

# **Massachusetts Climate Action Network**

86 Milton Street, Arlington, MA 02474  
(781) 643-5911 [www.massclimateaction.org](http://www.massclimateaction.org)

May 22, 2006

## **Comments of Massachusetts Climate Action Network (MCAN) on the draft model rule for the Regional Greenhouse Gas Initiative**

Marc Breslow, Ph.D., Executive Director

The draft Model Rule represents another step forward in the arduous process of developing and implementing a regional cap-and-trade program for carbon dioxide emissions from power plants. We thank the governors, environmental and energy agencies, and the Staff Working Group for their leadership and hard work in bringing the region to this point.

We are pleased that plans for RGGI are proceeding, as the program holds the potential to constitute a major advance in the United States' efforts to address global warming. If properly designed, RGGI will yield a significant reduction in emissions from the electricity sector, while demonstrating to the rest of the country that it is possible to do so in a cost-effective manner while protecting consumers and promoting technological innovation.

The draft Model Rule does a good job of providing the detailed language that each state will need to write its own rules. In particular, the specific criteria for the offset categories appear to be a serious effort to implement the "additionality" criterion by which offsets are only available for projects that would not occur without financial incentives from electricity generators.

Yet the draft fails to resolve several inadequacies in RGGI's design that were included in the December, 2005 Memorandum of Understanding, and introduces several new problems that were not present in the MOU. Given that RGGI's emission-reduction goals are modest to begin with, any provision that threatens to weaken those goals cannot be justified. Below we discuss a number of such problems in the Model Rule, related to allowance allocation, leakage, offsets, exemptions from the cap, impacts on the voluntary market for electricity from renewable sources, and early reduction credits.

### **Need for Principles from MOU to be Restated and Clarified in the Model Rule**

RGGI state staff have said that principles enunciated in the MOU need not be repeated in the Model Rule, and that the normal format of environmental agency regulations would make it difficult to include such principles. We disagree with this conclusion. Since there is no regional government, the MOU carries no legal force on its own. Only the state regulations will have legal meaning, particularly beyond the tenure of the governors who signed the MOU. Assuming that the states will be using the Model Rule as the basis of their regulations, it is vital that the Model Rule

reiterate the key principles that are articulated in the MOU. Among the most important of these are:

**1) General principle for eligibility of offsets:** “At a minimum, eligible offsets shall consist of actions that are real, surplus, verifiable, permanent and enforceable.” (Section (2)(F)(1)(a) of the MOU). It is vitally important that this sentence be reiterated in the Model Rule, particularly because additional offset types may be added over time. In addition, since the MOU does not define these terms, the Model Rule must do so. This is true particularly for the term “surplus,” for which it must be stated that “surplus” is to be interpreted as “additionality,” with a definition of the latter term.

**2) Statement of intent on leakage:** “The Signatory States agree to pursue technically sound measures to prevent leakage from undermining the integrity of the Program.” (Section (6)(A)(6) of the MOU). Section (6)(A) makes a number of statements about leakage, but only the sentence quoted above makes a clear declaration that the states intend to prevent imports from causing the actual emissions reductions due to RGGI to be less than the 10 percent stated goal of the program. Since, more than any other factor, imports/leakage could prevent RGGI from actually reducing global warming pollution, it is essential that the sentence above, or something similar, be included in the Model Rule.

In addition, section (6)(A)(1)(a) of the MOU contains language that could be interpreted to mean that the states will consider using leakage as a means of controlling the costs of the program. We assume that this was not the intent of the section, since doing so would completely undermine the goal of RGGI. The Model Rule should make clear that there is no such intent.

### **Allocation of allowances**

We have several concerns here. First, we are concerned about the scope of the strategic energy purposes provision in the allocations section. There must be a much better definition of this term. At a minimum, the Model Rule should clarify that all of the “consumer benefit or strategic energy purpose” allowance value must be used to: (1) reduce the costs of the RGGI program to the state’s electricity ratepayers; (2) provide additional benefits for activities or projects that would not have occurred anyway and not replace existing programs or investments; and (3) support programs and activities that do not pose a significant risk to human health and the environment.

Second, the Model Rule says on page 40:

[Allocation provisions will vary from state to state, provided at least 25% of the allocations will go to a consumer benefit or strategic energy purpose.] (section XX-5.3 (a) of Model Rule draft)

We appreciate that the words “at least” are included here, since they are absent from the corresponding sentence in the MOU:

“each Signatory State agrees that 25% of the allowances will be allocated for a consumer benefit or strategic energy purpose.” (Section (2.)(G)(1) of the MOU).

Since it is the intent that 25% be a minimum, the words “twenty-five percent” in Section XX-5.3(b) of the Model Rule should be changed to indicate an unknown figure for the actual percentage in each state: “The REGULATORY AGENCY will allocate \_\_\_\_\_ percent of the NAME OF RELEVANT RGGI STATE CO2 trading program base budget to the consumer benefit or strategic energy purpose account.”

Third, given the evidence which has been accumulating both for the United States and for Europe’s trading program, we believe the states should revisit the decision made in the MOU and revise the 25 percent minimum upwards. Research studies and news reports in Europe, particularly the United Kingdom, are finding that due to free allocations windfall profits for generators are likely to be in the billions of dollars (one billion pounds in the U.K. alone): “Power firms could make a £1bn windfall profit from the EU Carbon Emissions Trading Scheme, BBC News has learned.”<sup>1</sup> Given this, consumer allocations much closer to 100 percent would be appropriate. The language in Massachusetts’ pending legislation to join RGGI, which begins the auctioned allowances at 50 percent and scales them up to 100 percent over five years, is a good model for the region to consider.

### **Exemptions from the Cap**

We have been concerned since the first draft plan in August 2005 that the combination of design elements included would mean that the cap would have little effect on emissions, particularly in the early years of the program. This is the case because the baseline cap level is on the order of 6 percent above actual emissions during the past few years, no actual reductions are required until 2015, and the 10 percent cut by 2018 is modest to begin with.

The proposals in the draft Model Rule to exempt certain plants from the cap have the potential to exacerbate this problem. These proposals were not discussed in the Stakeholder meetings, and no justification for them has been provided by the State Working Group. Particularly given the weaknesses listed above, these exemptions are unjustified and should be removed from the Model Rule. Alternatively, if these exemptions are retained, the cap levels for the affected states should be reduced by

---

<sup>1</sup> “£1bn windfall from carbon trading,” Roger Harrabin, BBC News environment correspondent, May 1, 2006; *Platts Emissions Daily*, 1 March 2006; *Implications of the EU Emissions Trading Scheme for the UK Power Generation Sector*, IPA Consulting for the UK Dept. of Trade & Industry, November 2005

amounts equal to the exempted emissions. Included here are the proposals to exempt:

1) self-generators that sell less than 10 percent of their power to the electric grid (page 20). In order to judge the implications of this element of the rule the states should immediately identify those units they think could be eligible for this exemption.

2) plants that use a combination of biomass and fossil fuels, where the fossil fuels constitute 50 percent or less of the total fuel (definitions section, pp. 11-12). Carbon emissions do not disappear at any arbitrary percentage of fuel inputs, and should be calculated based on the proportion of fossil fuel input to any dual-fueled plant. In addition, annual reporting should be required from all plants over 25 MW that burn fossil fuels to ensure compliance and improve state GHG inventories.

### **Early Reduction Credits**

The cap would be further inflated by allowing early reduction credits to be additional to the cap. This should not be allowed. Instead, incentives for early reductions should be provided from within a state's existing cap level. In addition, any improvements in plant efficiency or reductions in emissions due to court orders or settlement agreements prior to December 2005 should not be eligible for early reduction credits.

RGGI is a modest program that starts by capping carbon dioxide emissions above today's levels. The increase in emissions that is already allowed between now and the start of the program is a significant concession to the companies regulated by the program. Anything else that would inflate the cap should be rejected.

### **Adjustment of the Cap to Reflect Voluntary Purchases of Electricity from Renewable Sources**

RGGI must have a mechanism to reflect the "voluntary" market for "green" or "clean" electricity, supplied from non-emitting sources. We believe that the State Working Group has indicated in the past that such a mechanism would be proposed, but it does not exist in the current draft Model Rule.

Without such a mechanism, voluntary purchases of renewable power simply make it easier for generators to meet the cap, but do not actually achieve further reductions in emissions. Renewable energy generators, marketers, and companies or individuals who purchase green energy will not be able to make valid statements that their purchases are actually reducing carbon emissions.

Such a result could effectively kill the market for clean power in the RGGI region. This is important, because at the national level voluntary sales, especially to commercial and institutional customers, have been responsible for between one-quarter and one-third of new renewable energy development in recent years. Our own organization, MCAN, is engaged in intensive marketing efforts in a number of communities, which would be made invalid by RGGI unless a mechanism to adjust the cap to account for voluntary purchases is included.

Recognizing this, the Model Rule should include language such as the following, which has been proposed by a renewables working group that includes the Center for Resource Solutions:

### **Generic Language**

The voluntary market for renewable energy in the RGGI states provides an avenue for businesses and individuals to reduce their greenhouse gas emissions. In recognition of the importance of allowing for voluntary action to reduce greenhouse gas emissions in the RGGI states, each State's REGULATORY AGENCY shall incorporate a solution enabling the voluntary market for renewable energy to continue.

*Voluntary Renewable Energy Market:* The voluntary purchase of renewable energy and/or renewable energy certificates by or for retail customers as a method for reducing their greenhouse gas footprint.

*RGGI Voluntary renewable energy market sales:* This is the number of megawatt hours of renewable energy, or renewable energy certificates from renewable energy projects located in RGGI states sold to retail electricity customers in a RGGI state.

### **Specific Language**

*Deductions for the Voluntary Renewable Energy Market* --The REGULATORY AGENCY will forecast the anticipated volume of Voluntary Renewable Energy Market sales (MWh) to or for retail customers in their state over the relevant three year time period (beginning 2009), and retire the appropriate number of allowances on behalf of the Voluntary Renewable Energy Market before allocating or auctioning the remainder. After each three year Compliance Period each state will "true up" the difference between the forecast of Voluntary Renewable Energy Market Sales and actual sales by adjusting the going forward forecast accordingly for the next Compliance Period."

### **Offsets**

**1) State where application is filed** - Section XX-10.4(d)(2) says: "For a CO2 emissions offset project located wholly outside all Participating States, the application may be filed with the appropriate regulatory agency in any one Participating State."

This provision appears to allow offset providers to "game" the system by choosing to apply to the state where they think they will get the most favorable treatment, and/or to a state which has the least resources to evaluate offset applications, and so may allow an offset to be certified with the least scrutiny. To prevent such a possibility, the Model Rule should contain a mechanism for interstate cooperation in the

handling of offset applications. This could include a provision, for example, by which state agencies voluntarily agree to assign offset applications to those states which are in the best position to evaluate them. Or, since offsets must be associated with emissions from particular states, the applications could be assigned to those states. If more than one state is involved, the state agencies could choose how to divide up the administrative work, rather than leaving this power to the applicants.

**2) Geographic limits and valuation of offsets** - Section (2.)(F)(2)(a)(2) says: “allowances for projects located outside the Signatory States shall be awarded one allowance for every two CO<sub>2</sub>-equivalent tons of certified reduction.”

This provision may well raise legal problems. It would be preferable to limit the geographic scope of offsets initially to the RGGI states and other states that have comparable carbon cap regimes in place. If it is considered necessary to expand the geographic scope of offsets, this should be done at a trigger price point, such as \$10 per allowance, and then count all offsets, whether within or outside the RGGI states, on a one-for-one basis.

**3) Trigger mechanisms on expansion of offsets** - Several stakeholders have commented on the problems with the trigger mechanisms that increase the availability of offsets if allowance prices reach \$7 or \$10 per ton. These triggers raise substantial uncertainty concerning the program, including the possibility that the expanded geographic scope and one-for-one crediting of outside-the-region offsets will cause a sharp fall in the price of offsets. Just the possibility of such a change in offset prices could well dissuade investors, having the perverse effect of making offsets less available below the trigger prices.

In addition, the possibility of greatly expanded offsets at the \$7 or \$10 levels could well bias plant owners against making the investments needed to reduce emissions within the electricity supply system itself. There is evidence that this is taking place in the somewhat parallel situation of the Renewable Portfolio Standard (RPS) in Massachusetts, where electric utilities are choosing to make Alternative Compliance Payments (ACP) rather than make long-term investments in renewable energy generation -- even where the long-term investments would yield generation at substantially lower costs than the ACP price, which is now above \$50 per MWh.

In order to prevent the problems described above, we recommend that the trigger mechanisms be eliminated. As a second-best choice, the \$7 trigger could be removed while retaining the \$10 trigger. However, the expansion at \$10 to allowing offsets to constitute 20 percent of all reported emissions is too extreme. It would allow not only all of the reductions to come from offsets, with none coming from the power plants themselves, but an actual increase in emissions from the plants. If the \$10 trigger is retained, the percentage allowed should be reduced to no more than 10 percent, since this is the entire emissions reduction planned for RGGI.

Thank you for the opportunity to provide input on the proposed Model Rule.