



MEMO

To: RGGI Environmental & Energy Commissioners, Air Bureau Chiefs,
and State Working Group
From: Derek Murrow, Environment Northeast
Date: February 14, 2006
Re: Design Recommendations Related to the RGGI Model Rule

Since the completion of the Regional Greenhouse Gas Initiative (RGGI), Memorandum of Agreement (MOU), Environment Northeast has been reviewing the document and considering some of the critical decisions that need to be made as the MOU is translated into a model rule for adoption in each state. Getting the MOU finalized and endorsed by the Governor was a great achievement and we congratulate you and your staff for your leadership and hard work. This document attempts to identify issues in the MOU that could be clarified in the model rule and also some ideas about specific design elements that need to be further developed in the model rule.

We will follow up with the state's RGGI team on these ideas and will also look forward to participating in any public forums and opportunities for public comment once the draft model rule is released for review and comment. We are also happy to continue to serve as a stakeholder in processes related to offsets, leakage, or other issues.

Early Reduction Credits

The MOU explicitly establishes the cap levels that each state has agreed to. The MOU also indicates that states may develop early reduction credits that give companies an incentive to reduce emissions prior to the start of the program. The language in the MOU on early reduction credits, however, is not clear on where these credits come from. Recently, some state staff have suggested that these allowances could inflate the cap. Such a result would conflict with the clear intent of the MOU to establish firm state by state emission ceilings and would undermine the MOU's credibility and effectiveness. **Under the terms of the MOU, any allowances issued above the cap levels agreed to by the states would require an amendment to the MOU and a new agreement on each state's cap level.** The states should make it clear in the model rule that early reduction credit can be awarded to a generator through the allowance allocation method used by each state. Depending on the allowance allocation method used for generators

(assuming any are given away for free) the base year and metrics can accommodate early reduction credit. Output based allocations inherently reward emissions improvements and other metrics could reward early action if the base year for allocation used a 2004 to 2006 average.

Specific Recommendations:

- *The early reduction credits should in no way inflate the cap levels the states have explicitly agreed to or an amendment to the MOU would be required.*
- *Early action can be rewarded through the allocation method a state may use for generator allocation.*

Cap Level & Emissions Reporting

As the RGGI start date approaches in 2009, it will be extremely important for regulated entities and the market to understand current emissions trends in relation to the total carbon cap in the region. The total emissions in relation to the cap level determine the degree of allowance scarcity, which will be critical to understanding what kinds of investment decisions need to be made and what the value of allowances will be. In order to maximize transparency and decrease uncertainty, the states should require reporting of emissions from regulated units in the manner required for compliance as soon as possible. Emissions should be reported to the states using the centralized emissions registry being developed by NESCAUM for the region, which is based on EPA's EATS tool. This data should be publicly available and easy to access. A reporting fee could be required to recover the cost of developing and maintaining the registry. Prior to implementation of mandatory reporting, the state agencies should continue to update their inventories of estimated emissions based on existing data sources and make these data publicly available.

The RGGI program is explicitly intended to expand to other sources and gases over time. In order to prepare for and assess the viability of this expansion, a high quality inventory of these emissions sources is required. The states should therefore also require mandatory reporting of greenhouse gas emissions from other large stationary sources and the reporting of all greenhouse gas emissions (not just CO₂) from sources within the RGGI program. If states add this mandatory reporting requirement to their current emissions statements, they will be able to upload this data into the Regional Greenhouse Gas Registry (RGGR) through an .xml transfer (this function has already been built into RGGR to accommodate mandatory reporting needs for the State of Connecticut).

If there is a change in the final list of regulated sources in the individual states due to exemptions of facilities that sell only a small portion of their energy into the grid, the states should voluntarily reduce their caps or retire allowances equal to that facility's average emissions. The cap levels were set with a specific population of plants in mind and if that population is reduced, the cap should also be reduced accordingly.

Finally, the goal of RGGI is to expand over time and become part of a national or international carbon trading scheme. There are other carbon trading programs in existence and RGGI should strive to be compatible with them. The international standard unit, or currency, for carbon is one *metric* ton of carbon dioxide or one *metric* ton of carbon dioxide equivalent for other gases. RGGI should adopt this standard and convert cap levels and reported emissions to metric tons and issue allowance and offsets in metric tons.

Specific Recommendations:

- *Mandatory reporting of greenhouse gas emissions from units regulated by RGGI should be initiated immediately upon completion of the rule making in each state; states should publish best estimates of emissions by unit or plant prior to this official reporting.*
- *Mandatory reporting of greenhouse gas emissions from other large stationary sources in the states should be required in the near future; a reporting threshold should be developed related to total emissions that is easily estimated from fuel use data.*
- *The Regional Greenhouse Gas Registry (RGGR) being developed by NESCAUM should be funded and developed by the states in anticipation of these reporting requirements; a reporting fee should be set that over time recovers program development and maintenance costs.*
- *State cap levels should be reduced if any facilities originally on the list of regulated units are exempted in a state's final rule making process.*
- *State cap levels should be converted into metric tons, all reporting of emissions should be in metric tons of the pollutant and in metric tons of carbon dioxide equivalents (registry can make these conversions), and allowances and offsets should be issued in metric tons of carbon dioxide equivalents.*

Safety Valve and Offsets Expansion

The mechanism developed to control the costs of the program is slightly confusing. The model rule should work to clarify how the mechanism and timing would work.

We suggest that the 2X offset requirement for states outside the RGGI region presents numerous complications to the development of a viable model rule. Because of environmental and economic co-benefits; the fact that offsets are a new commodity created by the RGGI states; and, most particularly, that verification and enforcement can not be done in other states, there is ample justification to limit offsets to the RGGI region and to other regions that have a compatible carbon trading system and offsets program. The 2X requirement should be removed and the geographic scope limited to the RGGI region and other regions with a compatible system in place. An expansion of the offsets geography could be considered in 2012 during the program review, once protocols have been fully developed, reviewed, and tested. Keeping the geographic region limited will have the added benefit of not creating rapid changes in the

scope and size of the RGGI offsets region which could distort and confuse the development of a strong offsets market.

The inclusion of price based triggers that change the regulatory requirements and dynamics of the offsets market mean that regulators will need to ensure that market indices and market monitoring procedures are in place to facilitate a review of market prices. We believe that a minimum of three market indices should be used by the states to track allowance prices and determine if the average price in a given period has exceeded any of the triggers. Multiple indices should be used for redundancy and to ensure that the maximum number of transactions is being tracked. We encourage the states to build off of work such as the Federal Energy Regulatory Commission, Commodity Futures Trading Commission and the National Association of Regulatory Utility Commissioners which have been working together to develop index standards for natural gas and electricity markets.

Specific Recommendations:

- *In order to clarify the mechanism, the model rule should include diagrams and timelines that illustrate how the offsets requirements and compliance period change in relation to worst-case price scenarios.*
- *Remove the 2X requirement on offsets from outside the RGGI region and limit the geographic extent to the RGGI states and regions that have a compatible carbon trading system and offsets program.*
- *Develop requirements for the market indices the states will use to track allowance prices; and develop a protocol detailing how many indices will be used and in what way to determine when a trigger has been exceeded.*

Protocols & Approval Process for Offsets

In talking with the public and other RGGI stakeholders there still appears to be some confusion about the definition of an offset. It would be helpful to make it clear that offsets are *off-system emissions reduction projects*. Given that the RGGI program regulates grid connected electric power system, no grid-connected electricity projects will qualify. This means electric energy efficiency, renewable energy generation, nuclear uprates, improvements in plant efficiency, or other projects that reduce demand or increase clean electricity output fall under the capped grid-connected system and do not qualify as an offset.

Developing a clear process and specific criteria for offsets will be critical to having a robust offsets market. Developing criteria for offsets is not a simple process and the states should not rush to complete this task without seeking expert advice and input from stakeholders. **We believe the states should define basic criteria for offsets within the model rule, indicating exactly what is meant by the minimum requirements of *real surplus, verifiable, permanent, and enforceable* but avoid detailing each offset type and baseline information within the model rule.** The initial list of offset types should be described

in the model rule, as well as the process for developing technical guidance documents for each offset type. The technical guidance documents should set standard protocols and baseline assumptions for each offset type, and address how the minimum requirements of real surplus, verifiable, permanent, and enforceable will be measured for that project type. They should also ensure that offset projects do not lead to additional damage to the environment or human health. These rules should be developed cooperatively among the states with input from technical experts and general RGGI stakeholders.

The process by which an offset gets approved and tracked should also be defined. Technical guidance protocols should be developed for each offset type that set specific standards and allow for certainty and simplified review of projects. Projects should be third-party certified by a list of accredited entities, which will ensure that the project has followed the technical guidance protocol and that the emissions reductions have occurred. At least initially, offset allowances should be issued by the state for emissions reductions that have already occurred. Subsequent reductions in emissions would require additional monitoring, certified, and state approval. A project developer should submit the third party certified project materials to the state for approval. Upon approval the state should add project information and approved offset allowances to the allowance tracking system or registry under the project developer's name. Subsequent certified submissions illustrating additional reductions in emissions would be issued additional offset allowances. Once offset allowances have been entered into the allowance tracking system or registry they should be tradable and bankable among any entity.

Specific Recommendations:

- *Define offsets as off-system emissions reduction projects with the system currently being grid connected electric power.*
- *Define the minimum requirements of real surplus, verifiable, permanent, and enforceable.*
- *Avoid using the model rule to detail specific offset protocols; develop a stakeholder process and hire technical support to develop offset technical guidance protocols for each offset type.*
- *Spell out the process by which an offset project is reviewed, approved, and offset allowances are issued; the following is our recommendation:*
 - *Projects should be required to follow a technical guidance protocol for that offset type*
 - *Projects should be third party certified by state accredited entities*
 - *Projects should submit project specifics and emission reductions to-date, after certification, to the state for approval*
 - *Approved projects should have offset allowances issued to the project developer, which should be tracked in the allowance tracking or registry system*

Allowance Allocation

The Consumer Allocation represents a unique opportunity to reduce the cost of the RGGI program on electric ratepayers. The model rule should develop minimum standards for the way this allocation of allowances and the value they represent are invested in each state. These allowances should explicitly be

used to: reduce the long-term costs of the RGGI program on the state's electricity ratepayers; provide additional benefits – not replace other programs or investments; and support programs and activities that do not pose a risk to human health and the environment.

The 75% of allowances left to state discretion should remain that way with three additional recommendations. The model rule should explicitly recommend how to address the market for voluntary renewables. Second, the need to sell some allowances or collect fees to cover state program administration should be addressed. And third, consistent with the polluter pays principle, generators should receive only a small and declining portion of the allowances to assist with the transition into this new program.

The voluntary renewables market (not renewables used to satisfy the RPS requirements in each state) relies on the ability to claim a reduction in carbon emissions from the purchase of their energy sources. This market allows individuals and companies to procure zero emitting power and reduce their carbon footprint. By retiring a set number of allowances per unit of power sold by voluntary renewables marketers in their state, the state will enable customers to continue to claim a reduction in emissions.

Specific Recommendations:

- *The Consumer Allocation should be required to go towards programs and activities that: reduce the long-term costs of the RGGI program on the state's electricity ratepayers; provide additional benefits – not replace other programs or investments; and support programs and activities that do not pose a risk to human health and the environment*
- *The State should commit to retiring allowances on a yearly basis in relation to the sale of voluntary renewables (non-RPS) in their state; renewable marketers should be required to report sales (MWh) on an annual basis and the state to retiring allowances at a set rate (say 1,200 lbs/MWh or 0.6 tons per MWh); the amount retired would be adjusted each year to reflect actual voluntary renewable sales*
- *Program administration costs should also be recovered from permit fees or from the limited sale of a set percentage of allowances (say 5%) from the 75% pool.*
- *Consistent with the polluter pays principle, generators should receive only a small and declining portion of the allowances to assist with the transition into this new program.*

Leakage Policy Development

The goal of the leakage Working Group should be to develop a viable policy proposal(s) to address leakage that is technically and legal defensible. This would go beyond considering options to recommending specific implementation details for a policy or multiple policy proposals. This issue is complicated from both a technical and legal perspective and the states should commit resources to hire experts as needed. The working group process should be an open one and a group of stakeholders be assembled to advise and assist in the development of the policy proposal(s).

Specific Recommendations:

- *The leakage working group should be to develop a viable policy proposal(s) to address leakage that is technically and legal defensible, going beyond just a list of options.*
- *Resources should be committed to hire technical and legal experts; a group of stakeholders should be invited to participate in the process.*

Contact Information: Derek Murrow, Director of Policy Analysis
Environment Northeast
101 Whitney Avenue
New Haven, CT 06510
Phone: (203) 495-8224
Email: dmurrow@env-ne.org