Con Edison and O&R Comments on Items Raised in the October 18, 2012 RGGI Webinar

October 26, 2012

Consolidated Edison Company of New York, Inc. and Orange and Rockland Utilities, Inc. (together, "the Companies"), respectfully submit the following comments in response to issues raised in the October 18, 2012 webinar hosted by RGGI, Inc. as part of the 2012 Program Review of the Regional Greenhouse Gas Initiative (RGGI).

Introduction

The Companies have supported RGGI since its inception. We value the opportunity to participate in the Program Review to ensure that the interests of our customers are fully represented. As the 2012 Program Review nears its final stages, the Companies urge the States participating in RGGI ("the RGGI States") to select program and market design options that afford meaningful protection for our customers against unmitigated increases in energy supply costs due to carbon dioxide (CO2) emissions allowance prices. Equally important, we are supportive of program changes that foster a transparent and predictable market for CO2 allowances that is not subject to routine adjustment, revision, or uncertainty regarding the supply of allowances.

In the comments that follow, we offer our perspective on the specific design concepts addressed at the October 18, 2012 stakeholder webinar and make recommendations regarding proposed changes to the RGGI Model Rule. The Companies believe the recommendations laid out below would modify RGGI in a way that both preserves the integrity of the RGGI market and limits the impact of cost increases borne by utility sector customers.

Treatment of Unsold Allowances

On October 18th the RGGI States indicated that they are considering placing parameters around treatment of unsold allowances held by state agencies. Specifically, the RGGI States are considering three options regarding when decisions about allowance retirements are made and communicated to the market: in advance of program changes (e.g., one year prior to implementation); at specified intervals (e.g., at the beginning of each year); or on an ad-hoc basis. In the interest of transparent and predictable markets, the Companies support a one-time decision from the RGGI States about how they will manage their unsold allowances. The Companies support making this announcement to market participants sufficiently in advance of the first auction subject to the RGGI program changes so that participants can appropriately factor the new treatment of unsold allowances into their auction bidding strategies. Making a single announcement will prevent a situation where the States retire allowances on an inconsistent basis and arbitrarily drive the RGGI market toward additional allowance scarcity. Such non-market decision-making would introduce price volatility into the market that would result in unnecessarily higher bills for our customers. Instead, the States should describe, as part of the revised Model Rule, how they will treat unsold allowances and allow the market to function based on that information.

Consideration of Banked Allowances and Potential Cap Changes

The RGGI States are considering if the bank of allowances held by market participants should be factored into potential changes to the regional CO2 emissions cap. The Companies support the RGGI States' proposal not to take actions, such as an allowance exchange, that would reduce the utility of allowances that have already been purchased. It is critical that RGGI support the rules that were set forth for the initial auctions and make changes only prospectively, including maintaining its original banking policy; doing otherwise would undermine the integrity and long-term development of the RGGI market. As the RGGI States weigh their options regarding the relationship between the existing bank and possible cap reductions, the Companies would reiterate the importance of making the RGGI market both transparent and predictable.

Cost Containment Reserve

The Companies have previously expressed support for the concept of a cost containment reserve (CCR), and incorporate those earlier comments here.[1] Creation of a CCR and a reserve trigger price that releases reserve allowances into an auction is one of the most important aspects of this Program Review. The Companies support the RGGI States' proposal to create CCR and populate it with a fixed quantity of allowances "in addition to the cap," with annual replenishment as needed.[2]

Regarding the design of the CCR, the Companies suggest that in addition to their price collar proposals that will trigger the release of additional allowances to the market if prices rise to specific levels, described at the March 2012 stakeholder meeting, the RGGI States should also consider, as an alternative to a 'fixed-price trigger,' the merits of a dynamic reserve trigger price that would be indexed or otherwise linked to a relevant, real-world energy-related price. One factor that is important to customers but not readily apparent in the modeling process undertaken by the RGGI States as part of this program review is the proportion of total energy supply costs that RGGI compliance represents on

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[1] *Con Edison and O&R Comments in Response to RGGI, Inc.'s May 2012 Request for Stakeholder Comments on Program Review*, May 31, 2012.
[2] Slide 8, *RGGI Program Review – Program Design Concepts*, presented October 18, 2012.

customer bills. By way of example, if allowance prices were to rise to $10/ton of CO_2, it would have a substantial impact on customers regardless of power prices at the time. However, a $10/ton allowance cost would affect customer bills more with low electricity prices as compared with higher electricity prices. The Companies respectfully request that the States take this proportionality into consideration when discussing CCR price triggers, and examine ways to make the reserve price sensitive to the energy prices that drive customer supply costs.

Flexibility Mechanism Triggers

During the Program Review, the RGGI States have been clear that they are interested in maintaining or expanding compliance flexibility in the RGGI rules. In addition to creating a CCR that would contain price increases and introduce additional allowances into the market when necessary, the RGGI States also have the option of modifying the way that emissions offsets are used for compliance. The Companies agree with the RGGI States' proposal to eliminate the existing offset price triggers once a CCR is created and to allow use of offsets to meet compliance up to a specific percentage of the total allowances available. Allowing the use of offsets encourages market participants to undertake cost effective greenhouse gas (GHG) reductions. Eliminating triggers for offsets will reduce the risk of undesirable market behavior caused by an overlap in flexibility mechanisms if the RGGI States adopt a CCR, and will support the integrity of the allowance market. However, the RGGI States should consider increasing the current 3.3 percent offset limitation to make the compliance flexibility that offsets can provide more realistically attainable. We make this suggestion for two reasons. First, the 3.3 percent limit puts offsets at a serious economic disadvantage, because the process of obtaining and certifying emissions offsets is both stringent and time-consuming. The Companies are not recommending that the RGGI States change the process for certifying offsets, however. If the amount of offsets usable under the cap were expanded, it would reduce per-offset transaction costs and make them more realistically competitive as a means of compliance if allowance prices rose. Additionally, simply having the flexibility to use offsets for more than 3.3 percent of compliance is a valuable option that will reduce the perceived financial risk of covered entities.

Second, it is important to note that the generating fleet of the northeastern U.S. is already among the cleanest in the country leaving limited opportunities to use fuel-switching to reduce CO_2 emissions, and there is not yet a cost-effective means of controlling for carbon emissions in these efficient, high-performing plants. If the RGGI allowance market demonstrates that the cost of reducing carbon in generation facilities is prohibitively high given the current state of emissions control technology, or if allowance prices rise unexpectedly for other reasons, and if the overwhelming majority of fossil-fired generation in the RGGI States is already using low-carbon fuels like natural gas, it is logical that compliance entities should be able to seek out more cost-effective means of reducing GHG emissions. From a public policy perspective, this is an important point, because the goal of RGGI is reduce GHG emissions at the lowest possible cost. The RGGI States should therefore consider increasing the offset limitations to the more meaningful level of 8 percent, which would encourage GHG reductions by making offset actions more cost-competitive, provide additional flexibility to covered entities, and preserve the environmental integrity of the RGGI cap.

Reserve Price

As part of the original RGGI program design, the RGGI States retained the option to use a current market reserve price, which is set based on the clearing price of allowances in prior RGGI auctions, to establish the minimum floor price in future RGGI auctions. In the October 18th webinar the RGGI States raised the possibility of eliminating this option and simply using the existing minimum reserve price, adjusted each year based on the Consumer Price Index (CPI). The Companies previously stated their support for the RGGI States' proposal to remove provisions in regulations for a current market reserve price, where applicable.[3] We reiterate our support for such a decision here. Additionally, we find it reasonable to simplify the annual CPI adjustment to the auction reserve price to an annual increase of 2.5 percent, which conforms to recent experience with changes in CPI.

RGGI Proceeds

In addition to mitigating the impact of cost increases on customers via the market design options discussed above, the RGGI States should be open to establishing principles which will guide the investment of RGGI allowance auction proceeds. While the Companies understand that this is an issue that is decided at the state level, it is difficult to make judgments regarding changes to the RGGI CO2 cap or flexibility mechanisms if the use of RGGI auction proceeds is not accompanied by a clear rationale. At the inception of the RGGI program, the RGGI States assured stakeholders that auction proceeds would be reinvested in the states in ways that lowered the overall cost of compliance borne by electric customers. However, this reinvestment loop has not taken shape in all states, leaving electric customers with higher energy costs and no end-user benefits to help reduce emissions and lower the impact of RGGI on their bills. Indeed, many of New York State's investments have been made outside the electricity sector entirely, effectively diverting funding from electric customers and spending it, for example, on heating oil efficiency programs and cultivation of New York's clean tech sector. While both of those examples ostensibly contribute to emissions reductions, they do not provide direct benefits back to electric

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[3] *Con Edison and O&R Comments in Response to RGGI, Inc.'s May 2012 Request for Stakeholder Comments on Program Review*, May 31, 2012.

customers. The RGGI States could do more to mitigate RGGI-related customer costs if they consistently invested RGGI proceeds in end-use electric energy efficiency programs, or used RGGI proceeds to offset collections for other social benefit programs funded by surcharges on electric bills.

Conclusion

The Companies respectfully request that the RGGI States take the above comments into due consideration as they prepare revisions to the Model Rule. On behalf of our customers, who ultimately bear both the compliance costs of the RGGI program and the added cost of higher electricity clearing prices paid to all generators, the Companies encourage the States to carefully weigh the impacts that changes to RGGI may have for allowance prices. Making the changes described above would balance the benefits of carbon price signals with reasonable cost protection for our customers.