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Comments Related to Connecticut's Rulemaking on RGGI

We wish to comment today on two particular aspects of Connecticut's rulemaking for its participation in RGGI -- allocation of allowances and "leakage."

Allocation of Allowances

The agreement on RGGI signed in Dec. 2005 by seven Northeast governors says that the states will charge electricity generators for a minimum of 25% of their permits, and use the funds for the benefit of consumers. It is up to each state how to "allocate" the other 75% – whether to charge for them or give them to power plant owners for free, and what to do with the money.

We believe there are strong arguments for all the RGGI states, including Connecticut, to sell 100% of their available permits, and to use the resulting money primarily to fund energy efficiency programs, with consideration of also using some for renewable energy development and direct consumer rebates. The reasons are discussed below.

Support from state governments and businesses
The tide has clearly turned in support of auctioning the CO2 allowances in most of the northeast states, including Vermont, New York, Massachusetts, Maine, and New Jersey. Vermont passed a law in April, 2006 that requires all of its allowances to be sold and used for the benefit of consumers. New York's Dept. of Environmental Conservation on Dec. 9, 2006 proposed regulations that would require 100% sale of allowances, and Governor Eliot Spitzer has strongly stated his support for selling all the allowances. The DEC's press release says:

"New York's preliminary draft rule announced today also includes the auction of 100 percent of emissions allowances… The emissions allowances would be sold on the open market, and the proceeds of the sale would support energy efficiency and clean energy technology investments in the State."

Just a few weeks ago Massachusetts Governor Deval Patrick stated his strong support for selling the allowances, and he was followed shortly by Governor Baldacci of Maine. In addition, New Jersey officials have said that they are leaning toward auctioning all or almost all of their RGGI allowances.

Among utilities and other businesses, National Grid, the region's largest electric distribution utility, has strongly stated its support for selling 100% of the allowances and using the proceeds to benefit consumers. At the RGGI stakeholders meeting in Concord, New Hampshire on December 14, NGRID's Environmental Affairs Director, Joseph Kwasnik, stated that the company is now in favor of using a portion of the funds to support energy efficiency programs.

The Energy Consortium (a trade association for large commercial, institutional, and industrial energy consumers in Mass.) has stated: "Ideally TEC believes that there should be <u>no</u> free allowances given to generators. Consistent with the principles of market efficiency, generators in a competitive marketplace should purchase allowances, just as they do any other cost of production…"

Pollution is a burden on society
All companies and individuals should be required to pay for the environmental damage they create. Doing so both provides an incentive to pollute less and yields funds that can be used to prevent pollution and rectify its impacts.

Large savings to consumers & business
Charging generators for their permits will yield funds for energy efficiency programs and consumer rebates that could fully protect electricity consumers against the costs of RGGI (which could raise electricity rates a few percent by the year 2018). Research by the state governments shows that using RGGI permit fees to double spending on energy efficiency would cause the average household electric bill to fall by more than $100 a year, or around 12%[i] -- and business customers would obtain similar savings. <u>But, depending on what permits sell for on the free market, 50% to 100% of them (not 25%) will be needed to fully fund efficiency spending or rebates.</u>

Analysis performed using the ICF model, and then converted into retail electric bill impacts by Mass. DOER, also broke down the savings from efficiency by individual state. The projected savings to electricity consumers in Connecticut are shown in the table below. They are quite dramatic, well exceeding the forecasted impacts of RGGI on electric rates.[ii]

Benefits to Connecticut Consumers from Doubling Energy Efficiency Spending, Using Sales Value of RGGI Allowances

	Ave. bill (2003)	**$ saved due to efficiency**	**% saved**
Year 2015			
Residential	$1,061	$103	9.7%
Commercial	$8,736	$721	8.3%
Industrial	$75,786	$3,887	5.1%
Year 2021			
Residential	$1,061	$166	15.6%
Commercial	$8,736	$1,145	13.1%
Industrial	$75,786	$5,853	7.7%

Sources: Summarized by Marc Breslow, New England Climate Coalition, from spreadsheets of Mass. Department of Energy Resources, December 2005. Based on modeling by ICF, Inc. using their IPM model (Integrated Planning Model) on behalf of the RGGI State Working Group; and on efficiency scenarios designed by NYSERDA and ACEEE.

Setting a precedent

Raising the percentage of permits that generators pay for would show that policies to halt global warming can be done in a manner that does not harm, and actually benefits, residential, low-income, and business electricity consumers. This is a critical precedent to set if we are to achieve the deeper emissions cuts that are necessary eventually to stabilize our climate.

Windfall profits from free permits

If they are given allowances for free, generators will make large windfall profits from the program. Economic studies forecast that the costs to power producers of complying with the cap will only be a small fraction, about 10% to 20%, of their gains from higher electricity prices. Capping carbon dioxide emissions will likely require more of our power to come from sources other than coal, which is currently the cheapest source of electricity. This will cause electricity prices to rise modestly (a few percent by 2018). But because electricity demand, like that for gasoline, does not respond much to price rises, the rate increases would not trigger equivalent reductions in demand. As a result, power producers would sell almost the same amount of power at higher prices, thus generating windfall profits well above the cost of complying with the program.[iii] The European Alliance of Power Intensive Industries has made the following statement (excerpted):

"Yes to Emissions Trading but No to Windfall Profits!...
As power prices are set on the basis of marginal cost, which is normally determined by fossil fuelled production, the market price will include the cost of CO2 allowances."

Charging for permits will not affect electricity prices

Charging generators for their allowances will not cause electricity prices to rise compared to giving the allowances away for free. In the Northeast's deregulated electricity market, prices are based not on the cost of producing power, but on the highest priced source of generation at any given time. This "marginal" generation is almost always natural gas. So, regardless of whether highly polluting coal-fired generators are required to pay for their allowances or are given them for free, the price of power will likely be the same. Charging for the allowances merely reduces the windfall profits of fossil-fuel generators and uses them for public benefit.

NY Attorney General Eliot Spitzer (and incoming governor) has stated: "Free allocation of allowances to CO2 generators will not lead to lower electricity prices to consumers. The price of electricity will rise to the same extent under RGGI whether the allowances are given to the generators for free or auctioned for the benefit of the public."[iv]

Europe regrets free permits

In Europe regulators are already regretting having given out most of the permits for free. For example, a Nov. 2005 report by IPA Energy Consulting for the United Kingdom's Dept. of

Trade & Industry was reported as saying: "The big six UK electricity generators have seen profits rise by at least £800 million per year as a result of the EU emissions trading scheme… It confirms that a combination of free allocation to power stations and full pass-through of marginal costs to consumers has led to a massive increase in the electricity industry's profitability."[v]

Leakage

It is absolutely critical that Connecticut, along with the other RGGI states, addresses the problem of "leakage," meaning increases in imports of fossil-fuel power from outside the RGGI region, due to RGGI's limit of emissions from within the region. For leakage not to undermine the 10% emissions reduction mandate of RGGI, any increase in emissions from plants outside of the region must be counterbalanced by a further reduction in emissions from plants within the region.

The IPM modeling indicated that leakage could wipe out a large fraction of the gains from RGGI, and more recently we have hard evidence of the dangers. TXU corporation is planning to build at least two 865 MW coal-fired plants in eastern Pennsylvania, and has told investors that they are planning to locate 4,000 to 6,000 MWs of new coal capacity in the PJM grid region. There is every reason to think that a substantial portion of this capacity is intended for export to the RGGI states. By themselves, just two 865 MW plants could counteract most of the reductions mandated by RGGI.

The RGGI states have a task force looking at the issue of leakage, but to the best of my knowledge to date Connecticut is not planning to take any specific action. The most straightforward means of accomplishing this goal is to require that generators from outside the RGGI states purchase allowances in order to export into the RGGI region, or alternatively that transmission/distribution utilities purchase allowances sufficient to account for the emissions taking place at all power plants from which they purchase. If utilities are purchasing system power then there will need to be a system for estimating the average emissions of the plants involved in the system purchases.

We would urge the State of Connecticut to put into its regulations provisions that require imported power to hold allowances. While there are indeed legal issues in doing so, any other solution could make RGGI's emissions reductions into a fiction.

Yours truly,

Marc Breslow, Ph.D.
On behalf of the New England Climate Coalition
and Mass. Climate Action Network

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[i] "REMI Impacts for RGGI Policies based on the Std REF & Hi-Emission REF," Lisa Petraglia (Economic Development Research Group) and Dwayne Breger (Mass. DOER), 11/17/2005, slide 4, at www.rggi.org.

[ii] DOER's original Excel spreadsheets can be provided if desired.
[iii] See for example: "Evaluation of CO2 Emission Allocations as Part of the Regional Greenhouse Gas Initiative: Final Report," June 30, 2005, Center for Energy, Economic & Environmental Policy, Edward J. Bloustein School of Planning and Public Policy, Rutgers University; "Allocation of CO_2 Emission Allowances in the Regional Greenhouse Gas Cap-and-Trade Program," Dallas Burtraw, Resources for the Future, Feb. 2005; "Shifting the Cost Burden of a Carbon Cap-and-Trade Program," Terry Dinan, Congressional Budget Office, July 2003; "Neutralizing the Adverse Industry Impacts of CO_2 Abatement Policies: What Does it Cost?," A. Lans Bovenberg and Lawrence Goulder, in *Behavioral and Distributional Effects of Environmental Policy*, C. Carraro and G. Metcalf, editors, University of Chicago Press, 2001.
[iv] Statement of NY Attorney General for the May 2, 2006 RGGI Stakeholders Meeting.
[v] *Platts Emissions Daily*, March 1, 2006; "Implications of the EU Emissions Trading Scheme for the UK. Power Generation Sector," IPA Consulting for the UK Dept. of Trade & Industry, Nov. 2005.