

# May 2012 Stakeholder Comments

May 31<sup>st</sup>, 2012 – *Developed and endorsed by: ENE (Environment Northeast), Adirondack Council, Chesapeake Climate Action Network, Conservation Law Foundation, New York Public Interest Research Group, The Wilderness Society*

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The undersigned organizations welcome the opportunity to submit initial comments on offsets and other market design components of the Regional Greenhouse Gas Initiative (RGGI), and we look forward to continuing engagement as states consider improvements to RGGI.

Before addressing topics raised in the latest request for stakeholder comments, it bears noting that changing certain elements of RGGI such as the offset mechanism and price controls must be predicated on updating the emissions cap and addressing the surplus of banked allowances. As a consequence of the decline in emissions from RGGI-regulated power plants,<sup>1</sup> allowance demand and prices are likely to stay low for the foreseeable future unless states make significant changes to the program.<sup>2</sup> In simple terms RGGI market rules intended to reduce volatility do not merit attention unless and until states adjust the fundamental imbalance of supply and demand to create a robust market with prices well above the minimum reserve.

As states continue to evaluate potential modifications of the RGGI cap and accumulating surplus we strongly recommend that assumptions be updated to incorporate latest available data, particularly in relation to demand growth projections<sup>3</sup> and fuel prices.<sup>4</sup> If these key emissions drivers are not updated decisions on the RGGI cap level adjustment will be based on outdated information, likely perpetuating the discrepancy between emissions and the cap. In modeling the economy wide impacts of RGGI changes it is important to recognize that macroeconomic impacts relate directly to the use of auction proceeds, investment of which should maximize consumer benefit, particularly through investment in energy efficiency. Analysis of RGGI's economic impact shows that all states have benefitted from the program,<sup>5</sup> and projections show that states could add an additional \$11.6 billion in value to their economies and generate over 82,000 job years of employment by resetting the cap at present emissions levels and continuing to invest in energy efficiency and other state programs.<sup>6</sup>

## Offsets

Modifying RGGI's offset trigger mechanism may be worthwhile to the degree that it enable states to update RGGI's emissions limit and link with market-based climate programs in other jurisdictions, but any changes to the existing system should be elaborated and evaluated in a dedicated public process that allows for analysis and input more rigorous than is possible in the short comment periods conducted

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<sup>1</sup> Recent analysis of RGGI emissions trends and drivers by ENE (Environment Northeast) finds that fuel-switching, non-emitting generation, and efficiency investments caused 2011 emissions to fall an estimated 34% below the current cap, available at: <http://www.env-ne.org/resources/detail/rggi-emissions-trends-report-jan-2012>

<sup>2</sup> Olga Chistyakova of PointCarbon projected that allowances will remain at the floor price unless states reduce the cap by half and/or address banked allowances, see:

[http://rggi.org/docs/RGGI\\_Stakeholder\\_Presentation\\_Thomas\\_Reuters\\_Point\\_Carbon.pdf](http://rggi.org/docs/RGGI_Stakeholder_Presentation_Thomas_Reuters_Point_Carbon.pdf)

<sup>3</sup> The ISO-New England Regional System Plan for 2012, for example, projects that increased investments in state energy efficiency programs will offset load growth entirely in New England over the next ten years, see : [http://www.iso-ne.com/committees/comm\\_wkgrps/othr/engry\\_effncy\\_frct/frct/2012/draft\\_final\\_ee\\_forecast\\_3\\_16\\_12.pdf](http://www.iso-ne.com/committees/comm_wkgrps/othr/engry_effncy_frct/frct/2012/draft_final_ee_forecast_3_16_12.pdf)

<sup>4</sup> Given the significant decline in natural gas prices, latest available projections from the Energy Information Administration's 2012 Annual Energy Outlook should be incorporated into modeling.

<sup>5</sup> Analysis Group report *The Economic Impacts of the Regional Greenhouse Gas Initiative on Ten Northeast and Mid-Atlantic States* found that investment of RGGI revenue in energy efficiency contributed the greatest portion of the \$1.6 billion in net benefits from the program, see: <http://www.analysisgroup.com/RGGI.aspx>

<sup>6</sup> See ENE's Current and Potential Benefits of RGGI, available at: [http://www.env-ne.org/public/resources/ENE\\_RGGI\\_Economic\\_Benefits\\_20120426.pdf](http://www.env-ne.org/public/resources/ENE_RGGI_Economic_Benefits_20120426.pdf)

thus far in the program review. Offset registries and protocols are detailed and complicated, and the implications of incorporating offset types other than those currently approved in RGGI should be evaluated in a parallel or separate forum to other Program Review elements. Establishing a separate process for incorporating other offset types would allow states to continue adapting to the fragmented and still-evolving offset market.

As states consider modifying RGGI's offset mechanism we offer these initial comments and look forward to deeper engagement on the issues.

#### A. Potential Changes to Existing Offset Project Categories

As stated in earlier comments,<sup>7</sup> we support initial consideration of compliance-grade offset types approved in by the California Air Resources Board (ARB). If states consider incorporating offsets deemed ARB compliance grade, legal enforcement responsibilities would need to be resolved, as offsets approved by ARB are presently subject to CA administrative law. RGGI states could conceivably take a similar approach to ARB and certify offsets from other registries, but the mechanism for such certification is unclear under existing RGGI rules. Technical inconsistencies related to project duration, baselines, and verification standards would also need to be resolved. Additionally, harmonization with CA's offset mechanism should be considered in parallel with broader discussions of market integration.

Particularly worthy of consideration for addition to RGGI are forest management and avoided deforestation projects. The opportunity to increase carbon sequestration through afforestation (the only RGGI protocol at present related to forestry) is important but very limited in the Northeast. Sustainably managing forests to increase carbon storage, and conserving forests threatened with development present greater opportunities for offsets. In addition to reducing greenhouse gases and potentially providing revenue through an offset system, improved forest management and forest conservation also have substantial co-benefits, in the form of clean water, biodiversity protection, and more resilient forests. There are 44.48 million acres of privately-owned timberland in the 10-state RGGI region. An economic analysis commissioned by The Nature Conservancy found that up to 23.9 million Mt CO<sub>2</sub>e of present value carbon could be sequestered in the region for \$10/Mt CO<sub>2</sub>e. Loss of forest land to other non-forested uses is a large problem in the Northeast, and threatens the long-term ability of the region's forests to remove carbon dioxide from the atmosphere. Within the RGGI region, approximately 0.3 million acres of forest land were converted to other non forested uses between 1997 and 2002. This conversion has resulted in approximately 105 million MtCO<sub>2</sub>e of greenhouse gas emissions.

We believe that the ARB forest protocols for afforestation, improved forest management and avoided deforestation provide an important template for increasing carbon sequestration from northeast forests, consistent with a proposal by Maine Forest Service (MFS), Maine Department of Environmental Protection, the Manomet Center for Conservation Sciences, and ENE submitted a to RGGI in 2009.

Potential expansion of RGGI's offset mechanism needs to be paired with a reassessment of existing offset types to assess their continuing inappropriateness within RGGI. Sulfur Hexafluoride is a high global warming potential (GWP) industrial gas 22,200 times as potent as CO<sub>2</sub> at trapping heat in the atmosphere. As such high GWP industrial gas projects were initially

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<sup>7</sup> See: [http://rggi.org/docs/ProgramReview/StakeholderComments/SC021012\\_ENE.pdf](http://rggi.org/docs/ProgramReview/StakeholderComments/SC021012_ENE.pdf)

considered ideal candidates for offset projects. However, mounting evidence shows that industrial gas offset projects provide few environmental or sustainable development benefits and crowd out other worthwhile offset projects. Based in part on evidence that industrial gas (HFC 23 and N<sub>2</sub>O) projects were creating perverse incentives to continue the production and use of high global warming potential gases, and were crowding out other offset projects with greater co-benefits, the European Union decided to decertify such projects.<sup>8</sup> End-Use Energy efficiency improvements may more appropriately be pursued through other policy mechanisms such as ratepayer funded thermal energy programs are that are increasing significantly in a number of RGGI states. Though no end use efficiency offsets have yet been developed, if such project types created an alternative revenue stream and financial driver for consumer efficiency improvements, it could disrupt existing programs by complicating attribution of savings.

#### B. Other Existing Protocols for Further Consideration

As stated above we believe that compliance grade ARB-approved offsets may merit consideration for recognition in RGGI. Given the legal and administrative complexity of potentially incorporating even these high-quality offsets, states should hold off considering other protocols at present. Once a mechanism is established to evaluate additional offset types, and if additional need (i.e. offset demand) is apparent, states could potentially evaluate other protocols.

#### C. Potential Changes to Offset Program Components

If states establish a cost containment reserve mechanism we believe that that permissible use of offsets should be limited to 3.3%, as the price triggers expanding offset usage would be replaced by the reserve. Limiting offset usage would also build on accumulating evidence of the drawbacks to allowing significant quantities of offsets in a market-based program. Offsets are intended to alleviate potential allowance shortages, but in Europe compliance entities are using record quantities of offsets for compliance despite a significant and growing surplus of allowances.<sup>9</sup> The decision to use cheaper offsets for compliance rather than more expensive allowances is not driven by a shortage of allowances, but rather by economics. Unfortunately the effect is that offsets in Europe are contributing to a mounting surplus that threatens to undermine confidence in the program, a problem that RGGI should forestall by limiting offset usage, particularly when other price control mechanisms are available (not the case in Europe).

In relation to geographic expansion, any offsets from beyond the borders of RGGI states must be enforceable and verifiable, whether through memoranda of understanding with regulatory authorities in host jurisdictions, or through certification standards that preserve the legal authority of certifying states.

The prohibition of RGGI offset projects monetizing renewable energy credits is needed to preserve the distinction that offsetting activities take place outside of the regulated electric sector, and the prohibition should be preserved.

### **Cost Containment Reserve (CCR) Design**

Establishing a cost containment reserve (CCR) is worthwhile if it facilitates meaningful adjustment of the emissions cap and preserves the environmental integrity of the program. The reserve should be as small as possible to avoid inflating the cap. As described by Professor Brian Murphy at the January 24<sup>th</sup> learning session, a small supply of allowances is sufficient to meet incremental increases in allowance

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<sup>8</sup> See <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/10/614&language=EN>

<sup>9</sup> See: <http://www.sandbag.org.uk/blog/2012/may/2/influx-carbon-offset-credits-adds-pressure-eus-fal/>

demand and suppress price increases, with a reserve of 1%-3% of the cumulative emissions limit sufficient to protect against price risk.<sup>10</sup> The reserve proposed at the March 20<sup>th</sup> meeting would provide 10 million allowances each year of the seven years in the revised program, for a total of 70 million allowances – over 10% of the total “106 Cap.” The reserve can also be created and structured as a pool of allowances held back from auction and thus within the cap, or as an additional pool. The reserve should be a pool of allowances held back from auction and thus under the cap, especially given concerns about large numbers of banked allowances in the system. Prices for allowances sold from the strategic reserve should be high enough to preserve the market signal to reduce emissions, and it is doubtful whether the \$5-\$15 range of proposed reserve prices would support this objective.

In relation to other design components of a reserve mechanism (eligibility, distribution method, qualification process, temporal interactions, and price points), we encourage states to enlist the perspective of academics and other experts in the field to ensure that the RGGI market remains transparent and free of manipulation, perhaps through trial runs similar to those utilized in the design of RGGI’s auction format.

### **Control Period**

To the extent that they reduce price volatility, facilitate compliance, and enable linkage with other market based climate programs, changes to RGGI’s control periods may merit consideration, but changes should not inhibit robust market oversight and enforcement, and should be balanced against the volatility-reduction benefits of a three year control period.

### **Use of Current Market Reserve Price**

Setting minimum prices for auctions is necessary to reduce the risks of collusion and preserve minimum funding levels for consumer programs supported with RGGI revenue. In addition to setting minimum prices for allowances, states should also establish clear procedures for retiring allowances that are not sold at auction. We believe the reserve price should remain and the price point should rise over time.

While the Current Market Reserve Price was included by some states as a helpful mechanism to mitigate price volatility, due to the fact that only a few of the states include it in their RGGI regulations/statutes and because the floor price has functioned as intended thus far, we recommend the CMRP be eliminated. This will reduce any confusion across states, and also avoid the negative outcome of flooding the market with the vast number of unsold allowances if the CMRP were to be triggered.<sup>11</sup>

Finally, while we appreciate and support the desire to move forward with the Program Review in an expeditious manner, we would appreciate more time to comment on important RGGI design components.

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<sup>10</sup> See [http://rggi.org/docs/ProgramReview/LearningSession2/Murray\\_120124.pdf](http://rggi.org/docs/ProgramReview/LearningSession2/Murray_120124.pdf)

<sup>11</sup> NYCRR 242-5.3(a)(3)(ii), see: <http://www.dec.ny.gov/regs/47181.html>

(ii) All unsold allowances of an allocation year will be made available for sale in the succeeding auction of that allowance’s allocation year, or control period if its allocation year has ended, in which a reserve price greater than the MRP is in effect. At the end of each control period, the Department may retire any unsold allowances from the concluding control period or offer them for sale in a subsequent auction(s) during the subsequent control period(s) in which a reserve price greater than the MRP is in effect.