

Center for Climate and Energy Solutions Comments on the Regional Greenhouse Gas Initiative Program Review

November 9, 2012

The Center for Climate and Energy Solutions (C2ES) appreciates the opportunity to comment on the Regional Greenhouse Gas Initiative's (RGGI)'s 2012 Program Review and commends the RGGI member states for their continued work on improving the first market-based policy in the United States to reduce greenhouse gas (GHG) emissions. C2ES is an independent, nonprofit, nonpartisan organization dedicated to advancing practical and effective policies and actions to address our global climate change and energy challenges. As such, the views expressed here are those of C2ES alone and do not necessarily reflect the views of members of the C2ES Business Environmental Leadership Council (BELC).

C2ES believes that market-based policies are the most effective and efficient means of reducing GHG emissions, and we are accordingly very supportive of RGGI. We appreciate the opportunity to provide input in the program review process and would be happy to assist further if requested.

Treatment of Unsold Allowances

As discussed further below, we agree that the number of available, unsold allowances should be reduced in order to drive GHG emission reductions. We encourage RGGI states to give as much notice as feasible to regulated entities regarding decisions about unsold allowances. Thus, we encourage RGGI states to make decisions at times specified in advance, and to include a delay between these decisions and their implementation. To promote a well-functioning marketplace and minimize administrative burdens, we encourage RGGI states to minimize the uncertainty faced by regulated entities.

Compliance Period

C2ES cautions against adjustment to the current, 3-year compliance period. Global climate change is a long-term problem, so with all else equal, implementing reduction goals each year versus every three years should not have significant environmental consequences as long as reduction targets are met. The timing and frequency of compliance deadlines are key concerns for generators. If a yearly true-up were added to the current process, both generators and RGGI administrators could be negatively affected by the increased complexity and additional reporting that goes with the shorter true-up period. Generators also have long-term planning horizons and can receive significant benefits from spreading unexpected allowance shortfalls across multiple years. The 3-year compliance period allows for more generator flexibility and better accounts for variability in production caused by unpredictable circumstances.

Instead of implementing an interim true-up for every generator, RGGI should investigate the possibility of implementing the yearly true-up only as a penalty to noncompliant generators. If a generator fell into noncompliance for a period, then it would enter into the interim true-up process as penalty until it again became compliant. Through such a policy, compliant generators

will continue to have the benefit of three-year flexibility, while RGGI would have greater assurance that those that have been noncompliant would meet the next three-year target.

Consideration of Banked Allowances and Potential Cap Changes

In addition to the direct impacts on carbon dioxide emissions of the RGGI cap-and-trade program, CO₂ emissions from power plants have fallen sharply in RGGI states due to increased renewable generation, low natural gas prices, and a relatively sluggish economy, among other factors. While RGGI's goals were laudable when the program was being designed, the current reality is that GHG emissions are much lower than were projected; hence, the cap should be adjusted accordingly. As a pioneering program in the reduction of U.S. GHG emissions, we strongly encourage RGGI states to take advantage of the opportunity to pursue further emission reductions, which will require a tightening of the allowance cap. We commend the modeling work commissioned by RGGI and encourage the use of this work in setting a more ambitious, but economically achievable, target.

One element of this adjustment should be a revision of the 2009 baseline to actual 2009 emissions, rather than continued reliance on the projection of 2009 emissions made in 2006. To ensure that a cap adjustment leads to real emission cuts, the revision must account for the large quantity of excess allowances currently banked by regulated entities. The Integrated Planning Model (IPM) analysis assumes that private entities held 44 million allowances in excess of compliance requirements at the end of the first compliance period, and that they will accrue an additional 47 to 53 million allowances before a 2014 adjustment of the allowance budget. If the cap is not tightened sufficiently, these banked allowances could potentially substitute for any real cuts.

One method to account for these banked allowances would be to start by setting a new 2018 cap and interim targets, based on what is determined through the IPM to be achievable at a reasonable cost. The resulting total number of allowances, across all compliance years, should then be reduced by the number of allowances banked before the 2014 adjustment. This will ensure that the emission cuts determined to be achievable actually occur and are not replaced with previously banked allowances.

Though encouraging a cap reduction, we do not recommend any alteration to the number or fungibility of allowances currently held by compliance entities. This sort of alteration would reduce trust in the program, which is essential for a proper functioning market. Additionally, such a move may make regulated entities less likely to bank allowances in the future, which could result in a more volatile market down the road. This move would also reduce the near term environmental improvement that comes with emitting less than what is allowed.

As discussed below, if the cap is tightened, we encourage RGGI to adopt additional compliance flexibility mechanisms to balance real emission reductions with a reasonably achievable compliance burden.

Cost Containment

Assuming that the carbon dioxide cap is tightened, RGGI should put additional compliance flexibility mechanisms in place to provide some cost certainty to regulated entities. The Cost Containment Reserve (CCR), as proposed during the October 18 Stakeholder Webinar, would give regulated entities increased certainty when making long-term planning decisions. One advantage of the CCR is that it is consistent with the Strategic Reserve that California is incorporating into its cap-and-trade program. However, the CCR would also add complexity, reduce transparency, and may be subject to participant gaming. As an alternative that would further increase certainty for industry, we encourage RGGI to explore a price ceiling that would allow regulated entities to comply by paying a per-ton price. This price ceiling would be complementary to the price floor already in place, and would be specified in advance and set well above the expected market price. An unlimited amount of allowances would also be available for generators to buy at this price, and would be held outside of states' allowance budgets. However, a number of issues would need to be analyzed before a price ceiling could be implemented, for example the possible impacts to potential linkage to other cap-and-trade programs as well as potential compliance with Section 111(d) of the Clean Air Act. (See linkage and 111(d) sections below.)

We do not believe the creation of a CCR or another cost containment mechanism should preclude the expansion of eligible offsets, as long as the offsets included are of very high quality.

Offset Eligibility

To date no offset credits have been pursued by generators due to the consistently low allowance price and the relatively small number of RGGI offset protocols. More offset demand would be expected, however, should the emissions cap be tightened. C2ES recommends that RGGI expand the scope of the offset program to increase compliance flexibility. To this end, C2ES recommends that RGGI states consider the possibility of including offsets of eligible projects within parts of North America outside of the RGGI territory. State governments would likely prefer regulated entities to invest in local offset projects, and see those projects develop within their respective states. Expanding the geographic scope to other areas of the country would, however, allow additional offsets to enter the market, which would increase the supply and lower costs. When compared to abatement, a generator may choose to invest partially in offsets, increasing flexibility and providing further cost reductions.

We agree with the proposal to simplify the offset availability price trigger. Assuming that offset eligibility is expanded, C2ES would prefer to see either of RGGI's proposed adjustments (replacing the offset price triggers with a CCR or using a single offset price trigger) rather than the current triggers.

We also encourage RGGI to consider using third parties, such as the Climate Action Reserve (CAR), to accredit offsets. The California Air Resources Board (ARB) has developed methods for expanding offset eligibility, which RGGI may use to leverage previous research and trials while considering specific offset projects.

Reserve Price

To increase certainty, and thereby the ability of regulated entities to make long-term plans informed by RGGI requirements, we support both the proposed change to remove provisions for a “current market reserve price” and to simplify the CPI adjustment to an annual increase of 2.5 percent.

Consider Clean Air Act 111(d) Compliance

EPA may release, as soon as 2013, a draft New Source Performance Standard (NSPS) for GHG emissions from existing power plants through its authority under Clean Air Act Section 111(d). Section 111(d) appears to allow EPA to grant a significant amount of flexibility to the states in how reductions are achieved, and it is possible that RGGI could be used as the primary compliance mechanism for participating states. For example, the guidelines for the GHG NSPS for existing power plants could take the form of a rate-based performance standard, but allow states to demonstrate equivalent environmental performance to that standard through a more flexible approach that the states can implement. Though a draft of these guidelines has not been released, there seems to be a reasonable chance that a cap-and-trade program such as RGGI could be a valid compliance tool. To minimize the burden on both state regulators and regulated entities, we encourage RGGI states to take 111(d) into account when making adjustments to the cap-and-trade program to increase the likelihood that it could be used to comply with the section 111(d) requirements.

Specifically, RGGI states should prepare for different requirements EPA may impose for compliance. EPA may allow states to convert a rate-based NSPS to an absolute GHG emissions cap based on historical emission rates and projected electricity demand, and states may be given the flexibility to achieve this emissions cap though means that reduce electricity generation emissions generally. Compliance methods might therefore include measures that: reduce demand for electricity, such as an energy efficiency resource standard; reduce the share of fossil generation in the state’s portfolio, such as a renewable portfolio standard; or drive emission reductions through a cap-and-trade program such as RGGI. However, EPA may impose restrictions on where emission reductions are achieved. For example, since the regulation will be directed at the power sector, offsets that come from another sector may not be valid for 111(d) compliance. Additionally, EPA may require emission caps that apply to individual states rather than allowing cross-state emissions trading as is available in RGGI. If RGGI’s new cap is more ambitious than EPA’s standard, these restrictions might not require much adjustment on RGGI’s part. Otherwise, they might.

Since it is difficult to project how much flexibility EPA will allow states when implementing 111(d) requirements before draft guidelines are issued, we recommend that RGGI consider what actions it can take under different regulatory scenarios. We would be happy to engage with RGGI further to outline what these scenarios may look like and how RGGI states can use cap and trade to meet EPA’s guidelines in each.

Sectoral Expansion

An economy-wide cap-and-trade program has the potential to achieve greater GHG emission reductions at a lower per-ton cost due to the increased options for how these reductions might be achieved. This concept is reflected in RGGI's acceptance of offset credits in lieu of allowances. We recognize that an economy-wide program, as California has embraced, is not currently being considered by RGGI states. However, we encourage RGGI to explore the possibility of adding sectors beyond electricity, such as the industrial sector, to the program. Increasing the scope of the program would need to be a long-term process, based on rigorous analysis and careful rulemaking, but it could reduce per-ton compliance costs for currently regulated entities and would enable RGGI states to have an even stronger impact on GHG emissions by sending a price signal through more of the economy. Consideration of sectoral expansion is especially important in the continued absence of an economy-wide federal program to reduce GHG emissions. C2ES is more than willing to assist RGGI in exploring this possibility.

Program Linkage

Along with offsets and sectoral expansion, linkage with other cap-and-trade programs can produce the same combined emission reductions at lower total cost. Coordination of compliance requirements can also reduce the administrative burden for regulated entities that operate within more than one region covered by a cap-and-trade program. We recognize that many challenges exist when linking cap-and-trade programs due to variations in scope, goal, and auction mechanics. To successfully link two programs, regulations should provide guidelines to ensure that allowances are interchangeable and can be used in either program. Linkage regulation should also provide standards to ensure the integrity of the market. Although these considerations are necessary, we encourage RGGI states to explore the possibility of linking its program with the Western Climate Initiative and the associated cap-and-trade programs of California and/or Quebec.

Ultimately, the GHG emissions of the world's major economies must become subject to equitable and efficient mitigation measures – perhaps through market-based measures of the type RGGI has pioneered. In addition to the market-based GHG reduction program of the European Union, similar programs are in various stages of development in Australia, New Zealand, South Korea, China, and India. At the end of August, the European Union and Australia announced that both jurisdictions would be linking their emissions trading systems. Both as a model of a future U.S. GHG reduction program, and until such a program is established, it might benefit RGGI to design its cap-and-trade program such that linkage is possible with programs in other economies.

Linking provides more options to allowance buyers and lays the groundwork for other partners to join the initiative. It also sends a strong message to governments, encouraging them to support and join such greenhouse gas reduction programs. While many such benefits to a linkage exist, developing a linkage should not take priority over the continued individual success of RGGI.