

## **COMMENTS BY EXELON CORPORATION ON DESIGN ELEMENTS FOR RGGI 2012 PROGRAM REVIEW**

Exelon Corporation (“Exelon”) offers the following comments on the design elements that should govern RGGI’s 2012 program review and the program modifications resulting from that review. Exelon, one of the nation’s leading electricity suppliers, is comprised of four principal subsidiaries. Commonwealth Edison Company (“ComEd”), PECO Energy Company (“PECO”) and Baltimore Gas & Electric (“BG&E”) are regulated electric utility subsidiaries serving approximately 6.6 million residential, industrial and commercial customers across northern Illinois, southeastern Pennsylvania, and central Maryland, respectively. Through these subsidiaries, Exelon is engaged in the purchase, transmission, distribution and sale of electricity. Exelon is also the parent company of Exelon Generation Company, LLC (“Exelon Generation”), which owns and operates over 35,000 megawatts (“MW”) of nuclear, coal, wind, hydroelectric, solar, gas and oil-fired generation – one of the largest generation fleets in the United States. Exelon Generation is engaged in the generation and sale of electricity in wholesale and retail markets.

The increasing evidence of the sensitivity of climate to rising levels of greenhouse gases (“GHGs”), such as Superstorm Sandy and more rapid disappearance of Arctic sea ice, underscores the need for the RGGI states to continue and to build upon the program’s success both in reducing greenhouse gas emissions and creating a market for GHG allowances. These developments support the comments of many stakeholders that the current program review result in a program that encourages real reductions in GHG emissions levels that will meet or exceed the underlying state reduction goals.

For the reasons set forth below, Exelon believes that the interests of the RGGI states and regulated industry alike will be best served if the cap for 2014 is set no higher than the current 91

million tons per year emissions rate and is reduced at a rate of 3% per year. The auction price floor and the CCR trigger should also be raised by a greater amount than contemplated by the current modeling to facilitate the future development of a national trading market. Exelon also suggests providing that allowances other than offset allowances should expire if not used by the end of the compliance period following that in which they are created. A meaningful allowance price structure and real emissions reductions are essential to providing industry with the assurance that it needs to invest in low and zero emission generation. Moreover, because the RGGI states invest the auction proceeds in the economy, these measures will result in both economic and jobs growth, as indicated by the most recent macro-economic modeling.

A lower cap and meaningful allowance prices are necessary to meet the RGGI states' objectives. They are essential to achieving the stated RGGI goals of creating a program that can be consistent with a future federal program under section 111(d) of the Clean Air Act and to provide the potential for future trading and consistency with the California cap and trade program and the related Western Climate Initiative ("WCI"). The current RGGI allowance price, the current and currently proposed floor, and the current and proposed CCR trigger prices are all far below any independent valuation of carbon reductions and these prices should better represent the state of the science on this issue.

The following principles should therefore govern the current review of the RGGI program:

- The program should encourage real reductions in GHG emissions through low and zero carbon generation, energy efficiency and energy conservation.

- Consistent with the foregoing goal, the allowance price target should be sufficiently high and consistent to provide assurances of an adequate return to those investing in low and zero carbon electricity, as well as energy efficiency and conservation.
- The allowance auctions should generate a reliable revenue stream for the state energy efficiency and adaptation programs.
- The program should, to the extent possible, be structured to be consistent with the anticipated future federal program and other state and regional programs to allow the expansion of the GHG allowance trading market.
- The program should not undermine the value of existing privately held banked allowances.

**I. THE RGGI CAP SHOULD BE ESTABLISHED AT A LEVEL NO HIGHER THAN CURRENT EMISSIONS AND DESCEND BY 3% ANNUALLY AND ALL EXCESS PRIVATELY HELD ALLOWANCES SHOULD BE USED OR EXPIRE BY THE END OF 2020.**

The foregoing principles will best be served if the RGGI GHG cap for 2014 is set no higher than the current emissions level of 91 tons and then descend by 3% per year. The cap should be reduced further by an interim adjustment to a level sufficient to result in the use, by December 31, 2020, of all excess allowances that are held in private hands at the end of 2013.

A meaningful cap is important for numerous reasons, all of which militate towards establishing a higher cap coupled with a higher price floor. Without a cap below the actual level of emissions, the cap and trade program will not achieve its principal goal of driving GHG emissions lower. Equally significantly, without a cap that is lower than the demand for allowances, there will be no meaningful price for allowances and if allowance prices are too low, they will be insufficient to support new investment in energy efficiency and energy conservation and sources of electricity generation that produce no or low greenhouse gas emissions. These

investments are necessary to drive GHG emissions reductions in the future, while maintaining reasonable retail electricity costs.

A cap sufficient to produce stable and meaningful allowance prices is important to securing revenues to support the state energy conservation and efficiency, alternative energy, retail rate relief and adaptation to the impacts of climate change. By generating new productive investment and providing retail rate relief, these programs guarantee that the RGGI cap and trade program will provide economic stimulus rather than depressing growth, as evidenced by RGGI's macroeconomic modeling and discussed further below.

Equally importantly, a sufficiently low cap is important to assure that RGGI will be consistent with other state programs and future federal program under section 111(d) of the Clean Air Act. EPA is currently required by the Clean Air Act and a settlement agreement to develop guidelines for GHG emissions limitations for electricity generating units ("EGUs") under section 111(d) of the Clean Air Act that must be implemented by states through their state implementation plans ("SIPs"). Because section 110(a)(2)(D) of the Clean Air Act specifically authorizes states to employ auctions and other market based approaches to implement emissions controls, many states urged EPA to develop standards that would allow states with existing cap and trade programs, such as the RGGI and California programs, to satisfy their SIP requirements by reliance on their participation in the existing programs. Because a cap higher than existing emissions will neither cause emissions reductions nor drive development of new technology, it ought not satisfy these SIP requirements. A cap that is set too high will also generate a bank of surplus privately-held allowances that will further fail to drive actual emissions reductions. These additional allowances will also "inflate" the allowance currency, thereby interfering with a

potential expansion of RGGI's cap and trade program to include California and other states that may elect cap and trade to meet the requirements of section 111(d) in their SIPs.

## **II. THE AUCTION PRICE FLOOR AND THE CCR TRIGGER FOR THE RELEASE OF ADDITIONAL ALLOWANCES SHOULD BE INCREASED.**

RGGI should also increase both the reserve price for its GHG allowance auction ("price floor") and the price at which the release of additional allowances from the CCR ("CCR trigger") and then increase these benchmarks annually so that, by 2020, they support prices in line with EPA's estimates of the value of GHG reductions, as follows:

- The CCR trigger should initially be set at \$10/ton and increase by at least the same amount as the reserve price, so as to maintain a constant difference between the floor and the CCR trigger.
- The minimum reserve price (the floor) should increase by a specific increment per year above the consumer price index ("CPI"). Specifically, Exelon suggests that RGGI increase the floor for 2014 to \$4/ton and increase it incrementally to \$7.00/ton in 2014\$ by 2020. Thus, the RGGI floor would be \$4 in 2014\$ in 2014, \$4.50 in 2014\$ in 2015, \$5.00 in 2016, \$5.50 in 2014\$ in 2017, \$6.00 in 2014\$ in 2018. \$6.50 in 2019 and \$7.00 in 2020.

Setting the initial floor at \$2/ton and a CCR trigger at \$5, as contemplated by the current RGGI modeling and proposal would create an initial trading range of \$2 to \$4.99. That range is far too low to support an active trading market will not allow the market to determine the price of allowances associated with the applicable cap (i.e. it will allow no price discovery). It will also likely trigger the release of additional allowances. RGGI's current modeling shows, where the initial cap is set at 91 million tons, the CCR trigger will be reached twice, once in 2014 and again in 2017, triggering the release of excess 10 million additional allowances in 2014 and 7

million in 2017. Because the 2014 cap of 91 million allowances would be set at the actual 2012 emissions, this release of 10 million allowances due to the unrealistically low CCR trigger will have the effect of increasing the “cap” or supply of above actual emissions to a level 10 million allowances above actual emissions. This will only perpetuate the glut of excess allowances and recreate the same issue that RGGI is now addressing.

The target prices for GHG allowances should also be more representative of the value of GHG emissions reductions. For purposes of cost-benefit analysis, EPA currently values GHG emissions reductions at \$10/ton. Many have suggested that EPA’s price is far too low. It is lower than the prices at which allowances have traded in EU carbon markets. It is also far lower than the value calculated in the Stern report<sup>1</sup> and other credible economic analyses. These analyses also support increasing the floor, and establishing a higher CCR ceiling starting at the EPA \$10/ton level and increasing it with the floor to allow allowances to trade at levels more consistent with analyses of the value of reductions.

An unrealistically low CCR trigger and floor will also create barriers to incorporation of the RGGI program into a future federal program and expansion of the RGGI trading region to include other states. The only other state with a cap and trade program is California, whose first auction of 2013 vintage allowances resulted in a price above its *reserve* price of \$10/ton (based on EPA’s valuation). The unrealistically low proposed CCR trigger price and release of RGGI allowances above actual emissions will create a significant barrier for incorporation of the RGGI into the federal program under section 111(d) and expansion of the trading market.

More realistic allowance prices will also stimulate the economy. The macroeconomic modeling that RGGI has performed to date confirms that concerns that lower emissions caps and

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<sup>1</sup> Nicholas Stern, *Stern Review on the Economics of Climate Change*, Cambridge University Press (2006), available at [http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/independent\\_reviews/stern\\_review\\_economics\\_climate\\_change/stern\\_review\\_report.cfm](http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/independent_reviews/stern_review_economics_climate_change/stern_review_report.cfm).

higher allowance prices could impair economic growth are misplaced. This modeling shows that the lower 97 ton cap will produce great emissions reductions, higher allowance prices, a higher GDP and more jobs than the meaningless 106 ton cap. Although RGGI has not yet modeled the impacts of the 91 ton cap, Exelon expects that this will produce the same trend – greater economic growth and greater job growth than the higher caps with lower allowance prices.

Although these macroeconomic modeling results are different from the results of the modeling of the proposed federal climate legislation, this is not unexpected because (1) the RGGI structure differs in a very significant way from the proposed federal legislation and (2) the RGGI modeling is based on state and regional level data derived from stakeholders, which is more robust than national level data. Unlike the proposed federal system, the RGGI program generates revenues that are directed to investment in productive activities and to mitigate the adverse impacts of both the program and climate change, creating a “double dividend” that stimulates economic growth while reducing pollution.<sup>2</sup> Also, studies based on more robust state and regional data tend to show that emissions reductions can be achieved at a lower cost and with greater benefits than less detailed national level data and modeling.<sup>3</sup>

Concerns regarding residential electricity price increases resulting from a lower cap and higher allowance prices are also unfounded in light of the many other measures that provide significant flexibility and buffer against undue price increases. The use of auction proceeds to provide assistance to lower income residents offsets adverse revenue impacts on the sector of the population that is most likely to restrict its purchase of goods and services. Investment in energy

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<sup>2</sup> See Robert B. McKinstry, Jr., Adam Rose & Coreen Ripp, *Incentive-Based Approaches to Greenhouse Gas Mitigation in Pennsylvania: Protecting the Environment and Promoting Fiscal Reform*, 14 Widener L.J. 205, 220-21 (2004) and sources cited therein.

<sup>3</sup> See Robert B. McKinstry, Jr., Thomas D. Peterson, Adam Rose & Dan Wei, *The New Climate World: Achieving Economic Efficiency in a Federal System for Greenhouse Gas Control Through State Planning Combined with Federal Programs*, 34 N.C. J. Int'l L. & Com. Reg. 767 (2009)

efficiency and conservation programs has provided further buffers to consumers against price increases. Provision for creation of allowances through offset projects provides yet another safeguard. The multiple belts and suspenders in the existing RGGI program have resulted in a price signal that is insufficient to encourage implementation of offset projects, and investment in new low carbon electricity alike and resulted in a huge bank of unused and unsold allowances. The large bank of unsold allowances and the additional allowances that will be banked in 2013, coupled with the requirement for interim control periods, should also allow adequate time and information for adjustments to be made to prevent any significant retail electricity price shocks.

**III. RGGI SHOULD LOWER THE CAP SUFFICIENTLY TO CAUSE THE USE OF ALL PRIVATELY HELD BANKED ALLOWANCES BY THE END OF 2020 AND ALL ALLOWANCES OTHER THAN THOSE GENERATED BY OFFSETS SHOULD EXPIRE AT THE END OF THE CONTROL PERIOD AFTER THE PERIOD DURING WHICH THEY ARE ISSUED.**

RGGI should also adopt certain measures to assure that the existing bank of excess privately held allowances is consumed and an oversupply does not recur. First, as currently proposed, RGGI should reduce the caps through 2020 sufficiently to cause the use of all privately held banked allowances by that date. In addition, RGGI should provide that all allowances other than those generated by offsets will expire by the later of December 31, 2017, or the end of the control period after the period during which they are issued. Thus, the existing bank of privately held allowances and those purchased and banked in 2013 would expire if they were not used by the end of 2017.

Requiring the expiration of allowances and raising the auction reserve price (floor) and CCR trigger will prevent limit speculative purchase of allowances while allowance prices remain unrealistically low while assuring a constant adequate revenue stream to support state energy conservation and efficiency and adaptation programs. The changes being contemplated will cause the purchase of all available 2013 allowances at the current floor. If, as Exelon proposes,



both the price floor, these allowances and the current banked allowances must be used by the end of 2017, buyers will still have an incentive to purchase all allowances that are put up for auction in the years 2014 through 2017 because higher price floors will prevail during the next compliance period. These rolling price floors and provisions for the expiration of banked allowances will assure that the states will continue to have a constant stream of revenues from allowance sales with which the states can finance their mitigation and adaptation programs. In addition, requiring allowances to expire if they are not used by the end of the next period will reduce the risk of undue market power and manipulation.

**IV. IF THE CCR IS TRIGGERED, THE ALLOWANCES SHOULD BE BORROWED FROM THE ALLOWANCES FROM THE NEXT YEAR (OR CONTROL PERIOD), RATHER THAN CREATING NEW ALLOWANCES.**

If the CCR is triggered, any additional allowances should be borrowed from the next year's (or control period's) supply rather than creating new additional allowances. This borrowing will allow the RGGI states to assess the causes of the triggering event and to adjust the cap only where necessary. Thus, if a price spike is caused by an unscheduled, one time shut down of a nuclear facility, the borrowing from the next allowance pool can be dealt with as a one-time adjustment to the cap to increase the number of allowances. On the other hand, if the price spike is due to speculative trading and there are sufficient allowances available for surrender, the RGGI states should not create additional allowances that might eventually be used to profiteer.

**V. RGGI SHOULD ESTABLISH INTERIM CONTROL PERIODS.**

Exelon supports RGGI's proposal to establish interim control periods. Interim control periods are important to assure that banked allowances are actually used. They are also an important tool for assuring price stability and providing information to allow potential adjustments to be made in the second (2018-2020) control period.

## **VI. RGGI SHOULD NOT INITIATE PROGRAMS TO ADDRESS LEAKAGE AT THIS TIME.**

Some stakeholders have raised concerns that reduction in the cap would increase leakage and have recommended that RGGI initiate programs to address leakage. Exelon believes that it is premature to attempt to address leakage. Developments that will likely occur in the near future should prevent leakage. First, the anticipated federal program for existing utility units under section 111(d) of the Clean Air Act will reduce the likelihood of leakage. Second, Quebec, which is a major electricity trading partner with RGGI states is participating in the WCI and is both mandating emissions reductions and imposing anti-leakage programs vis-a-vis U.S. sources.

## **VII. RGGI SHOULD SCHEDULE ADDITIONAL PROGRAM REEVALUATIONS.**

In light of the many ongoing developments, RGGI should schedule program reevaluations (1) immediately following EPA's adoption of 111(d) regulations for the utility sector, (2) immediately following EPA's adoption of 111(d) regulations for the refinery sector, and (3) for 2018.

As noted above, states should be able to meet their SIP requirements for regulating emissions from existing EGUs under section 111(d) of the Clean Air Act through use of cap and trade programs, including RGGI. The RGGI program budgets and other requirements will, therefore, need to be reconsidered after EPA adopts regulations governing the utility industry under section 111(d) of the Clean Air Act to make the RGGI states' SIPs approvable under the new program. Reconsideration is also appropriate at that time because additional states may wish to join (or rejoin) RGGI. Because the section 111(d) regulations that EPA is required to adopt for the oil refining sector may also be implemented through a cap and trade program, the RGGI states may want to expand the RGGI program to include this sector after those regulations are adopted and should schedule a program reevaluation at that time. Notwithstanding the

emerging federal requirements, a reassessment in 2018 is required to address the next compliance period.

## **VIII. CONCLUSION**

For the foregoing reasons, Exelon supports reduction of the current cap, measures to eliminate the bank of surplus allowances by further reduction of the cap, and increases in both the auction price floor and the CCR trigger. The cap for 2014 should be set no higher than the current 91 million tons per year emissions rate and should be reduced from the current 91 ton per year emissions level at a rate of 3% per year. The bank of excess allowances should be phased out over the next seven years as proposed and allowances should expire if not used by the end of the compliance period following that in which they are created. Both the auction floor price and the CCR trigger should be raised. A meaningful allowance price structure and real emissions reductions are essential to providing industry with the assurance that it needs to invest in low and zero emission generation and energy efficiency. The investment of the proceeds from such a program will create a double dividend and spur greater economic and job growth than either the existing program or the weaker programs that are under consideration.

Should RGGI, Inc. have any questions or need further information please contact:

Amy M. Trojecki  
Director, Environmental and Fuels Policy  
Exelon Business Services Company, LLC  
101 Constitution Avenue, NW  
Washington DC 20001  
Direct Dial: 202.637.0320  
Amy.Trojecki@exeloncorp.com

