To: **RGGI State Environmental & Energy Commissioners and the RGGI Staff Working Group**

From: **Derek Murrow & Jessie Stratton, Environment Northeast; Dale Bryk & Luis Martinez, Natural Resources Defense Council; Larry DeWitt, Pace Energy Project**

Date: **September 12, 2005**

Re: **Comments on the Revised RGGI Staff Working Group Package Proposal of August 24, 2005**

Environment Northeast, NRDC and Pace Energy Project offer these summary comments on the August 24 Revised Staff Working Group Package Proposal. Through RGGI, the Northeast states have an enormous opportunity to demonstrate that we can reduce global warming emissions in a smart way that will bring economic development to the region, drive investment in the new, clean energy technologies of the 21st Century, and at the same time help consumers and businesses to operate more efficiently and reduce energy costs.

The draft proposal needs several improvements if the states are to achieve this goal – the most important of which are:

1. Adopting a program that delivers significant emissions reductions by starting with a cap that reflects a reasonable calculation of "current emissions" and that commits to a greater reduction by 2020 – the program costs as they have been modeled are extremely cheap and we can do better;
2. Ensuring that program costs are as low as possible by using allowances primarily to protect consumers and secondarily to drive investment in clean energy technologies; and
3. Reducing the quantity of offsets allowed so that the program leads to real reductions in emissions from the electric sector.

We appreciate the hard work that has gone into producing this draft and make these comments with the goal of strengthening the proposed Model Rule in a way that allows us to support it. We look forward to continuing to work with the RGGI states and stakeholders as a final Rule is refined and implemented. Please do not hesitate to contact any of us to discus these comments.

We have highlighted our priority comments and concerns separately from more minor comments in the sections below.

Priority Comments and Concerns

Reduction Goals & 2015 Review

A 10% reduction from current levels by 2020 will deliver environmental benefits, but given the low cost of the program with this level of emissions reduction, **we believe the states can and should be more ambitious and begin the emissions reductions prior to 2015 and achieve a 15% reduction by 2020**. This is especially true given the inflated initial cap (see below) and the fact that historically modeling of the economic impacts of environmental regulations consistently overestimates costs and underestimate benefits.

Comprehensive review should occur in 2020 not 2015. The program should strive to maximize certainty and reduce the risk of making changes mid-stream. In addition, review is appropriate if the MOU articulates an intent to require further reductions (beyond the 10 or 15%) after 2020. This would strengthen the rule and provide greater certainty for those making investments based on the carbon price signal RGGI is designed to send, while still allowing for some reconsideration.

Regional Cap Level and Apportionment

The initial regional cap level is significantly inflated above current emissions. The statement that the initial cap level is approximately equivalent to the "average emissions of the highest 3 years between 2000 and 2004" is inaccurate as compared to actual emissions data. **The starting point of approximately 150 million tons CO_2 is dramatically higher than any current emissions data we have seen from any available source. This program must be based on the most accurate and credible information available. If not, the program risks starting with an overly inflated cap that will not hold emissions to current levels until the mid 2015-2020 timeframe.**

The most recent data we have seen compiled by the states indicates that recent RGGI region emissions have been as follows, with averages shown in comparison to the cap levels proposed:

RGGI Region Total Emissions v. Proposed Cap	
Year	Emissions (Short Tons CO_2)
2000	148,722,545
2001	143,298,225
2002	140,360,000
2003	145,234,376
2004	144,948,399
5 Yr.Avg.	144,512,709
Top 3 Avg.	146,301,773
02-'04 Avg.	**143,514,259**
2009-2015 Proposed Cap	150,602,356
Mid 2015-20 Proposed Cap	**143,072,238**
2020 Proposed Cap	135,542,120

Source: RGGI State Working Group Data, Provided at CT RGGI Stakeholder Meeting, August 31, 2005

We cannot support a program that does not achieve actual emissions reductions from today's levels until 2017 or 2018, especially in light of the fact that tens of millions of tons of allowances are likely to be banked in early periods. **The initial regional cap level should be based on the most recent data with a preferred cap of approximately 143,500,000 tons .**

Apportioning the initial cap among states by using a mix of metrics that recognizes both consumers and generators makes sense.

Allowance Allocation

A minimum consumer allocation below 50% can not be reasonably justified. Because consumers will pay most of the cost of this program, the value that allowances represent should be used to reduce the cost of the program for consumers.

The definitions associated with minimum allowances to be used for public benefit should be changed to make it clear that these allowances will only be used for the benefit of consumers. **The term *public benefit* should be changed to a *consumer allocation* and the rule should make clear that these allowances will be used for programs and activities that reduce the cost of the program for the state's consumers, with a focus on end-use energy efficiency and consumer rebates.**

We support using a portion of the allowances to address the generation side of the equation, but any allowances (or preferably proceeds from the sale of allowances) should be used as incentives to promote clean energy investments such as repowering or combined heat and power installations, or to offset costs such as must run payments. There is no legitimate public policy reason to give allowances or any other

public resources to a private company without getting some public benefit in return. Giving allowances to generators for free in the hope that they will use them for such investments is simply not sound public policy.

We do not support the Strategic Carbon Fund as a method to address leakage (see comments below regarding leakage). We have not been provided with details regarding the investments the Fund would make, but even assuming that those investments will provide some environmental benefit, they will not reduce the cost of the program in the way a consumer allocation can.

Potential Emissions Leakage

The best way to avoid leakage is to minimize RGGI's impact on wholesale electricity prices by using the value of allowances to reduce consumption and adopting complementary energy policies that will allow states to meet all projected demand growth through energy efficiency.

Although the modeling likely over-estimates the potential leakage from new imports of power, and states could reduce leakage with increased efficiency investments, **we believe that states should develop a specific policy to prevent leakage in the event that those investments are not made. Such a targeted policy fix would treat imports as a source of emissions in equal measure to in-region power plants, and would require the purchaser of imported power to hold allowances equal to the emissions associated with those power imports.** This policy may not have to be implemented in all states and can be developed over the next months or years, but at a minimum states within or adjacent to PJM should commit to adopting this kind of policy. Preferably all states would commit to implementing such a policy. This is critical to the environmental and economic integrity of the program.

As we understand it, the Strategic Carbon Fund is designed not to prevent leakage, but to compensate the environment under the assumption that some leakage will occur. Although we do not have details regarding the design of the Fund, it does not appear to require the delivery of a specified number of emission reductions and therefore will not achieve this goal. We can support using some of the value that the allowances represent to fund additional emissions reductions or demonstration projects for new clean energy or carbon reducing technologies, but such efforts are distinct from, and must be in addition to, a specific policy to prevent leakage and the allocation of allowances to protect consumers.

Offsets

A prerequisite to an offsets program is a credible cap level that reflects actual emissions. With a meaningful cap, a well structured but limited offset program could be an important part of the rule. The offsets proposal should be amended to ensure that most emissions reductions occur in the electric sector, which is the goal of this policy. In all previous conversations, offsets were included as a percentage of actual reductions and never as a percentage of business as usual reductions, which is an

imaginary number at best. Under the current proposal, all emission reductions could come from offsets and none from the electric sector if, for example, electric demand does not grow at the projected rate because states increase energy efficiency. We understand the benefits of some flexibility mechanisms, but they must supplement, not supplant, the cap on electric sector emissions. **To achieve this, the percentage of offsets allowed should be based on a maximum percentage in relation to actual emission reductions *not* in relation to reductions from business as usual emissions as the current proposal describes. In addition, the percentage should be reduced to 25% of the emissions reduction instead of 50%.**

States should apply the numerical limitation to individual regulated facilities in order to ensure the use of least cost offsets. If states apply the limitation to the sector as a whole or to the offsets themselves (e.g., approving only a set number of offsets each year), they will approve the offsets developed first and exclude from the market later developed but possibly cheaper offsets. They will reward investors (and purchasers) who act quickly, rather than those who develop the least cost offsets. And they will needlessly develop a market-stalling regional queue, either for facilities that want to use offsets or developers that want to sell them. If states apply the numerical limitation to regulated facilities, there will be no limit to the number of offsets the states can approve, and no obstacles to the trading of offsets among facilities, all of whom will have an equal interest in seeking least cost investments. This will promote the most robust offsets market.

We strongly support the proposed performance standard approach for approving offsets, whereby states will develop specific protocols for specific offset types. Such protocols should be sufficiently detailed that they will not leave room for discretionary decision-making and therefore can support third-party verification by qualified engineers, or other professionals approved by state DEPs. Each RGGI state must approve a specific protocol before an offset type can qualify for use in any RGGI states. This approach will provide much needed certainty to offset investors. Provided that states develop protocols through a public process, with input from environmental groups, industry, and outside experts, this approach will ensure that protocols are practical and commercially feasible to implement and likely to deliver investments that are above and beyond industry standard practice and that do not result in collateral environmental harms.

Finally, the rules and requirements for offset accreditation have not been shared with us, and the details of an offsets proposal will be directly impacted by the quality of those rules. The protocols must ensure that offsets deliver emission reductions that are above and beyond industry standard practice. For example, if state RPSs are likely to drive investment in landfill methane projects of a certain size or type, allowing such projects to qualify as RGGI offsets would not deliver emission reductions beyond what the RPSs would provide.

Complementary Energy Policies

Earlier discussions included a proposal that each state would commit to adopt policies and programs needed to meet projected load growth through energy efficiency and renewable energy. Most participating states have conducted independent analyses that indicate that it is both technically and practically feasible to meet all future demand growth with energy efficiency that is cheaper than electric generation. Even though several northeastern states have energy efficiency programs and policies that are among the best in the nation, no state is anywhere near capturing all cost-effective energy efficiency. All modeling conducted to date makes clear that states will dramatically reduce the cost of the program if they adopt policies and programs that will meet projected demand growth through energy efficiency. While we support continued investment in renewables, those resources are already included in the base case assumptions regarding RPS compliance and this type of commitment would not increase support for them. States should reinstate their commitment to meet all projected demand growth through energy efficiency in the RGGI MOU.

Other Comments

New Sources & Early Action Credits: The discussion of new sources and early action credits should be moved to the section on allocation, as this is an issue associated with allocation of allowances to generators from within the agreed to state caps (more detail and clarification would be helpful).

Compliance Period: A three year compliance period is too long and will create significant uncertainty in the marketplace regarding the value of allowances. In addition, a three year period does not match well with the cap level periods described. The compliance period should be changed to a 1 or 2 year period.

Voluntary Market for Renewable Energy: Under the allocation section, the proposal should make clear that states will retire allowances equal to emissions avoided on account of the voluntary purchase of renewable energy, or adopt a comparable mechanism to ensure the continued integrity of the market for green power in accordance with the recommendations submitted by the Center for Resource Solutions.

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