



EDISON ELECTRIC INSTITUTE

September 20, 2005

Franz Litz, Esq.
Chair of the Regional Greenhouse Gas Initiative
Senior Attorney, New York Department of Environmental Conservation
625 Broadway, 14th Floor
Albany, NY 12233-1500

Dear Mr. Litz:

Please find attached comments submitted by the Edison Electric Institute (EEI) regarding issues raised by the August 24 Staff Working Group proposal and the modeling results presented to date in the Regional Greenhouse Gas Initiative (RGGI). These comments are in addition to the ones we submitted on June 17, 2005. EEI is participating in the RGGI process as an interested observer, and respectfully requests to have its comments posted on the RGGI web site.

EEI is the association of U.S. shareholder-owned electric companies, international affiliates and industry associates worldwide. EEI's U.S. members serve nearly 97 percent of all customers served by the shareholder-owned segment of the industry, generate almost 60 percent of all electricity in the country, and serve more than 70 percent of all ultimate customers in the nation.

As with our previous submission, we call to your attention a very serious deficiency of the RGGI process to date – the lack of availability of the detailed modeling results, which is crucial for understanding better the potential impacts of the program. **We urge RGGI, as a matter of policy, to make publicly available the detailed results of current and future modeling runs.**

We appreciate the opportunity to comment on issues raised in the RGGI process to date, and plan to comment further once the model rule is finalized and the final reference case background information is made available. If you have any questions, or would like to discuss our comments further, please do not hesitate to contact myself (202-508-5617, bfang@eei.org) or Eric Holdsworth (202-508-5103, eholdsworth@eei.org).

Sincerely,

A handwritten signature in cursive script that reads 'William L. Fang'.

William L. Fang
Deputy General Counsel and
Climate Issue Director

Enclosure

WLF:eh

September 20, 2005

**Edison Electric Institute Preliminary Comments on
Regional Greenhouse Gas Initiative Implementation Issues**

The “program goal,” as stated in the Regional Greenhouse Gas Initiative (RGGI) web documents, is to “[d]evelop a multi-state cap-and-trade program covering greenhouse gas (GHG) emissions”-- which RGGI notes “are not bound by state or national borders” -- that “will emphasize uniformity to facilitate interstate tracking” and that “will initially be aimed” at reducing carbon dioxide (CO₂) emissions from “power plants in participating states, while maintaining energy affordability and reliability and accommodating, to the extent feasible, the diversity in policies and programs in individual states.” It is intended that the program “will be expandable and flexible, permitting other states” outside the region to “seamlessly join. . .when they deem it appropriate.”¹

There are nine Northeast and Mid-Atlantic states represented in this “cooperative effort” to discuss development of the program. We understand that late last month a staff working group (SWG) proposal was circulated to RGGI “Agency Heads” for “consideration,” with the understanding that the group will “solicit” input from stakeholders. Our member companies and the Edison Electric Institute (EEI) look forward to having that opportunity.

¹ The relevant RGGI web documents are relied on here and elsewhere in these comments “About RGGI,” “Goals & Guiding Principles,” “Working Groups” and “Action Plan.”

In advance of that opportunity and as a follow-up to our June 17 comments, EEI submits the comments below that address the following implementation-related issues:

- Implications of non-participating states.
- State implementation issues.
- Severity of the cap and implications for emissions trading.
- Leakage issues.
- Key allowance allocation issues
 - i. Public benefits and Strategic Carbon Fund set-asides.
 - ii. Offsets.
- Stakeholder opportunity to comment.

The following comments are based on our understanding of the “reference case” as of September 19, 2005, which raises a significant concern with the RGGI process. As noted in our June 17 submission, much of the background information on modeling assumptions and results has not been made available publicly, and so these comments are based on our current understanding of what the RGGI program will encompass. Furthermore, the reference case has continued to change throughout the RGGI process, making it difficult to know which version is under active consideration and what the assumptions are behind the reference case. As we stated previously, such information should be shared in a timely manner with all stakeholders. Not making such information available gives the appearance of a rush to agreement without proper stakeholder involvement, which would not auger well for RGGI serving as a national model or program.

I. Implications of Non-participating States

A key question for the RGGI process is the critical mass needed for the program to operate regionally and cost effectively. It is unclear what would happen if some, but not all nine, Northeast and Mid-Atlantic states participate, or at least not all at once. Given the widely varying impact each state has on the region's CO₂ emissions and economic productivity, RGGI policy-makers – all of whom are “designated representatives” of the nine states – need to consider the impact of such non-participation on the implementation and effectiveness of RGGI, since such non-participation, even temporarily, could exacerbate competitiveness impacts on generators in other RGGI states.

Of the nine participating states, the majority of the region's CO₂ emissions (approximately 75 percent) are from just three states – New York, Massachusetts and New Jersey. However, New Jersey is the only one of these three states to operate in a regional power pool (PJM) that involves states outside the RGGI region. Such a situation could exacerbate competitiveness impacts on New Jersey generators since the other states in their regional power pool are largely coal-based generators not subject to RGGI restrictions, allowing them to sell power into the region at lower rates. See also EEI comments of June 17, 2005, to RGGI on the leakage issue. In such a situation, or anticipation thereof, New Jersey could elect not to participate, even if only temporarily.

Similarly, RGGI must consider what would happen if one or all of the other six states ultimately fail to agree to participate. It seems unlikely that citizens of a state (*i.e.*, utility customers) or the

state legislature would be supportive of a state's electric utilities paying money to neighboring states to buy allowances to meet the RGGI targets, particularly if the state's reduced emissions are offset by increased global emissions associated with electricity generated from outside of the RGGI region and from other sources.

The situations of Vermont and New Jersey are worth examining. Apparently, Vermont currently stands to be a seller under the RGGI program. However, if Vermont were to decide to oppose relicensing of the nuclear plant that operates in its state and provides electricity to neighboring states, it too would find itself with a heavy burden to meet the proposed RGGI targets, since that generation would have to be replaced in large part by fossil fuel-fired generation. Thus, it could go from being a seller to becoming a buyer. New Jersey could be in a similar situation, as it also faces a critical issue with respect to relicensing of a nuclear plant. As these examples and comments submitted by the Nuclear Energy Industry demonstrate, the role of nuclear power in the Northeast and Mid-Atlantic states and under the RGGI program is critical.²

Even if the RGGI program is fully implemented in all nine states, it is unclear whether it can make a significant impact on reducing GHG emissions in the U.S. As Joseph Kruger and William Pizer have observed, "If state actions do not lead to longer-term, comprehensive federal and international action, they will not make a significant impact on climate change." "Regional Greenhouse Gas Initiative: Prelude to a National Program?," Resources (winter 2005), p. 4. If

² The importance of nuclear power in relation to the RGGI program was also highlighted in a September 13, 2005, *New York Times* article (p. 16).

one or more of the nine states do not participate, the impact on national GHG emissions will be even more doubtful.

II. State Implementation Processes

Another key question for RGGI state representatives is the nature of the process in the region and the several states for adopting and administering the RGGI proposal. For example, there is the question of whether the program can be implemented merely through the states individually adopting a proposed Memorandum of Understanding (MOU) and Model Rule by executive action, or whether each state must adopt implementing legislation and regulations.³ The function, purpose, and legal and constitutional nature or consequences of an MOU among the RGGI states with the SWG proposal for a “Regional Non-Profit Technical Assistance Organization” are particularly unclear. According to the RGGI “Action Plan,” each state’s representative was to provide to the SWG “a short briefing on that state’s recent legislative, regulatory and administrative initiatives relating to the control of GHG emissions.” However, to our knowledge those briefings have not been made available to stakeholders, and we are not aware of any analysis by the SWG of state laws regarding RGGI or the MOU.⁴

³ At least one New York legislator, in an August 24, 2005, letter to his governor, has asked about the role of the legislature and whether the proposal can be modified or “be presented as a *fait accompli*.”

⁴ States’ adoption of a RGGI MOU that purports to bind the states to a Model Rule and establish a regional organization appears to be of questionable validity under the Compact Clause of the U.S. Constitution, Article 1, section 10, clause 3 in light of the federal interest. See n.6, *infra*. The RGGI states thus far have given no indication that they intend to adopt a RGGI agreement under the federal Clean Air Act (CAA), 42 U.S.C. § 7401 *et seq.* Like the U.S. Constitution, that Act has provisions requiring the consent of Congress to state agreements. Moreover, neither CO₂ nor GHGs are listed as a “regulated air pollutant” under the CAA, and on September 8, 2003, the Environmental Protection Agency (EPA) issued a notice denying a petition to regulate

Recent media reports have quoted various RGGI participants as saying that first the governors will sign an MOU setting the parameters of the program on a regional basis, which will be followed by individual states preparing draft rules and undertaking their own rulemakings. That approach appears to be independent of any input by the state legislative bodies. Given the potentially far-ranging consequences of the RGGI program on individual state economies and revenues, it would appear reasonable that each state should pursue a legislative process for adoption of the program, as well as regulations, subject, of course, to a review of its authorities and their possible application to RGGI, the MOU and the model rule. Indeed, an adoption process that goes through each state legislature and allows for the greatest level of participation by stakeholders and citizens in the development of the legislation and implementing regulations is the only reasonable means of implementation.⁵ Such a process would allow for greater participation by concerned stakeholders and citizens.⁶

such emissions, declaring that EPA “cannot and should not regulate GHG emissions.” 68 *Fed. Reg.* 52922. That decision was upheld by the U.S. Court of Appeals for the D.C. Circuit in *Massachusetts v. EPA*, Nos. 03-1361-03-1368 (D.C. Cir. July 15, 2005), *petition for reh’g pending*.

⁵ One area of concern is the lack of sharing by RGGI with stakeholders of various documents and models apparently relied upon by RGGI in the development of the program, even though all of the RGGI state “designated” representatives are from states with broad Freedom of Information or Public Access laws that apply to them and thus to RGGI.

⁶ Even that process raises questions of federal preemption, in that the RGGI program adopted by individual states appears to be in conflict with the foreign policy that several Presidents have established and that the Congress has supported, as well as with the closely related domestic policy on global warming that Congress has adopted. It is noted that the Supreme Court has found federal foreign policy has particularly strong preemptive force (see *American Insurance Association v. Garamendi*, 123 S. Ct. 2374 (2003)). For example, based on legislation enacted in 1987, the President and the Secretary of State began multilateral negotiations on global warming that culminated in the U.S. ratifying after Senate advice and consent in 1992 the United Nations Framework Convention on Climate Change (FCCC). Additional negotiations ended in 1997

Other issues are: whether state adoption requires that the program be adopted as proposed by the RGGI state representatives; whether there can be differences on a state-by-state basis; and what would be the implications of such different state adoption schemes for the region, the states, the utilities, the economy and emissions and for the possibility of other states joining.

Another issue relates to the lead time afforded the states to adopt the program and to several electric utilities that are expected to implement the program and all of its requirements as developed by the states. The 2003 RGGI "Action Plan" called for "Phase I development work within the first 20 months (April 2005) of the effort." That schedule was obviously too ambitious. As noted, the RGGI state representatives have developed a proposal that would impose limits beginning in 2009. That indicates that the states and, most importantly, the affected utilities will have but three years lead time to consider, adopt and implement a program that is only a proposal and not a final RGGI staff recommendation for any state, let alone the affected utilities and the affected public or ratepayers. Such a short lead time is unrealistic and unreasonable.

with adoption by the FCCC's Conference of the Parties of the Kyoto Protocol, which was signed by the President but never submitted to the Senate for advice and consent to ratification. In addition, in 1987 Congress initiated a long-term study of global climate change and in 1990 amended the CAA mandatory research, study and other **non-regulatory** programs related to the possible effects of CO₂ emissions. (The only congressional regulatory requirement is the annual reporting by electric utilities to EPA of CO₂ emissions pursuant to section 821 of Public Law Number 101-549 enacted in 1990.) Only a few weeks ago the Congress rejected, in enacting the Energy Policy Act of 2005, a Sense of the Senate Resolution that called for enactment by Congress of domestic climate change **regulatory** legislation.

Importantly, each state must ensure – through the MOU process, which is of at least questionable validity, and state legislative and regulatory implementation processes – that the RGGI program will, at a minimum, not become binding unless and until all the states that form the critical mass have adopted the program with adequate lead time.

III. Severity of the Cap and Implications for Emissions Trading

The tighter the cap, the greater the need for allowances by covered sectors in order to mitigate the cost of meeting the target, and consequently the higher the market price of the allowances will tend to be. However, if the cap is made too tight, the emissions trading system could suffer. If the supply of credits is too low and the demand too high, the permit price could reach levels where it is cheaper or less economically harmful for the entity to shut down rather than continue operations and incur ongoing financial risk and possibly regulatory consequences. Alternatively, the cap or target could be so stringent that no entity is able to comply, and therefore the efficacy of the cap level, or program in general, could be called into question by the public and stakeholders, as well as by the governors and the legislatures.

We encourage the RGGI process to consider the use of economic mechanisms to control compliance costs, specifically the use of either a “safety valve” or a “circuit breaker.” The safety valve would establish a price cap on the cost of permits, **mitigating the emission reductions expected to occur under the cap-and-trade program by allowing more emissions than a straight cap-and-trade system.** In light of the fact that the main purpose of RGGI is to establish a model that other states can use to achieve CO₂ emission reductions – not to achieve a

specific level of CO₂ emissions reductions needed to achieve a specific environmental goal – the impact of possibly not achieving the cap due to the use of a safety valve is negligible. On the other hand, the safety valve does provide some level of price certainty, a critical feature given the risk of rising prices that can occur under a cap-and-trade system, such as in the European Union emissions trading system where allowance prices have risen almost four-fold since January 2005. In this sense it acts essentially like a carbon tax. A similar scenario could be expected to occur under RGGI since, unlike the experience with trading under the federal Clean Air Act title IV program, there currently is no commercially feasible control technology for CO₂ and new technologies are not expected to be developed and deployed by the program's start date. Indeed, compliance could be largely dependent on fuel switching from coal to natural gas, which has significant cost and supply ramifications for the RGGI states and their citizens currently and for the foreseeable future.

The “circuit breaker” would delay the increase in the target's stringency if the allowance price became too high. Such a policy also would help contain the potential cost impacts of rising allowance process, but on the other hand would mitigate some of the expected reductions under the program.

While both instruments – the safety valve and the circuit breaker – would help reduce the economic impacts on electric utilities under the proposed RGGI system, consideration of their use also leads to the following conclusion: The targets under consideration are too onerous when considering the level of emissions reductions that would be required under conservative

projections of anticipated emissions growth. Many stakeholders believe that the “reference case” being used as the general view of how the future will look without RGGI is inappropriate. For example:

- It uses what many believe are unrealistically low gas price projections.
- It does not allow for future new coal-fired generation plants within the RGGI region, regardless of their economic competitiveness and their ability to meet aggressive emission standards.
- It assumes 100 percent achievement of renewable generation goals.
- It assumes 100 percent nuclear relicensing.
- It assumes unlimited gas and transmission infrastructure – with no additional costs for any additional infrastructure needed.

When considering the “high emissions case” (which does not represent worst-case conditions), one sees that the level of reductions that will likely be needed to achieve the proposed cap are onerous.

Rather than invent new bureaucracies and complicated processes to administer these types of programs, it would be better and more cost effective to adopt less onerous reduction targets. Such a philosophy – coupled with improvements in the offset provisions and elimination or at least minimization of such costly features as the Strategic Carbon Fund (SCF) and public benefits set-asides, as discussed below – would give the RGGI program a greater chance of gaining acceptance regionally and possibly beyond rather than being perceived as a program that failed to achieve its reduction targets and instead implemented a carbon tax. As noted in our June 17 comments to RGGI, implementation of a carbon tax on a national level seems highly unlikely at this time.

IV. The Leakage Issue

The recently released SWG proposal essentially ducks the leakage issue. The partial justification provided in the SWG proposal for the Strategic Carbon Fund – to counteract leakage – seems weak at best. In fact, it is counterintuitive to attempt to address the leakage issue by taking more allowances away from the generators subject to RGGI – who are already disadvantaged relative to generators in neighboring, non-RGGI states and Canada – thereby leaving these generators further disadvantaged. Regrettably, the SWG proposal does not really address the leakage issue, paying lip service by talking about monitoring and invoking the Strategic Carbon Fund. RGGI officials need to tackle the leakage issue head-on, not avoid it. Otherwise, the future of the RGGI program is bleak.

The importance of the leakage issue is illustrated by an evaluation of the results of the “high emissions” case, which many believe may more accurately reflect the future than does the “reference case.” The results demonstrate that if a national CO₂ program were enacted (which is the overall goal of RGGI), the increase in electric rates within RGGI would be roughly an order of magnitude greater than if RGGI is implemented as a regional program, due to the fact that a national program would allow less leakage. We question whether RGGI really wants to incentivize increased leakage, and possibly reduced generation and increased power plant retirements within the region, when ultimately such results could exacerbate the financial impacts on the region if and when a national program is implemented.

Another leakage issue that needs to be raised concerns the lack of data provided for stakeholder review to date with which the environmental consequences of sulfur dioxide, nitrogen oxide and mercury emissions leakage can be assessed. This information is supposed to be an output of the IPM, and should be made available for review. See also our comments of June 17 to RGGI on leakage.

V. Key Allowance Issues

A. Overview

Aside from the emissions cap, the method chosen for issuing allowances is the most critical factor in the design of a cap-and-trade program relating to carbon, and one that can lead to significant adverse reliability and market impacts. Furthermore, unlike the sulfur dioxide and nitrogen oxide emissions trading programs – which are often cited as models for a CO₂ trading program – there are no commercial feasible technologies currently available to limit CO₂ emissions, which makes a CO₂ trading program fundamentally different than any other trading program established to date. All of these factors point to the need to exercise a great deal of care in making this decision. The SWG proposal raises a number of concerns in this area.

B. Public Benefits and Strategic Carbon Fund Set-asides

The SWG proposal generally leaves decisions on allowance allocations to the individual states, which on its face seems reasonable, although it could result in nine different allocation schemes. As an exception to this general SWG proposal on allocation, SWG proposes that all states agree to propose for legislative and/or regulatory approval that 20 percent of each state's allowances be

set aside for a public benefits purpose, which may include the promotion of energy efficiency, mitigation of ratepayer impacts, promotion of renewables, and/or stimulation of investment in CO₂ reduction technologies. The SWG further proposes that each state set aside 5 percent of its emissions budget for the Strategic Carbon Fund to undertake projects that would achieve supplemental reductions beyond those required to reach the cap. However, the purposes – as well as the basis and need – for such broader set-asides are vague.

The two set-asides combined reduce by 25 percent each state's allowances, which is likely to increase the severity of the cap (see section III above) and raise serious concerns. Within the context of a regional program such as RGGI, such large set-asides have potentially harmful consequences, including significantly – and unnecessarily – increasing the costs of the program and exacerbating competitiveness impacts on companies in the covered states.

Given the economic, technical and practical difficulties that many states and utilities will have in meeting the RGGI targets (some of which also were discussed in our June 17 comments to RGGI), it would be illogical to create an SCF to pursue reductions additional to those required under the cap. Assuming an SCF is retained – which we do not favor – it would make more sense to use the reductions achieved through the use of the SCF first to help meet the overall RGGI target, particularly since the SCF further disadvantages generators in the RGGI region as noted in our comments above regarding leakage. As currently structured, the SCF would take away financial and other resources from entities trying to comply with the RGGI cap, which would be counter to the program's goal of full compliance. As for the 20 percent set-aside, it is

unclear what would be the effect if some, but not all, states actually adopt it in some fashion or if none did.

Faced with having to meet increased demand for energy, which will likely result in increased GHG emissions during the covered period, generators may have to turn in or retire all of the allowances they are given – and then buy more – in order to meet their obligations for energy while simultaneously being in compliance with the RGGI reduction targets. This situation is made all the more likely by the suggested 25 percent set-aside of allowances at the state level. Such a policy virtually guarantees that there will be few, if any, surplus allowances available and unduly constrains the effectiveness of emissions trading. Further, unless a company can reduce its emissions overall, any allowances sold on the market will have to be purchased back eventually for compliance. If anything, generators will suffer overall economic losses in meeting the cap as a result of the set-asides.

Significantly, the nine RGGI states and their utilities have to operate in a deregulated environment, with no hope of government-supported cost recovery, which further exacerbates the impact of the set-asides. These economic impacts, in turn, would likely exacerbate the impact of leakage by leaving covered generators at a significant competitive disadvantage with generators in neighboring, non-RGGI states and Canada.

By artificially restricting the pool of allowances available for trading, the set-asides would exacerbate distributional inequities by forcing companies that produce most of their power from

coal- or oil-fired generation either to buy a relatively large share of whatever allowances are available in the market or shut down plant operations. These same units are critical to maintaining system reliability, load following, ancillary services and fuel diversity in the region. Accordingly, such a situation will potentially create an immediate, negative step-change in available generation resources in the market in a region that has already indicated generation resource availability concerns in the 2008 and beyond timeframe, and will likely create immediate cash and credit management concerns. The end result is that longer-term energy deals will be more difficult to make going forward.

The use of set-asides also is in contrast to how the most successful cap-and-trade program – the Clean Air Act Title IV program – works. Under that program, more than 97 percent of the allowances were allocated free of charge by Congress. Only 2.8 percent of the allowances were auctioned, with Congress providing that the proceeds of the auction flow back to the covered sources. To our knowledge, that process worked well and did not result in increasing costs to electric consumers.

Most importantly, such set-aside proposals would surely require actions by each state legislature, again with no assurance that the results would be the same for each state, which would further exacerbate issues of competition and inequity. Indeed, some states might reject all or part of the set-asides, which would leave a patchwork.

C. Offsets

The SWG proposal contains several limitations on offsets, namely, a 50 percent numerical ceiling and restrictions to four specific categories within a participating RGGI state. None of these limitations make economic or practical sense, and they would only increase the costs of compliance. CO₂ and other GHGs are ubiquitous and well-mixed in the global atmosphere. We reiterate RGGI's very perceptive observation that GHGs "are not bound by state or national boundaries" or, for that matter, continental boundaries because of their "global" nature. It does not matter where in the U.S. or the world a utility reduces, avoids or sequesters GHGs. Thus, geographical, numerical or other offsets limitations should all be removed, lest the costs and practicalities of compliance become totally unwieldy.

Further, while we commend RGGI for including four specific categories of projects allowed under the SWG proposal – landfill methane projects, sulfur hexafluoride projects, afforestation projects, and natural gas/home heating oil/propane end-use energy efficiency projects – we encourage RGGI to fast track other project options both inside and outside the RGGI region that are equally valid. Among the equally worthy offsets are: energy efficiency and demand-side management projects; coal-bed methane projects; substitution of end-use technologies (such as electrotechnologies and hybrid vehicles) for fossil fuels; reforestation and forestry management projects; reuse of coal combustion products; and international energy projects. Emissions trading credits from other regions of the country also should qualify. Furthermore, we urge the RGGI process not to incorporate additionality criteria (*i.e.*, proving that reductions from an offset project were above and beyond reductions achieved previously for a similar project) to qualify

the use of offsets. As with the suggested 25 percent set-aside policy, the proposed restrictions on the use of offsets will unduly constrain the effectiveness of the cap and trade system.

VI. Stakeholder Opportunity to Comment

While EEI appreciates this opportunity to provide these preliminary comments on the RGGI process and program -- which is still in the proposal stage -- we look forward to, and take this opportunity to request that, RGGI and the states make available, when adopted by the RGGI representatives for presentation to the governors, the RGGI-recommended package to stakeholders and the public for review and comment. This package includes: the MOU, which apparently includes a commitment by states to adopt a model rule; the model rule; and the related technical support document. We urge that such a comment period occur before the governors and the legislatures consider these matters, so that they are aware of such comments and concerns as part of their consideration. We also urge that the time for such comments be at least 90 days. We will follow-up with additional comments as we learn more about the proposed program, and look forward to seeing the details and assumptions of the final version of the reference case so we can comment on them as well.