EDISON ELECTRIC INSTITUTE

February 10, 2012

Nicole Singh
Acting Executive Director
Regional Greenhouse Gas Initiative, Inc.
90 Church Street
4th Floor
New York, NY 10007

Re: info@rggi.org

Dear Ms. Singh:

Enclosed are comments by the Edison Electric Institute (EEI) regarding the 2012 comprehensive program review required by the RGGI Memorandum of Understanding (MOU). These comments address a series of questions on offsets and cost containment allowance reserve issues raised in the notice for the January 24, 2012, RGGI Learning Session, which asked for stakeholder input on those issues. EEI is participating in the RGGI process as an interested observer, and requests that our comments are posted on the RGGI web site.

EEI is the association of U.S. shareholder-owned electric companies, international affiliates and industry associates worldwide. EEI represents approximately 70 percent of the U.S. electric power industry.

We appreciate the opportunity to comment on issues raised in the RGGI review process to date, and plan to comment further as the review moves forward. If you have any questions about our comments or would like to discuss them further, please contact Eric Holdsworth (202-508-5103, eholdsworth@eei.org) or me (202-508-5617, bfang@eei.org).

Sincerely,

William L. Fang

William L. Fang
Deputy General Counsel and
Climate Issue Director

Enclosure

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Edison Electric Institute Comments on Offsets and Flexibility Mechanisms – Regional Greenhouse Gas Initiative 2012 Program Review

February 10, 2012

As part of the 2012 Regional Greenhouse Gas Initiative's (RGGI) Comprehensive Review by the Signatory States, RGGI recently posted a series of questions on offsets and cost containment allowance reserve issues as part of the notice for a January 24, 2012, Learning Session, and asked for stakeholder input on those issues. The notice explains that "no offset allowances have been awarded in the RGGI region" to date and suggests that "potential reasons" may include the lack of supply of offsets in the region (which presumably is attributed to the lack of offsets projects in the region), the low price of allowances, and the requirements for approval of offsets projects. Stakeholder input is sought as to why offsets are not currently in use in the region. The notice also indicates that the states are considering how to make more offsets available in the region while maintaining environmental integrity, and seek stakeholder input on the opportunities and challenges of expanding the supply of offsets, including the broadening of limits on the geographic location and category types. This raises the possibility that states may seek changes to the RGGI Memorandum of Understanding (MOU) and Model Rule XX-10 regarding offsets in the future.

The Edison Electric Institute (EEI) welcomes the opportunity to provide comments evaluating the role of, and what changes are needed to foster the full utilization of, offsets, cost-containment allowance reserve pools and other potential flexible mechanisms. In fact, the RGGI MOU calls for such an evaluation by the states, particularly in the case of offsets, and for recommended changes to the CO_2 Budget Trading Program where warranted. Our comments are intended to be responsive to the notice's inquiry about the RGGI offsets program and possible use of other flexibility mechanisms.

EEI is the association of U.S. shareholder-owned electric companies, international affiliates and industry associates worldwide. EEI members serve 95 percent of the ultimate customers in the shareholder-owned segment of the industry, and represent approximately 70 percent of the U.S. electric power industry. EEI member companies have a strong interest in the RGGI Program Review since they are covered sources under the RGGI program.

I. General Comments

It is reasonable to assume that economic conditions will improve and that the RGGI states will experience economic growth, which will increase emissions and therefore demand for allowances during the current and future compliance periods. This likely increase in demand for allowances, combined with the likely decreased supply as the RGGI program evolves, will mean that the RGGI region will need the utilization of offsets and possibly other flexible mechanisms, making RGGI's consideration of expanding the use of offsets and incorporating other flexibility mechanisms very timely.

Offsets offer the potential not only to increase compliance flexibility and cost-effectiveness for generators, but also for measurable environmental benefits to the RGGI states, electric utilities and their electricity consumers. As a result, according to RGGI

Fact Sheets and other publications, "RGGI Offsets" are viewed by the Signatory States as an important component of each state's program. Accordingly, the RGGI MOU and the Model Rule – on which state CO_2 Budget Tracking Programs are based – have established requirements for the utilization of the offsets mechanisms. In addition, in May 2010 the region published an 81-page Offset Handbook to explain RGGI's Model Rule.[1]

As RGGI moves forward with its program review, we strongly encourage RGGI to retain and expand the current offsets provisions to ensure that there is an adequate supply of offsets and to help covered sources meet the RGGI emissions caps in the most cost-effective fashion. Expansion of the offsets provisions should include broadening both the approved project types and the geographic location of offsets project activities, and eliminating the current restrictions on the use of allowances. EEI also encourages RGGI to incorporate additional flexibility mechanisms into the program, including cost containment. In particular, the use of a safety valve or price collar can help ensure price stability and facilitate compliance planning. As RGGI considers the possible strengthening of the program, it will be more important than ever that RGGI utilize a wide range of flexible mechanisms, such as the expanded use of offsets and cost-containment mechanisms, in addition to its emissions trading program. These mechanisms can help ensure that the RGGI emissions caps are met in a responsible way that does not unduly affect electricity rates.

[1] The handbook contains a caveat that it is for "informational purposes only" and "does not constitute formal guidance or an official integration of any individual RGGI participating state regarding its CO_2 Budget Tracking Program."

II. Specific Comments On Offsets

A. The Geographic Location of Offsets Projects Should Be Broadened

Because GHGs are well-mixed in the atmosphere, are carried long distances and are a global phenomenon, it makes no difference to the atmosphere where a U.S. electric utility reduces, avoids or sequesters GHGs – whether inside its plant's boundaries, inside its service area, inside a state, inside the RGGI region, inside the U.S. or even outside the U.S., the impact is the same.

While the amended MOU specifies that allowances may be awarded for projects anywhere in the U.S., it requires that at least one of two conditions be met for projects located outside the region: 1) that there be a cap-and-trade program "in place" with a specific tonnage limit; and/or 2) that there be an executed MOU with a RGGI state under which the non-RGGI state or other jurisdiction agrees to aim at ensuring the credibility of the offsets allowances from the state. Because the words "and/or" connect the two conditions, this creates uncertainty for offsets project developers and covered sources whether a RGGI state may require these other jurisdictions to meet one or both conditions, delaying offsets project development.

Furthermore, imposing one or both of these requirements before offsets projects are even initiated may be viewed by non-RGGI governmental jurisdictions as either too burdensome or overkill, particularly given the fact that there is only one non-RGGI state, California, with a cap-and-trade program. It is worth noting that the RGGI Offset Handbook states that as of May 2010, the RGGI participating states had not been approached by any other jurisdiction interested in executing an offsets MOU and that there were no active efforts to negotiate such an MOU with any other jurisdiction (p. 22).[2]

As a result of these requirements, offsets projects are effectively limited to solely within the RGGI region. In order to enhance the supply and use of offsets, RGGI should encourage offsets projects outside the region – particularly if the caps are tightened or the pool of available allowances is reduced. Signatory States should also examine the current requirements to see whether they are practical or even necessary. RGGI and the Signatory States may also want to consider allowing the use of certified emission reductions from the clean development mechanism under the Kyoto Protocol. This would be another means of expanding the geographic location of offsets projects under RGGI, and making more offsets available.

B. Project Category Types Should Be Expanded

The amended MOU lists only five categories of offsets projects "that may be eligible" for allowances. They are:

1) Landfill methane (CH_4) capture and destruction (Mode Rule XX-10.5(a)).

2) Reduction in emissions of sulfur hexafluoride (SF_6) from equipment in the electricity transmission and distribution sector (Model Rule XX-10.5(b)).

3) Sequestration of carbon due to conversion of land from non-forested to forested (Model Rule XX-10.5(c)).

[2] In addition, in May 2010 a working group composed of the Midwestern Greenhouse Gas Reduction Accord, the Western Climate Initiative and RGGI designed criteria for a white paper, without stakeholder input, for what was described as a high-quality offsets program. However, these other non-RGGI GHG regional programs have not yet been fully established, nor have these regions established GHG emissions trading or offsets programs.

4) Reduction or avoidance of CO_2 emissions by reducing combustion of natural gas, oil or propane in an existing or new commercial or residential building due to end-use energy efficiency (Model Rule XX-10.5(d)).

5) Avoided methane emissions from agricultural manure management and organic food waste through use of an anaerobic digester and capture and destruction of methane (Model Rule XX-10.5(e)).

All were established by the amended MOU and the Model Rule in 2006 and restated in the Offset Handbook in 2010. While the MOU provides that the Signatory States agree "to continue to cooperate on the development of additional offset categories and types, including other types of forestry projects and grassland revegetation projects," such development – if it has occurred – apparently has not resulted in any expansion of the list in six years. The Learning Session notice suggested that adding such category types is one way to make more offsets available. Indeed, increasing the number of categories and types of projects allowed will benefit both the region and its electricity consumers. The Signatory States are certainly capable of managing the offsets program effectively and ensuring environmental integrity regardless of the number of eligible projects or their location.

C. <u>Percentage Limitations on Offsets Allowances Should Be Abandoned</u>

Not only does the amended MOU restrict the types and locations of offsets projects, it also prescribes a 3.3-percent limit on how many offsets allowances a covered source (i.e., any plant, facility, etc. that emits or has the potential to emit any air pollutant) may utilize for any 12-month timeframe within each compliance period (Model Rule XX-6.5). This percentage can only be increased if the allowance price averages at or above $7 or $10 (in 2005 dollars), which, based on current pricing experience, does not appear likely. Even when or if the price threshold is triggered for a compliance period, it is set back to the earlier percentage for the next period.

These added restrictions not only introduce unnecessary complexity into the RGGI offsets program, more importantly they preclude, when combined with the rigorous application process, the use of more cost-effective compliance options that could save electricity consumers millions of dollars annually. For example, covered entities and project developers are likely to assume that use will be limited to 3.3 percent, and therefore only plan or develop projects up to that level, if at all. In some cases, covered entities have chosen not to apply for allowance offsets for voluntary, large-scale emissions reductions because the rigorous application and verification process makes the transaction costs of registering the small number of offsets that could be used under the current RGGI offsets usage limits more expensive than the potential value of the offsets. If the RGGI ceiling on offsets usage were removed or raised significantly, the transaction costs of registering such offsets could be spread over a greater number of offsets, giving entities a compelling reason to move forward with the application process, which in turn, would mitigate the costs of the RGGI program for electricity customers.

In short, maintaining this percentage limitation would be an unnecessary drag on the usefulness of the offsets mechanism, particularly if the Signatory States opt to tighten the 2015-2018 caps and as the economy improves. These restrictions clearly need significant revision, such as either eliminating or at least adjusting upward the percentage limit and making it fixed. In short, RGGI should either reform the current structure of these usage limits or eliminate them all together.

Finally, as noted earlier in these comments, in 2010 RGGI helped develop a white paper that purported to describe offset quality criteria, including criteria for determining additionality, all of which appear to go beyond the current RGGI additionality requirements set forth in the MOU and model rule. We would strongly urge RGGI not to adopt such apparently new requirements for the RGGI offset program, as they could adversely impact the development of offsets.

III. Comments on Cost-containment Mechanisms

The Learning Session notice explained that the RGGI states, in addition to evaluating the amended MOU offsets previsions, are looking at other flexibility mechanisms, such as an allowance reserve. The notice asks questions regarding the benefits and workability of such a reserve, including how such a reserve and an offsets program might work together.

While the most direct and efficient means of containing the costs of a cap-and-trade program is to impose an upper limit on the price of an emissions allowance, (i.e., establish a safety-valve price), there may be concerns that a simple safety valve may not adequately incentivize investment in zero- and low-emissions GHG climate technologies. An alternative approach is to establish an allowance price pathway, with a ceiling and floor price. This concept, known as a price collar, can help to establish a predictable price pathway, limit allowance price volatility, and thus manage the overall cost of the program, including to energy consumers. RGGI already incorporates the floor of the price collar, which is known as the “reserve price” in the allowance auctions. The addition of a ceiling price to trigger use of an “allowance reserve” could be incorporated into the RGGI system, along with the modified offsets program described above.

As mentioned above, the ceiling of the price collar would function by creating a trigger price to address high allowance prices, which would provide access to an “allowance reserve,” which would increase quantities of allowances in the market in the near term, placing downward pressure on allowance prices. The price “band” between the floor and ceiling prices could be narrow in the early years to provide more predictability and limit volatility, with both the price differential and overall price levels increasing over time.

IV. Conclusion

Offsets offer an important flexible tool for compliance in a cap-and-trade system for electric utilities by allowing covered entities to comply in a cost-effective manner that minimizes impacts on customers. Unfortunately, that tool has not yet been available within RGGI, in part because of the limitations imposed on offsets discussed above. The MOU-required review offers a clear opportunity for RGGI to correct this problem, and develop a user-friendly and effective offsets program with environmental integrity.

In addition, RGGI should consider other flexibility mechanisms during its program review, including an allowance reserve, coupled with an upper ceiling price collar.