion appreciates the opportunity to submit comments to you and the Regional Greenhouse Gas Initiative (RGGI) Staff Working Group (SWG) regarding the key draft offsets provisions of the soon to be released 'Draft Model Rule' for RGGI. We also appreciate the opportunity to discuss and review a pre-draft of the offset provisions in a teleconference you held on March 9, 2006. The key provisions of the offsets establish the details of the criteria to reduce, avoid or sequester emissions of greenhouse gases (GHG) and to create a crediting process for these projects for purposes of compliance with RGGI. However, the criteria proposed contain several elements with which Dominion respectfully disagrees.

Particularly since the RGGI Memorandum of Understanding (MOU) limits offset use to no more than 3% of total emissions in a compliance period, we strongly encourage the SWG to consider reasonable environmental policies that will help keep electricity prices down while at the same time addressing the desired environmental goals. Overly stringent criteria for offsets will create many hurdles that will stifle the offsets market and encourage extensive price volatility, especially during an initial price discovery period for offset credits.

Dominion believes that for the RGGI program to be effective, the rules and criteria for offsets must be flexible, and that the model rule must ensure that offsets are both *available* and *affordable*. Clearly, the Model Rule should support and complement the regional goals of providing a diverse, secure, affordable and reliable energy supply for Northeast and mid-Atlantic areas. As stated in the MOU, the intent is to remain "consistent with continued overall economic growth and to maintain a safe and reliable electric power supply system."

Dominion offers the following comments and suggestions relative to some of the proposed offset criteria in order to improve these aspects prior to issuance of the Model Rule. Many of our comments echo portions of the oral or written comments provided by several industrial stakeholders.

## GENERAL ADDITIONALITY PROVISIONS

**Project Application Date:** The application provisions state that projects "Need to apply no later than 6 months after project initiation. (Exception is for projects undertaken between December 20, 2005 and December 31, 2008; would need to apply by June 30, 2009 for projects initiated in pre-2009 timeframe)." As indicated in the teleconference, the intent here was to prohibit 'cherry picking' of past projects and focus on (new) revenue flow from offsets. However, the side effect of this policy position is to dismiss any value to voluntary real reductions that have taken place to date. This sends the wrong message elsewhere where greenhouse gas reductions have actually occurred, including other sectors around the country where CO2 limits have not been imposed. It discourages the voluntary market and says that any early green house gas reductions are not worth doing since there will be no potential future value. The MOU states that offset credits will be granted to qualifying projects that take place on or after the date of the MOU. We suggest that there be no '6 month' restriction on the project application date and that any offset project 'temporal' language developed for the draft model rule remain consistent with, and no more stringent than, the MOU language.

**Regulatory Additionality:** Dominion agrees with the concept that no offset credit will be given for reductions that result from actions that are required pursuant to any local, state or federal law, regulation, or administrative or judicial order. This same concept of regulatory additionality is also known as "regulatory surplus."

While the basic concept of additionality may be easy to understand; worldwide, there is no common agreement about additionality. [1] As a policy matter, in the context of an emerging trading market, it is essential that the definition of additionality needs to remain flexible in order to promote offset market development and investment[2]; making it possible for facilities to obtain much needed greenhouse gas offsets in an open, liquid market. Therefore, we believe the concept of additionality must be limited to "regulatory additionality."

[1] World Resources Institute, Project Protocol, Issued November 2005, page 16.

[2] Ibid, page 19.

**Regulatory "Plus" Provisions:** Three other additionality issues reviewed on the conference call included:

- Projects may not receive funding or other incentives from any state system benefits charge (SBC) program or from funds provided through the RGGI consumer allocation.

- Project sponsors must transfer the legal rights to any attribute credits (except RGGI offsets) to the REGULATORY AGENCY or its agent (such as the regional registry). (RECs, etc.)

- Should the additionality provisions go beyond state renewable portfolio standard (RPS) and public benefit funds to disqualify other types of dedicated funding/incentives that are designed to encourage the specific types of activities that are being pursued as an offset using dedicated government funding or aid (e.g., USDA, DOE, EPA, State, Local, Tax Rebates)?

Regarding the fist and third bullets above, an alternative that the SWG may wish to consider is:

- *Projects that receive funding or other incentives from any state system benefits charge (SBC) program or from funds provided through the RGGI consumer allocation will only receive RGGI offset credits for those activities, or portions of activities, funded above and beyond those public program levels.*

The environmental reductions or benefits realized from funding reduction, avoidance or sequestration activities *above and beyond* those programs, or portions of programs, already funded by a SBC or any other type of public funding are just as legitimate and real as those activities otherwise conducted as a separate offset project type. Again, for the reasons stated above, there should not be a disincentive for voluntary programs which are designed to encourage the specific types of activities that are being pursued for offset registration.

Dominion requests that the concept presented in the second bullet above (regarding RECs) be dropped. As advocated during the draft MOU development last fall, Dominion continues to believe that Renewable Energy Certificates (RECs) are separate attributes from CO2 offsets. That is, CO2 offset projects should be allowed to simultaneously generate CO2 emission reduction credits (ERCs) and Renewable Portfolio Standard (RPS) RECs. As such, the RGGI SWG should issue a policy statement which indicates that CO2 ERCs from offset projects and RECs are separate and collateral, regulatory commodities, which may provide economic incentives for further renewables development. For example, landfill gas projects (LFG) that generate electricity, not only displace system power on a non-intermittent basis, but also actually reduce GHG emissions directly via destruction of methane that would have otherwise been emitted to the atmosphere. Therefore, such projects should qualify for both RPS REC's and CO2 offset credits.

As stated last fall, and in several RGGI stakeholder meetings by various entities, many states are implementing challenging Renewable Portfolio Standards, and load-serving entities are struggling to meet these standards. If projects are not allowed to simultaneously generate RPS RECs and CO2 equivalent offsets, RPS REC projects could take over a sizable portion of the available CO2 offset projects in the market or vice versa, exacerbating the lack of availability of either, driven by market prices and giving rise to significant market distortion. Therefore, it is especially important for the SWG to allow CO2 offset projects to simultaneously generate CO2 ERCs and RPS RECs for compliance with RGGI requirements.

On the conference call and in the handout, it was stated that allowing projects to receive incentives or credits from multiple programs, as mentioned above, would likely require a *further* "financial additionality[3]" test or other benchmark in addition to those in the current draft offsets provisions. Three options under consideration are:

- A standardized financial additionality test where the regulatory agency specifies the form of the financial analysis and most of the variables that are used in the analysis. The project sponsor supplies the project specifications. Examples discussed included an internal rate of return (IRR), net present value (NPV) or levelized cost of electricity.

- Size threshold: smaller projects could receive incentives from multiple programs.

- Market penetration threshold: Projects employing technologies/practices below a specified market penetration threshold could receive incentives from multiple programs.

Beyond regulatory surplus, Dominion is concerned that the burden of financial, investment, any other form of additionality or the size and market thresholds mentioned above, would considerably reduce the types of offset projects in which affected facilities could invest.

The underlying investment or other reasons for offset creation are not relevant, and their credit value should be based solely on the amount of greenhouse gas reductions, avoided emissions or sequestration realized. Allowing all projects to receive (financial) incentives from multiple programs simply makes a project more viable from the

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[3] Note this term is being used by the SWG and other stakeholders as what is internationally known as known as "investment" additionality. Investment additionality usually means the value of the offset must significantly improve (emphasis added) the financial and/or commercial viability of the project activity. [Intergovernmental Panel on Climate Change (IPCC), Working Group III, Third Assessment Report (TAR), Climate Change 2001: Working Group III: Mitigation, Appendix II, Glossary, http://www.grida.no/climate/ipcc_tar/wg3/454.htm] This international definition is not the more stringent perspective that some stakeholders interpret as a 'financial cut point' that prompts implementation or not of a project. According to IPCC above, under "financial additionality," the project activity funding shall be additional to existing Global Environmental Facility, other financial commitments of Parties included in Annex I, Official Development Assistance, and other systems of co-operation.

investment community's perspective and therefore more likely that the offset project will actually happen.

## OFFSET PROJECT PRINCIPLES

Another topic mentioned on the conference call was that the SWG did not want to "issue offset credits in perpetuity." It is contemplated that projects will have a 10-year life and then the project will have to re-apply for a "consistency determination." If, at that time, it is determined that an offset project has become a standard market practice, it will no longer be considered 'additional.' Also, if a project is approved in year one, and then a regulation is passed, so it no longer meets the criteria of regulatory additionality, then the project will not be considered "real" in the context of the RGGI program.

As indicated by industrial representatives on the call, these principles would inject much uncertainty on the value of offset projects; so much so, in fact, that it may be difficult to get investment community to buy into these concepts to get *any* project funded. Since you confirmed that the SWG has not touched base with the investment community, we strongly suggest that the investment community be consulted on these somewhat subjective principles to verify their viability in the marketplace. With such uncertainty, the investment community may demand that projects be "front loaded" with offsets – that is, provided offsets as they are determined consistent with the offset eligibility criteria, rather than given offset credit as the reductions are verified; otherwise. Otherwise, they may be unwilling to finance projects.

Another means of providing needed investment certainty would be to allow projects (investments) that meet a regulatory additionality test when project financing is obtained remain eligible for offsets for at least 10 years even if a law or rule is changed during that period. After this initial 10-year period, the project applicant should be provided an opportunity to re-apply for access to allowances, so that project eligibility could be re-evaluated at that time, and the opportunity to modify or adapt the project to secure approval based on updated eligibility criteria.

## AFFORESTATION

As contemplated, afforestation will have a 20% discount to address uncertainty of "permanence." Dominion respectfully suggests that this approach is an inefficient, overly conservative "insurance policy" mechanism. There are other mechanisms or instruments to address this concern, such as CO2e substitution clauses in contracts or insurance policies. A narrow use of the 20% discount could render many afforestation projects non-economic due to the discount amount. The SWG should let the market best cover this type of risk at the least cost, rather than dictating how the risk must be mitigated. Should a qualifying event take place, like a forest fire, then the market will cover the risk appropriately by obtaining equivalent reductions or sequestration elsewhere, while the same environmental benefits are ultimately achieved. Likewise, if a qualifying event never takes place, the market is not over-investing and market efficiency is maintained.

## SUMMARY AND CONCLUSION

Keeping energy costs down on the East Coast is one of the top issues on people's minds. It must be recognized that there currently are no economically feasible technologies to reduce greenhouse gases from fossil fuel-fired power plants. Although the U.S. has demonstrated the cost-effectiveness of market-based cap-and-trade programs for power plants for SO2 and NOx, mandatory programs to address these pollutants were not imposed in advance of available and economically feasible technologies with which to achieve reductions and advance the market. For this reason, the regulation of CO2 emissions, even through a cap-and-trade program, will be far more complex with uncertain consequences. Given the lack of readily available back-end control technologies, offsets are critical to the ability to achieve the desired reductions cost-effectively and the successful implementation of the RGGI program. Offset rules need to be reasonable, simple and flexible, in order to develop a robust offset market that promotes the availability of offsets. These principles will help to keep consumer prices low while enabling regionally important, base load facilities, to continue to operate. Many of the offset eligibility criteria RGGI seeks to impose are overly restrictive, burdensome, and do not provide the certainty needed to encourage longer-term financial investments in projects that reduce greenhouse gas emissions from unregulated sectors and stimulate the offsets market. Imposing such restrictions to offset projects that are essential to the successful implementation of the RGGI program adds difficulty to an already complex process that will stifle project development, particularly during the early years of the program when it is needed the most. The RGGI should be designed to maximize options for reducing emissions and to encourage investments that bring viable offset projects and their associated emission reductions to realization as quickly as possible. If these rules are simple and reasonable, then the RGGI program will not only be balancing environmental needs, but also will remain consistent with most state's desire to maintain fuel diversity which, in turn, contributes directly to keeping energy prices low and the grids stable and reliable.

Thank you again for this opportunity to comment on the key draft offsets provisions of the soon to be released 'Draft Model Rule' for RGGI. We ask that you please post these comments on the RGGI website. If you have any questions, please call Paula Hamel at 401-457-9234 or Lenny Dupuis at 804-273-3022.

Sincerely,

Pamela F. Faggert

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Cc:
F. Litz
RGGI Staff Working Group