

May 22, 2006

Franz Litz, Esquire  
Chair, Regional Greenhouse Gas Initiative  
NYDEC  
625 Broadway  
Albany, NY 12233-1500

**RE:           Comments on RGGI Draft Model Rule**

Dear Mr. Litz:

Conectiv Energy (CE) is pleased to provide the following comments on the Regional Greenhouse Gas Initiative Public Review Model Rule Draft entitled “Part XX CO2 Budget Trading Program” dated March 23, 2006.

CE is a wholly owned subsidiary of Pepco Holdings, Inc. (PHI). PHI is an energy holding company engaged in regulated utility operations and sale of competitive energy products and services to residential and commercial customers. PHI delivers electricity and natural gas to more than 1.9 million customers in Delaware, the District of Columbia, Maryland, New Jersey and Virginia, through its regulated subsidiaries: Delmarva Power, Pepco and Atlantic City Electric.

CE is an unregulated independent power producer headquartered in Delaware. CE owns and operates approximately 4,000 MW of generating capacity in the RGGI region, all within the PJM power pool. These generating assets are comprised of coal, oil and gas-fired units.

CE participates as a stakeholder in the RGGI process through the Northeast Regional Greenhouse Gas Coalition (NE RGGC), a multi-industry sector coalition, which is providing comments on the Model Rule Draft under separate cover. CE supports the comments filed by the NE RGGC and incorporates by reference those comments in this filing.

CE’s comments concern the following areas of the RGGI program: imports and leakage; harmonization with a federal program; consumer benefit allocation; safety valve trigger mechanisms, and carbon offsets.

In summary, our comments are as follows and detailed below:

- The model rule should incorporate controls of electricity imports and associated CO2 leakage as it is critical to the success of RGGI, so much so, that implementation of RGGI should not begin without it.
- The model rule must clearly convey the RGGI States’ intention to harmonize with a mandatory national program and not exist in parallel with a national program.

- Consumer benefit or strategic energy purpose allowances will be an enforceable compliance necessity and the majority of the consumer benefit or strategic energy purpose allocation must first be made available to affected sources.
- A new safety valve mechanism that provides adequate relief must be developed and incorporated.
- The limitations on the offset program should be removed so as to promote a robust offset market and drive cost effective CO2 reductions, which will be critical to RGGI and any subsequent national program in the absence of proven, cost effective CO2 control technology for the power sector.

## **Imports & Leakage**

The market for electrical power has experienced fundamental changes over the past decade. Power purchases, which once were limited mostly to transactions between adjacent utility systems, are now regional in scope. The recent expansion of the electrical transmission grid operator serving all of Conectiv's power plants, the PJM Interconnection (PJM), means that electrical power can now be imported from points south and west of the RGGI region more easily and efficiently than ever before.

The RGGI region encompasses New England, New York, and the New Jersey/Delaware/Maryland portion of PJM. PJM is the largest of the three power pools with over 160,000 MW of capacity in 2006. Since 2002, PJM has expanded west to Illinois and south to Virginia, adding six large utilities to its membership –Allegheny Power, ComEd, American Electric Power, Dayton Power & Light, Duquesne Light and Dominion, effectively tripling in size. Subsequently, there has been a threefold increase in power flows from west to east because many of the constraints that served to adversely impact power flows have been internalized.<sup>1</sup>

RGGI will increase the operating cost of electric generators in the RGGI region compared to the costs incurred by generators outside the region, giving generators outside the RGGI region an inherent, competitive advantage. The increased costs that such a program would impose on generators within the RGGI region will serve to exacerbate existing disparities in the price of power from local sources relative to those in the South and Midwest, making it more attractive to import power from those regions. The result is that while CO2 emissions in the RGGI region may be capped and then reduced under the program, CO2 emissions outside the RGGI region (along with collateral emissions of NOx, SO2 and Hg) will most likely increase due to the pricing signal sent to the regional electricity markets and the availability of lower cost coal-fired generation in the western PJM market. This is of acute importance to CE as all of its generation is within PJM.

---

<sup>1</sup> Testimony of Karl Pfirrmann, President, PJM Interconnection, L.L.C., Western Region, Prepared for the Federal Energy Regulatory Commission's Technical Conference: Promoting Regional Transmission Planning And Expansion to Facilitate Fuel Diversity Including Expanded Uses of Coal-Fired Resources Docket No. AD05-3-000, May 13, 2005.

The states that comprise the RGGI region are aware of the seriousness of this issue. Section 6 of the Memorandum of Understanding (MOU) states that “*the Signatory States agree to pursue technically sound measures to prevent leakage from undermining the integrity of the Program.*” To address this issue, the MOU mandates the creation of a multi-state working group that would consider potential options for addressing leakage and report on its findings by December 2007. The signatory states would then consider actions that could be taken to address potential leakage prior to the launch of the program in January 2009. Additional provisions call for ongoing monitoring of electricity imports into the RGGI region following the start of the program.

Recently, major transmission lines have been announced that will originate outside the RGGI region that will increase electricity imports, and significant sources of new coal fired generation in surrounding non-RGGI states have been announced. The RGGI modeling employed to support the MOU and the draft model rule did not incorporate these market changes. The leakage identified in the modeling is significant and these pending changes to transmission and generation infrastructure may exacerbate emissions leakage under the RGGI rulemaking as currently contemplated.

CE strongly contends that RGGI must credibly address electricity imports and the associated CO<sub>2</sub> emissions leakage with a direct regulatory approach to avoid negative environmental and economic impacts. The RGGI program should only move forward when electricity imports are credibly addressed and are part of program implementation. “Credible” means that it is legally defensible (especially in the context of the interstate commerce clause) and “implementable” means in the context of the realities of the workings of the wholesale markets and multiple regulatory jurisdictions (FERC, states, etc).

As we have stated, new transmission lines have been proposed that may exacerbate electricity imports and emissions leakage. PHI (CE’s parent company), American Electric Power, and Allegheny Power have all recently proposed major transmission lines. PHI has proposed construction of a new 500 kV interstate 230-mile line, which will originate in northern Virginia, cross Maryland and travel up the Delmarva Peninsula to New Jersey. The AEP transmission expansion proposal consists of a 765 kV line capable of carrying 5,000 MW of electricity from West Virginia to New Jersey. The Allegheny transmission expansion proposal consists of a 500kV line capable of carrying greater than 3,000 MW from West Virginia to Maryland. Additionally, a new 500kV transmission line from New Jersey to Long Island will further increase PJM power market. In its analysis of this last project, PJM found that it will increase PJM wholesale electricity prices because it is “essentially equivalent to the addition of new PJM base load...”<sup>2</sup>

CE’s New Jersey, Delaware and Maryland RGGI affected generation assets face direct competition from generators that operate in the PJM market but are not captured by the RGGI regulatory program. Load-following coal-fired units dispatch before combined-cycle natural gas

---

<sup>2</sup> PJM Market Simulation Analysis of Possible Affect of Neptune Project on PJM Wholesale Electricity Prices, March 1, 2006

units absent a significant and sustained drop in natural gas price, even in spite of a recent spike in coal prices and emission allowance costs. Rising environmental compliance costs continue to push load-following coal to the margin, with the future price of natural gas and cost of CO<sub>2</sub> compliance emerging as the two wildcards in the viability of load-following coal capacity in the RGGI region. Load-following coal units outside RGGI are set to enjoy a dispatch cost advantage over similar units in RGGI.

However, there is no mention of imports & leakage in the draft model rule. CE contends that (at a minimum) there should be a “placeholder” in the model rule to address leakage.

### **Harmonization with a Federal Program**

In light of the growing interest in regulatory programs that address climate change by restricting CO<sub>2</sub> emissions, CE has advocated for a national program as opposed to state-specific or regional programs. As RGGI intends to be a model for a national program, the model rule should clearly state that upon implementation of a national program, RGGI will cease and be superseded by the national program.

It is apparent and undisputed that RGGI will have minimal impact on CO<sub>2</sub> levels in the region, and essentially no significant impact on global emissions. In fact, if imports and leakage are not adequately addressed, the nation may very well experience increased levels of CO<sub>2</sub> due to increased emissions from sources surrounding the RGGI region. It is imperative that RGGI design a program that is easily scalable to a national program, if it is to have any effect on climate.

CE recommends that the following language be added to the RGGI model rule as it is finalized by the staff working group:

***XX-11 Harmonization with a Federal Program.*** *When a mandatory CO<sub>2</sub> emission reduction program is adopted at the federal level in the United States, The REGULATORY AGENCY will harmonize the CO<sub>2</sub> Budget Trading Program with that federal program.*

### **Consumer Benefit Allocation**

The consumer benefit or strategic energy purpose allocation provisions of the RGGI program are another area of concern for CE. The implication on the various power markets of an allowance withholding of this size is significant. Additionally, given the current structure of the safety valve/trigger mechanisms, the allocation of the consumer benefit or strategic energy purposes allowances will likely have a major impact on the prices for RGGI allowances. Such an approach could increase the compliance cost for RGGI CO<sub>2</sub> budget sources and therefore increase the costs of the program on RGGI consumers and the regional economy.

The RGGI MOU indicates that the states agreed that 25% of the allowances would be allocated for consumer benefit or strategic energy purpose. It appears that some states intend to increase this amount above 25%. To maintain regional consistency and a level playing field among CO<sub>2</sub> budget sources, CE contends that every Signatory State should allocate precisely 25% of its CO<sub>2</sub>

budget to consumer benefit or strategic energy purpose during the first two compliance periods. During the review of the first compliance period in 2012 and the second compliance period in 2015, the Signatory States could evaluate the impact the consumer benefit or strategic energy purpose allocation provision had on allowance prices, overall costs and effectiveness of the program. The Signatory States could then make an informed decision as to the percentage that should be dedicated to the consumer benefit or strategic energy purpose allocation in the third compliance period.

The draft model rule contains little, meaningful guidance for the States on the consumer benefit or strategic energy purpose allocations. This translates into a high level of business uncertainty and associated risk for CO2 budget sources. Regional consistency regarding the methodology and timing of the release of the consumer benefit or strategic energy purpose allowances to the market is critical for compliance and business planning purposes. The model rule must have prescriptive model rule language covering at least the following: the timing of the consumer benefit or strategic energy purpose allocations, access to the consumer benefit or strategic energy purpose allowances, and the methods of consumer benefit or strategic energy purpose allocations.

CE recommends that the following language be added to the RGGI model rule as it is finalized by the staff working group:

*XX-5.3(b) Consumer benefit or strategic energy purpose allocation. The REGULATORY AGENCY will allocate twenty-five percent of the NAME OF RELEVANT RGGI STATE CO2 trading program base budget for the 2009 through 2014 allocation years to the consumer benefit or strategic energy purpose account.*

*(1) By January 1, 2009, for the 2009 through 2014 allocation years, the REGULATORY AGENCY will:*

- i. determine the method(s) with which the consumer benefit or strategic energy purpose allowances will be allocated; and*
- ii. determine the quantity of consumer benefit or strategic energy purpose allowances that will be dedicated to each of the following categories:*
  - 1. to promote energy efficiency,*
  - 2. to directly mitigate electricity ratepayer impacts,*
  - 3. to promote renewable or non-carbon emitting energy technologies,*
  - 4. to stimulate or reward investment in the development of innovative carbon emissions abatement technologies with significant carbon reduction potential, and/or*
  - 5. fund administration of this Program.*

*(2) By no later than December 31, 2009, the REGULATORY AGENCY will make available one hundred percent of the consumer benefit or strategic energy purpose allowances for the 2009, 2010, and 2011 allocation years to CO2 Budget Sources or their agents only.*

- (3) *By no later than December 31, 2010, the REGULATORY AGENCY will make available the remaining consumer benefit or strategic energy purpose allowances for the 2009, 2010, and 2011 allocation years to CO2 Budget Sources or their agents and other participants.*
- (4) *By no later than December 31, 2011, the REGULATORY AGENCY will make available one hundred percent of the consumer benefit or strategic energy purpose allowances for the 2012, 2013, and 2014 allocation years to CO2 budget sources or their agents only.*
- (5) *By no later than December 31, 2012, the REGULATORY AGENCY will make available the remaining consumer benefit or strategic energy purpose allowances for the 2012, 2013, and 2014 allocation years to CO2 budget sources or their agents and other participants.*

### **Safety Valve Trigger Mechanism**

RGGI is based on a set of very optimistic modeling assumptions (e.g. gas prices, efficiency market penetration, renewable development). When RGGI was proposed, natural gas was \$4.47/mcf and oil was \$23/barrel.<sup>3</sup> The modeling results predict:

- Low CO2 allowance prices averaging \$2.00 -\$5.00/ton (2010-2024).
- Regional natural gas consumption nearly doubles by 2015.
- Wind generating capacity grows nearly 100 times from about 55 MW to 5,203 MW by 2012, and nearly 180 times to 8,700 MW by 2024.

Given the uncertainty associated with the projected costs of RGGI, the program's design should provide for at least one of the following:

- Unlimited use of carbon offsets (no absolute usage limitations, no geographic discount factors, and broad list of eligible projects categories) or
- A price certainty mechanism such as a safety valve.

Neither of these two necessary provisions are included in the RGGI draft model rule. In fact, the current RGGI "safety valve" trigger provisions do not provide price certainty. The safety valve triggers are far too convoluted and complex. In their current design, they serve to increase uncertainty for both the CO2 budget sources as well as the offset developers.

CE's preference to cost certainty is the safety valve mechanism. An escalating safety valve \$/ton that affected companies could pay if reasonably priced offsets or allowances are unavailable in the market. This provides the clearest price certainty to affected sources in light of the fact that there is no commercially available cost effective CO2 control technology.

---

<sup>3</sup> USDOE EIA Energy Price Data, April 2003.

We do acknowledge that a straight escalating safety valve may be unlikely in RGGI due to the perception of such a price certainty mechanism. Therefore, working within the current structure of the safety valve trigger provisions, CE recommends that they be simplified and changed as follows:

- \$7 trigger should increase the use of offsets to 15% and offsets should be able to come from anywhere in North America;
- \$7 trigger (twice in two consecutive 12 month) should increase the use of offsets to 20% and offsets should be able to come from anywhere internationally;
- \$10 trigger should allow the purchase of an unlimited number of allowances for compliance purposes from the REGULATORY AGENCY; and
- The reset provisions should be completely eliminated.

### **Carbon Offsets**

There is currently no commercially available and cost effective control technology to reduce CO2 emissions from electric generating units. As a result, carbon offsets must play a vital role in the near term (10-15 years) so that new technologies can enter the marketplace. However, the current RGGI offset provisions create considerable regulatory and financial uncertainty both on the demand and supply side for offsets. The current draft model rule offsets language is so constraining that it appears that the Signatory States are more motivated to establish barriers to offset development and use rather than encouraging least cost GHG emission reductions. An important asset RGGI can pass-on to a national program is a robust offset program.

CE's preference is for completely unconstrained offset provisions in RGGI. This would provide the clearest signal to both developers and CO2 budget sources alike to achieve GHG emissions at the lowest cost. However, we acknowledge that this is unlikely in RGGI due to the limitations on offsets included in the RGGI MOU. Working within the current structure of the offset provisions and safety valve triggers, CE recommends that the offset provisions be simplified as follows:

- eliminate the 2:1 discount for eligible offset projects located outside the RGGI region;
- eliminate the offset allowance use restrictions by CO2 budget sources completely; or
- increase the 3.3% limitation on the use of offsets to at least 5%.

Conectiv Energy appreciates your consideration of these comments, as well as those by the NE RGGC, and its member companies.

Kind regards,

M. Gary Helm  
Sr. Environmental Coordinator