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Attn: RGGI Staff Working Group

Re: Comments of the City of New York and the New York City Economic
Development Corporation on the Draft Model Rule

To the Regional Greenhouse Gas Initiative Staff Working Group,

This letter responds to the RGGI Staff Working Group's request for public comment on the draft model rule released on March 23, 2006. The draft model rule details proposed requirements for each of the participating states' RGGI regimes, whether they are enacted through legislation, administrative rulemaking or another mechanism. As the representative of approximately nine million energy consumers and as a major energy consumer itself, the City of New York ("City") has a strong interest in ensuring that the cap-and-trade market to be established under RGGI maximizes public benefits as it achieves real reductions in carbon dioxide ("CO₂") emissions from the electric generating sector. Indeed, RGGI can serve as a model of progressive environmental policy for others to emulate, but it is critical that it be developed in a manner that will not create incremental economic development barriers in our region, and that will not confer windfall profits on particular entities at the expense of the public at large.

The City's initial observations on program design issues are set forth herein. In addition, the City expects to actively participate in the anticipated New York State rulemaking process at the New York State Department of Environmental Conservation, and in any related administrative efforts.

Allocation of Emission Allowances [Subpart XX-5]

Under RGGI, participating states will create a CO₂ cap-and-trade program applicable to electric generation sources in the region. While this is a laudable initiative with the City's full support, it is imperative that the program be designed in a manner that imposes the lowest practicable cost on energy consumers. In addition, the program must be developed to be

consistent with the existing competitive wholesale markets for electricity. These two concerns are particularly relevant to the allocation of the CO₂ emissions allowances.

Under the draft model rule, up to 75% of CO₂ allowances apparently would be awarded to power plant operators in each participating RGGI State, while a minimum of 25% would be allocated to a “consumer benefit” or “strategic energy purpose.” The City disagrees with the decision to allow such a large percentage of allowances to be simply given away. The allowances created by RGGI should be sold, whether by auction or otherwise, to generators. The proceeds of such sales should then be returned to electricity consumers in order to reduce the net price impact of the program, or for a strategic energy use. Ultimately, the 75/25 allocation ratio is inadequate to compensate for the costs that will be imposed on electricity consumers by the operation of the RGGI program.

The awarding of allowances to power generators would in effect create a windfall to them without providing any accompanying public benefit.¹ As others have noted in the course of the RGGI process, the operation of the current wholesale market in the New York Control Area will ensure that the value of allowances will inevitably become a component of generator bids – and thus overall costs imposed on consumers – regardless of whether they are acquired by purchase or by grant. This has been the case in other pollutant emissions markets (*e.g.*, the NO_x market in California), where emissions credits allocated to historical emitters at no cost are available for sale to other generators at their market value.² The economic impact of such an arrangement can be substantial: for instance, once the RGGI market is in operation the highest bid price to clear the New York Independent System Operator (“NYISO”) market would include the market value of CO₂ emission allowances, increasing the clearing price for all wholesale energy transactions on the margin. Thus, electric customers would pay for the allowances through increased electricity prices, in addition to losing the market value of the allowances in the initial allocation.

Moreover, any RGGI costs will be incremental to the expenses associated with other beneficial energy-related programs³ and to the generally rising expenditures for energy in

¹ Informal estimates of projected values have ranged from a low of \$5.00 to a high of \$20.00 per CO₂ allowance. Thus, according to the lowest currently projected dollar value of RGGI allowances an aggregate value of approximately \$320 million will be created annually in New York State alone, based on the State’s allotment of approximately 65 million short tons of carbon dioxide emissions. Moreover, experience in recent years at the Chicago Board of Trade SO₂ market created under the Clean Air Act suggests that emission allowance prices such as those planned for CO₂ may fluctuate sharply. While not directly comparable to the marketplace contemplated under the RGGI regime, the high degree of volatility in the current SO₂ market suggests a need for caution in making predictions concerning the value of future RGGI allowances.

² See California’s Energy Crisis, Paul L. Joskow, MIT, Oxford Review of Economic Policy, Vol. 17, No. 3, pp. 15 & 16, at http://econ-www.mit.edu/faculty/download_pdf.php?id=551.

³ Including, *e.g.*, the System Benefit Charge program and the recently created Renewable Portfolio Standard. These programs confer substantial benefits on the public at large, and have enjoyed the consistent support of the City. In developing another regulatory regime such as the RGGI initiative, Continued...

our State – and in New York City, for capacity as well. Energy generation expenses are driven in large measure by the extremely volatile fuel costs experienced in recent years. There appears to be little reason to expect the future to bring about any material lessening of that trend.

Generators already benefit from a system that pays them the highest price needed to meet overall load demand regardless of their own cost of production factors as long as their bids are below the final market-clearing price. Given this reality, it does not make economic sense to simply make a cost-free award of RGGI allowances. Under RGGI, the electric generating companies should bear the full cost of generating electricity, including the purchase of carbon dioxide and other emission allowances at their market value, and pass those incurred costs on to the electricity customer through the operation of the regional electricity market, as they do with other costs of production.

Accordingly, the City proposes that the economic value of the full allotment of allowances should accrue to energy consumers. The City thus joins in the positions already publicly taken by a broad spectrum of RGGI stakeholders in favor of selling all allowances to the generators. Legislation recently enacted in the participating RGGI State Vermont⁴ is to the same effect, ensuring that the value of its allowances will accrue to the benefit of the public.

Allowance Approaches [Subpart XX-5]

The City urges that consideration be given to an allowance calculation system that encourages the use of low-carbon fuels and high generation efficiencies. In particular, the City urges that RGGI use an “output-based” approach that distributes allowances based on a generator’s useful output of both electric and thermal energy (such as steam in the Con Edison system). This approach would differ from the “grandfathering” system utilized by other emissions cap-and-trade programs, such as the sulfur dioxide (“SO₂”) acid rain program created in the 1990 Clean Air Act amendments, where allowances were allocated based on historic fuel use. While grandfathering is typically favored by existing generators, it does not adequately recognize the greater efficiencies of modern combined cycle natural gas plants such as the new Poletti Plant in Queens, New York, and it would not recognize the exceptionally high efficiency levels of cogeneration plants such as Con Edison’s newly repowered East River plant in Manhattan. With the advent of electric deregulation and the increased understanding of emissions trading mechanisms in clean air regulation, output-based allocation approaches have become generally recognized by federal and state regulators as a superior allocation approach to grandfathering or solely input-based determinations.

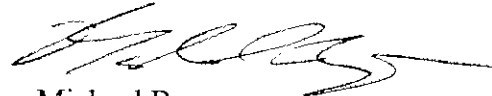
attention must be paid to the cumulative economic effects on consumers of all such programs. The existence of significant and in some instances rising market-related NYISO charges is yet another factor that must be taken into account in assessing the RGGI program impact.

⁴ See An Act Relating to Vermont’s Participation in the Regional Greenhouse Gas Initiative, H. 860, codified at 30 V.S.A. §254 (2006), which includes among its goals both minimizing “windfall financial gains to power generators” and ensuring that RGGI carbon credits are “assets managed for the benefit of electric consumers....” 30 V.S.A. § 254(c)(2)(A) and (F).

Offset Categories [Subpart XX-10]

The City understands that the number of offset categories has been intentionally limited to establish standardized offset criteria and to ensure that all offsets are real, surplus, verifiable, permanent and enforceable. In this context, the City supports the further study of a potential expansion of offset categories to include (a) methane capture at wastewater treatment plants and (b) urban afforestation. The City is examining the potential for it to undertake such projects.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael Burger", with a stylized, flowing script.

Michael Burger
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Environmental Law Division

/s/

Michael Delaney
Regulatory Counsel
New York City Economic
Development Corporation