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Via E-Mail (rggicomm@gw.dec.state.ny.us)

Staff Working Group  
Regional Greenhouse Gas Initiative

Re: Comments on Draft RGGI Model Rule

Dear Working Group Members:

Thank you for the opportunity to submit these comments on the Regional Greenhouse Gas Initiative ("RGGI") draft Model Rule on behalf of ISO New England Inc. ("ISO-NE").

## **I. Background**

ISO-NE is an independent, not-for-profit corporation serving as the regional transmission organization ("RTO") for Connecticut, most of Maine, Massachusetts, New Hampshire, Rhode Island and Vermont. Further information about ISO-NE is available at [www.iso-ne.com](http://www.iso-ne.com).

The objectives of ISO-NE as the RTO for the New England Control Area are (through means including, but not limited to, planning, central dispatching, coordinated maintenance of electric supply and demand-side resources and transmission facilities, obtaining emergency power for Market Participants from other Control Areas, system restoration (where required), the development of market rules, the provision of an open access regional transmission tariff and the provision of a means for effective coordination with other control areas and utilities situated in the United States and Canada):

- (a) to assure the bulk power supply of the New England Control Area conforms to proper standards of reliability;
- (b) to create and sustain open, non-discriminatory, competitive, unbundled markets for energy, capacity, and ancillary services (including Operating Reserves) that are (i) economically efficient and balanced between buyers and sellers, and (ii) provide an opportunity for a participant to receive compensation through the market for a service it provides in a manner

consistent with proper standards of reliability and the long-term sustainability of competitive markets;

- (c) to provide market rules that (i) promote a market based on voluntary participation, (ii) allow market participants to manage the risks involved in offering and purchasing services, and (iii) compensate at fair value (considering both benefits and risks) any required service, subject to Federal Energy Regulatory Commission (“FERC”) jurisdiction and review;
- (d) to allow informed participation and encourage ongoing market improvements;
- (e) to provide transparency with respect to the operation of and the pricing in markets and purchase programs;
- (f) to provide access to competitive markets within the New England Control Area and to neighboring regions; and
- (g) to provide for an equitable allocation of costs, benefits and responsibilities among market participants.

As noted above, ISO-NE operates bidding markets for wholesale electricity. Pursuant to the rules on file with FERC for its administration of these markets, ISO-NE “dispatches” generating units (i.e., directs them to run) based on their bids, except where transmission constraints or other national or regional reliability considerations dictate otherwise.

ISO-NE supports the environmental objectives which the draft Model Rule is intended to achieve. ISO-NE offers the comments below to identify possible areas of Model Rule refinement that can account for electric reliability and market considerations.

## **II. Comments**

Compliance with the carbon dioxide (“CO<sub>2</sub>”) cap-and-trade emissions reduction program reflected in the draft Model Rule is very likely to produce increased expense for owners of fossil fuel-fired electric generators in participating RGGI states, four of which are part of ISO-NE’s RTO region. These generation owners can be expected to pass through these expenses in their bids, raising wholesale energy costs and causing some changes in the units that are dispatched moment-to-moment to meet market demand. ISO-NE urges the Staff Working Group as it finalizes the Model Rule to mitigate these impacts, and others described below, in the manner suggested herein.

More specifically, the RGGI system contemplated in the Model Rule would create a new kind of emission allowance. The costs of the allowances that must be purchased to authorize the actual number of CO<sub>2</sub> tons a fossil-fueled generating unit emits – or the costs incurred to reduce

the number of tons of CO<sub>2</sub> it would otherwise emit – represent an incremental operating (or capital) cost for generators, much as SO<sub>2</sub> and NO<sub>x</sub> allowance schemes already create. New England generators will naturally seek to recover these costs through bids in the ISO-NE markets, or through bilateral energy sales in the region. Because generating units are dispatched based on their bids, the higher bids from fossil-fueled generators could affect their dispatch and the price of resources clearing in the market. In providing a mechanism for meeting greenhouse gas (“GHG”) emission control objectives, the Model Rule should avoid impairing the ability of the bulk power system of ISO-NE (or of other nearby RTOs) to meet peak load demands, and to respond to system emergencies and disturbances. The ability of ISO-NE and other RTOs to reliably serve wholesale power requirements must be preserved to allow for concurrent adherence to national and regional reliability standards.

ISO-NE believes that its market and reliability responsibilities, as articulated above, can be compatible with the draft Model Rule’s goal of reducing GHG emissions in an economically efficient manner. Accordingly, the following comments represent suggestions for maintaining a healthy balance among this goal and ISO-NE’s objectives (approved by FERC) of maintaining system reliability and administering competitive, efficient power markets.

#### **A. Reliability Emergencies**

ISO-NE recommends that the Model Rule add provisions to recognize that special exceptions may be needed when the reliability of the bulk power system is at risk due to unanticipated, extreme *force majeure* types of reasons. Environmental laws already provide examples of narrowly-defined exceptions to compliance requirements, for example by providing for presidentially-invoked exemptions based on national security considerations.

Consistent with such an approach, the Model Rule could waive the compliance requirement to apply allowances to excess CO<sub>2</sub> emissions for the period of an emergency if certain reliability thresholds are exceeded. A special provision could be invoked if there are sufficient emergency-related reasons and no alternative compliance measures are available, including the unavailability of allowances in the marketplace. Alternatively, the Model Rule could provide some mechanism to make additional allowances available, perhaps through a reserve built up through a broadened use of offsets beyond those authorized under the normal regulatory scheme. The public interest in reliable electricity supply in situations of unusual stress is an appropriate justification for tightly controlled, temporary exceedances of, or exceptions to, the regional CO<sub>2</sub> cap.

#### **B. Allowance Market Liquidity**

ISO-NE believes that the CO<sub>2</sub> allowance market created by the Model Rule must be designed for sufficient liquidity from the outset. In this context, liquidity means ready access to allowances at reasonable costs, at least relative to the costs of alternative means of compliance. The market will be more liquid if allowances are available from as many sources as reasonably possible, if they can be transferred efficiently, and if their availability and pricing is relatively

predictable. The more liquid the market, the more it will be capable of facilitating targeted CO<sub>2</sub> emission reductions without jeopardizing electric reliability or unduly increasing costs.

To facilitate maximum market liquidity, the ISO recommends that:

- 1. The Model Rule should be designed and implemented to minimize to the extent feasible the uncertainties regarding how generators will acquire or be allocated their share of CO<sub>2</sub> allowances.**

Using an allowance tracking system based on the systems used for SO<sub>2</sub> and NO<sub>x</sub> allowances could be helpful in this regard, in that participants have experience with the applicable rules and procedures. Promulgation by the state regulatory authorities of implementing rules based on familiar prototypes, prompt distribution of allowances, and clear rulings on case-specific proposals, will promote confidence in the RGGI system and enhance liquidity.

- 2. The Model Rule should require basic consistency across participatory states on the allocation and management of allowances, and should avoid differences that would create uncertainties in the market.**

Consistent rules among the RGGI states for allowance allocation and use will support a broader allowance market that is fairer, easier to understand and use. Consistent rules will also facilitate planning and investment decisions to achieve a more efficient and reliable regional electric system. To the extent allowance trading rules differ, the CO<sub>2</sub> allowance market becomes less liquid because trades across states become more difficult, and allowance trading pools tend to become smaller and less efficient.

- 3. The Model Rule should require participating states to create allowance set-aside accounts or their equivalent to allow room for new fossil generators needed by the market to meet peak growth and general energy demands by making needed allowances available at reasonable prices.**

From 2006 through 2015 the energy use and summer peak load are projected to grow, respectively, at the compound rates of 1.3% and 1.9% per annum. This will necessitate the addition of systemwide capacity resources totaling 170MW by 2009, growing to 4300MW by 2015.

To the extent public demand for energy continues to grow as many predict, a balanced cap-and-trade system should provide some flexibility to meet that public need. For example, the Model Rule could provide further flexibility by identifying the development of new, more modern energy sources (both alternative energy sources and more markedly-efficient, strictly-controlled fossil fuel-fired sources) to meet increased public demand as one possible “consumer benefit or strategic energy purpose” eligible to be addressed by the 25 percent allowance set-

aside already proposed for use by participating state programs to use under proposed section XX-5.3. In any event, the Model Rule should be clear that these set-aside strategic allowances should be made available in the market, (so the funds from their sale could be used to promote identified strategic purposes), and not simply retired in the interest of serving some strategic energy purpose.

### **C. Offsets**

The ability to use CO<sub>2</sub> emissions offset projects as part of a generator's CO<sub>2</sub> compliance strategy is important because it makes sense from an air quality standpoint and because it enhances the liquidity and effectiveness of the CO<sub>2</sub> allowance trading market. The five criteria identified in connection with the Model Rule for determining the acceptability of offset projects (real, additional, permanent, enforceable and verifiable) provide a relatively clear conceptual framework to use in this context.

That being said, ISO-NE believes the Model Rule could provide even further flexibility in Section XX-10.3 by making clear that the categories of activities deemed acceptable as "eligible CO<sub>2</sub> emissions offset projects" are illustrative and not as imposing limitations. Any list of this type will be prone to miss potential forms of CO<sub>2</sub> elimination, reduction or sequestration projects which can succeed in offsetting the impacts from other CO<sub>2</sub> sources. Other kinds of projects can be readily identified which can meet the five criteria of the Model Rule for eligible offsets and which could be equally effective in offsetting the impact from other CO<sub>2</sub> emission sources as those types of offset projects which are specifically listed in the Model Rule.

One way the Model Rule could be revised to address this point is to authorize a procedure (ideally, coordinated across RGGI states) to approve the eligibility of individual offset projects or categories of projects not otherwise listed, based on the five criteria for determining acceptability. Alternatively, an independent, third-party verification system could be used to evaluate conformance to the five criteria. Either way, concerns about build-up of ambient CO<sub>2</sub> (which is a worldwide, rather than regional, air quality problem) would still be addressed, even while allowance market liquidity and system reliability would be enhanced. Limiting the list of eligible projects unless further rulemaking occurs is unnecessarily inflexible.

Other features of the Model Rule regarding offset projects limit market liquidity, efficiency and system reliability, and are not necessary for air quality purposes. For example, limiting the number of CO<sub>2</sub> allowances that a generator may apply for compliance purposes to an amount covering 3.3% of the generator's annual CO<sub>2</sub> emissions under normal conditions is unnecessarily low.

Furthermore, the proposed Model Rule would establish a "staircase" of allowance price trigger thresholds that must be reached for a source to use a higher percentage of offsets, or to obtain them from other sources over a wider geographical area, for compliance purposes. Viewed one way, the staircase is helpful in providing greater flexibility if compliance turns out to be relatively expensive. Viewed another way, however, the staircase creates substantial

constraints against using these more flexible approaches (which can readily be justified in terms of air quality) regardless of how CO<sub>2</sub> allowances are priced. We recommend that the more flexible rules for applying offsets be available regardless of allowance pricing. Alternatively, the Model Rule could at least incorporate a procedure for adjusting or eliminating the triggers if the supply of offsets becomes too limited for the CO<sub>2</sub> allowance market to function as intended.

On the other hand, we support the provision in Section XX-10.3 allowing the use of CO<sub>2</sub> emission credit retirements, based on retirement of allowances issued under foreign cap-and-trade programs. This provision provides a way to foster the effectiveness of the RGGI cap-and-trade program consistent with its air quality goals.

#### **D. Leakage**

The upcoming results of the RGGI Imports and Leakage Working Group, whose work will be conducted as a follow-on to the Model Rule, will be significant to ISO-NE.

We understand the terms “import” and “leakage” as signifying concern that the RGGI-established cap on CO<sub>2</sub> emissions will be met simply by shifting production of electricity and accompanying CO<sub>2</sub> emissions from sources within RGGI states to sources outside of RGGI states which are not subject to controls on CO<sub>2</sub> emissions, then importing that power back into RGGI states. We also understand the importance of taking imports and leakage into consideration to maintain the integrity of the regional cap. We ask, however, that the Imports and Leakage Working Group take into account that ISO-NE’s operating procedures afford only very limited capabilities and options for measuring and controlling this kind of leakage. Overly-ambitious measures intended to limit leakage could create significant disruption to ISO-NE’s operation of the transmission and markets system, and to its ability to assure reliable electricity supply both in the near and long term.

In light of these constraints on its system capabilities, ISO-NE recommends the following, to the extent that the RGGI process calls for any actions to address leakage:

- Because ISO-NE is not capable of measuring the emissions characteristics attributable to power imported into RGGI states from any outside source when that source is unknown (which is often the case), the Working Group should consider calculating relevant CO<sub>2</sub> emissions attributable to electricity imported into ISO-NE’s service area based, for example, on specified default values reflecting average emission rates.
- Any attempts to identify and measure leakage should work with the existing Generation Information Systems and market settlement systems presently used by ISO-NE and other RTOs, again to permit efficient integration of leakage controls into ISO-NE’s existing transmission system. These efforts should not result in restricting any physical power flows, which would in turn impede the system reliability and market efficiency which regionalization of power transmission was

intended to promote. ISO-NE believes that leakage concerns should not necessarily trump the public interest in assuring energy flow and reliability of service by avoiding disruption in transmission system operations.

- Any attempts to control or rectify leakage should be pursued through mechanisms that do not affect either the physical transmission of power or system operations. Preferably, controls would be imposed through financial mechanisms, such as payment for allowances calculated on the bases of a presumptive average CO<sub>2</sub> emissions rate. A leakage control system which changes operating procedures could produce unintended effects or other uncertainties that would lead to a less predictable, and therefore less efficient, system for supplying electricity.

### **III. Conclusion**

We appreciate the Working Group's consideration of these comments. ISO-NE believes that the refinements offered herein will facilitate achievement of RGGI goals in a manner that will be consistent with reliability protection and efficient electricity markets.

Very truly yours,

/s/

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