



February 15, 2007

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**Re: Environment Northeast's Comments for the
Connecticut RGGI Stakeholder Meeting**

Environment Northeast is a nonprofit research & advocacy organization focusing on the Northeastern U.S. and Eastern Canada. Our mission is to address large-scale environmental challenges that threaten regional ecosystems, human health, or the management of significant natural resources. We use policy analysis, collaborative problem solving, and advocacy to advance the region's environmental and economic sustainability.

Environment Northeast is part of the 24 member Stakeholder Group which was selected by the RGGI states to represent electric generator, environmental, consumer, and other affected interests in the Northeast and Mid-Atlantic regions. We are very supportive of the RGGI process and look forward to working with the Connecticut Department of Environmental Protection as they move forward with the RGGI rulemaking process.

Our comments will focus on several issues:

- (1) Size and Use of the Consumer Benefit Allowance Allocations,
- (2) Implementation of the Consumer Benefit and Strategic Energy Purposes (CB&SEP),
- (3) Regional Organization,
- (4) Voluntary Renewable Energy Market Set-Aside Allocations.

(1) Size and Use of the Consumer Benefit Allowance Allocations:

The rational and fair decision is to auction 100% of the allowances and use the allowance value to reduce the cost of the program on the region's ratepayers.

Environment Northeast believes that 100% of allowances should be auctioned and used to reduce consumer costs. Connecticut should ensure that the allowance value from the auction is not squandered and is targeted to activities that reduce costs for the region's ratepayers, support RGGI program goals, and generally receive public support by limiting potential negative environmental and health impacts. Increasing investments in energy efficiency programs and clean energy alternatives have the effect of lowering the cost of meeting emissions limits.

As a result, all activities and programs supported through the Consumer Benefit Allocation should:

- 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.

We are encouraged that New York, Maine, Vermont and Massachusetts have decided that they will auction 100% of the allowances. In a letter describing their rationale, the New York Department of Environmental Conservation stated that there was widespread support for 100% allocations and “Large commercial and industrial consumers have likewise come out strongly in favor of a 100% auction, arguing that an allowance giveaway to generators would be grossly unfair and represent a poor public policy choice.”¹

Some large industrial consumers and regional electric utilities are calling for 100% auction of RGGI allowances.

- A letter and white paper from National Grid supports 100% auction or allocation to consumers with the money used for rebates or expanded energy efficiency investments.²
- The Connecticut Industrial Energy Consumers state, “Energy prices in Connecticut currently are significantly higher than the national average. And, consumers have experienced dramatic increases in the past several years. Consistent with Connecticut’s goal of reducing the price of electricity, the State should mitigate the impact of RGGI on the price of electricity by auctioning all of the RGGI air emissions allowances, to the maximum extent possible, and utilizing all of the auction proceeds as a credit on retail electricity consumers’ bills on a kilowatthour basis.”³
- Large industrial groups like New York’s Multiple Intervenors are saying, “All RGGI Emissions Allowances Should Be Auctioned And The Proceeds Should Be Applied As A Per-kWh Credit To Retail Electric Distribution Rates.”⁴

No persuasive reason has been presented for why allowances should be allocated to electric generators for free. On the other hand, economic and fairness issues clearly support a complete or large and growing auction of allowances, with generators having to purchase them and the proceeds used to reduce the cost of the emissions programs on electric ratepayers.

The arguments for an auction and against free allocation of allowances are strong:

- Air quality and the world’s climate are a public good that polluters do not have a right to spoil – the purchase of allowances is consistent with the ‘polluter pays’ principle with payment for pollution rights being a cost of production.
- Previous cap and trade programs, created prior to electricity restructuring, did not face the same issues, as cost of service regulations allowed excess profits to be returned to ratepayers; the electric markets are very different today than when the SO₂ and NO_x programs were first created.
- Most generators, and all economists we are aware of, agree that an allowance, whether allocated for free or purchased, has an opportunity cost as it can be used for compliance, banked, or sold to others.

¹ These commercial and industrial customers include the approximately 50 members of the Multiple Intervenors, as well as the New York Energy Consumers Council, National Grid (on behalf of its customers), the City of New York and Consumer Power Advocates, consisting of major institutional consumers of energy in and around New York City.

² National Grid comments submitted to the RGGI process: http://www.rggi.org/docs/national_grid_whitepaper.pdf

³ Connecticut Industrial Energy Consumers comments submitted to the RGGI process: http://www.rggi.org/docs/ciec_comments.pdf

⁴ Multiple Intervenors (New York) comments submitted to the RGGI process: <http://www.rggi.org/docs/mi.pdf>

- Allowances are assigned the market value (opportunity cost) by generators and that cost is built into their marginal costs or O&M costs that determine their bid prices in the marketplace.
- Because costs are built into bid prices, whether generators get an allowance free or have to pay for it, these costs are passed on to consumers – while making that expense to consumers larger than necessary.
- Because electric consumers will bear the very modest cost of the RGGI program, we see no reason for generators to profit at their expense.
- As a part of utility restructuring, part of the deal with moving to competitive markets was that generators took on regulatory risk in exchange for a significantly freer and less regulated market.
- This is consistent with the idea of competitive and free markets – let the markets work.
- In any case, New England consumers are already paying generators very significant amounts of money in the form of congestion payments and the forthcoming Forward Capacity Market payments – states should not add free allowances to this already very significant stream of payments.

Economists, consultants, and government agencies that have looked at the issue of allocation are increasingly in agreement that allowances should be auctioned to avoid windfall profits and avoid market distortions. This has been increasingly clear in the European Union where recent experience with its carbon dioxide cap and trade program has indicated that some companies are reaping very large windfalls because allowances were allocated to them for free (see references below).

For additional background on the issue of allocation of emissions allowances, please refer to the following documents:

- Åhman, et al, 2006-forthcoming, *A Ten-Year Rule to Guide the Allocation of EU Emission Allowances*. Accepted for publication in the Journal of Energy Policy, April 2006.
- Boemare, C., and P. Quiron, 2001. *Implementing Greenhouse Gas Trading in Europe: Lessons from Economic Theory and International Experience*. Report for the Interact project, DG Research of the EU Commission, Centre International de Recherche sur l'Environnement et le Developpement. www.centre-cired.fr.
- Burtraw, et al, K. 2006. *CO2 Allowance Allocation in the Regional Greenhouse Gas Initiative and the Effect on Electricity Investors*, The Electricity Journal, 19 (2): 79-90 (March).
- Burtraw, D., 2001. *The Effect of Allowance Allocation on the Cost of Carbon Emission Trading*, Resources for the Future Discussion Paper 01-30 (August).
- Burtraw, D., and K. Palmer, 2003. *Economic Efficiency and Distributional Consequences of Different Approaches to NOx and SO2 Allowance Allocation*, Prepared for the U.S. Environmental Protection Agency. <http://www.epa.gov/air/clearskies/econ.html> (accessed June 8, 2005).
- Burtraw, et al, 2002. *The Effect on Asset Values of the Allocation of Carbon Dioxide Emission Allowances*, The Electricity Journal, June 2002, Vol. 15, No. 5, pp. 51-62.
- Burtraw, et al, 2001. *The Effect of Allowance Allocation on the Cost of Carbon Emission Trading*, Resources for the Future Discussion Paper 01-30 (August).
- The Carbon Trust, 2004, *The European Emissions Trading Scheme: Implications for Industrial Competitiveness*, CT/2004/04
- Carlson, et al, 2000. *SO2 Control by Electric Utilities: What are the Gains from Trade?* Journal of Political Economy, 108:6, 1292-1326.
- CEEP, 2005, *Evaluation of CO2 Emission Allocations as Part of the Regional Greenhouse Gas Initiative*, Center of Energy, Economic, and Environmental Policy, Rutgers University
- Congressional Budget Office, 2003, *Issues in the Design of a Cap-and-Trade Program for Carbon Emissions*, Economic and Budget Issue Brief, November 25, 2003

- Cramton, P., and S. Kerr, 2002. *Tradable carbon permit auctions: How and why to auction not grandfather*, Energy Policy, 30, 2002, pp. 333–345.
- Electrowatt-Ekono Oy, 2004, *Emissions Trading and European Electricity Markets: Conceptual Solution to Minimise the Impact of the EU Emissions Trading Scheme on Electricity Prices*, for *The Alliance of Power Intensive Industries*, 60K04817.01-Q060-001
- Hamal and Madian, 2005, *Allocation of Emission Allowances for the Regional Greenhouse Gas Initiative*, White Paper for National Grid
- IPA Energy Consulting, 2005, *Implications of the EU Emissions Trading Scheme for the UK Power Generation Sector*, to: Department of Trade and Industry (DTI)
- Standard & Poor’s, 2006, *Gas And CO2 Prices Fuel Profits For Electric Utilities In Europe’s Deregulated Markets*, Standard & Poor’s Credit Ratings - Commentary & News, 6 April 2006
- Stavins, R., 1998. “What Can We Learn from the Grand Policy Experiment? Lessons from SO2 Allowance Trading,” *Journal of Economic Perspectives*, 12:3 (summer), 69-88.
- Sijm, et al, 2006, *CO2 cost pass-through and windfall profits in the power sector*, *Climate Policy*, 6 (1): 49-72
- Sijm, et al, 2005, *CO2 price dynamics: the implications of EU emissions trading for the price of electricity*, Energy Research Center of the Netherlands, ECN-C--05-081
- Tietenberg, T., 2001. *The Tradable Permits Approach to Protecting the Commons: What have we Learned?* Nota di Lavoro 36.2002, Fondazione ENI Enrico Mattei (FEEM).
- UBS, 2005, *CO2 – The Windfall Has Arrived*, UBS Investment Research, ETS Update, 7 June 2005

We also note that the average auction size suggested by the comments on the draft model rule is approximately 65-70%, demonstrating that there is wide consensus among commentators.

If Connecticut does not start with 100% auction, they should move to that point quickly such as through a scheduled ramp-up from 60% auction in the first compliance period, 80% in the second and 100% in the third. The following table illustrates the potential size and value of the Consumer Benefit and Strategic Energy Purposes allocation at allowance prices of \$2 and \$5 per ton CO2. The decision as to how much of this value should be given away for free is of critical importance.

Table 1: Estimates of the Value of the Consumer Benefit and Strategic Energy Purposes Allocation

State	RGGI Cap Level	Value of Allowances w/ a 25% Consumer Allocation			Value of Allowances w/ a 100% Consumer Allocation		
		Allowances (tons)	@ \$2/ton	@ \$5/ton	Allowances (tons)	@ \$2/ton	@ \$5/ton
CT	10,695,036	2,673,759	\$5,347,518	\$13,368,795	10,695,036	\$21,390,072	\$53,475,180
DE	7,559,787	1,889,947	\$3,779,894	\$9,449,734	7,559,787	\$15,119,574	\$37,798,935
ME	5,948,902	1,487,226	\$2,974,451	\$7,436,128	5,948,902	\$11,897,804	\$29,744,510
NH	8,620,460	2,155,115	\$4,310,230	\$10,775,575	8,620,460	\$17,240,920	\$43,102,300
NJ	22,892,730	5,723,183	\$11,446,365	\$28,615,913	22,892,730	\$45,785,460	\$114,463,650
NY	64,310,805	16,077,701	\$32,155,403	\$80,388,506	64,310,805	\$128,621,610	\$321,554,025
VT	1,225,830	306,458	\$612,915	\$1,532,288	1,225,830	\$2,451,660	\$6,129,150
Total	121,253,550	30,313,388	\$60,626,775	\$151,566,938	121,253,550	\$242,507,100	\$606,267,750
MA	26,660,204	6,665,051	\$13,330,102	\$33,325,255	26,660,204	\$53,320,408	\$133,301,020
RI	2,659,239	664,810	\$1,329,620	\$3,324,049	2,659,239	\$5,318,478	\$13,296,195

While it may seem at first glance that generators will be forced to pay the full costs of compliance with RGGI; however, in reality the costs associated with purchasing allowances are passed on to electricity consumers. The good news is that since these costs will be distributed among millions of customers, the

impact on individuals' electric bills will be small while the benefits to public health and the environment will be large.

- The projected direct electricity cost impacts due to RGGI would be modest under the best estimate and range from 0.3% to 0.6% in 2015 resulting in a bill increase in the range of \$3-\$16 per average household annually in 2015.
- In addition, designing expanded energy efficiency programs into the RGGI framework or providing direct rebates to electricity consumers from the sale of emissions allowances would reduce consumer costs and lead to improved job and economic growth.
- Studies have shown that investments in end-use energy efficiency programs, as a result of, or in conjunction with RGGI are projected to be so effective in reducing total electricity usage by households, that they will mitigate any cost increase associated with RGGI.
- In addition, while RGGI may have a very small impact on the regional economy (as measured by Gross Regional Product, Real Personal Income, and Private Sector Jobs), that impact is projected to be a *positive* one (primarily due to the benefits of investment in energy efficiency technologies) – ranging from a one hundredth to two-hundredth of one percent change (0.01% - 0.02% positive change in economic growth).

(2) Implementation of the Consumer Benefit and Strategic Energy Purposes (CB&SEP)

Environment Northeast would like to suggest a methodology to implement the Consumer Benefit and Strategic Energy Purposes (CB&SEP) portion of the RGGI program and note that the market will perform better with consistent methods across the region. In particular we believe there should be a clear set of criteria for projects and programs eligible for the allowance value; transparency in ownership and planning for the allocation and/or auction; and regular and predictable release or auction of these allowances.

In Connecticut the best vehicle for these activities and the auction of allowances is likely to be the state's local electric distribution companies, which run the state's efficiency programs. The utilities are still fully regulated by Department of Public Utility Control (DPUC) and supposed to hold their unique position with the understanding that they serve electric ratepayers.

In this process, state environmental regulators would allocate the CB&SEP allowances to the regulated electric distribution companies. That state's public utility commission would then have regulatory oversight of the sale of the allowances to generators and over the distribution of the resulting proceeds.

The following is a more detailed process Connecticut and other states could follow to implement the CB&SEP allocation and auction:

- The state environmental agencies would create a CO2 Allowance Tracking System Account for each local distribution company in the state;
- The total allowances to be allocated to the CB&SEP allocation would be split among distribution companies (including municipal utilities) based on the percent of the state's load they serve;
- The state Public Utility Commission (PUC) would hold a rulemaking or docket to develop a plan for the auction of the CB&SEP allowances and use of the revenue; this plan should be for the next three year compliance period and the process of finalizing the plan completed prior to the beginning of the compliance period (first plan would be completed well before 2009);
- The PUC could request written comments, hold technical meetings or hearings, request working group meetings among participants, or other suitable processes to develop a plan for the utilities to auction and invest the CB&SEP money;

- All relevant stakeholders could participate in this process as participants or interveners including the state environmental agency.
 - The plan would be developed based on the basic CB&SEP guidelines from the environmental agency (reduce the costs of the RGGI program to the state's electricity ratepayers, etc).
 - The plan would cover how the distribution companies should conduct the auction of allowances (it is critical that all allowances be sold in a market neutral, open, transparent manner which could be done by the Independent System Operator (ISO) or by an emissions broker under contract to the state's distribution utilities); coordination of this auction regionally would also help reduce transaction costs and increase transparency; the plan should also address concerns about market power and maximum percentages one entity would be allowed to purchase.
 - The plan would identify how the money should be invested by the utility; with our recommendation being to deposit it in the state's SBC efficiency account (or equivalent) and use the money to expand efficiency programs for all classes of customers; other options could include a direct rebate on a per MWh basis to customers or expanded investments in existing Clean Energy programs.
 - The distribution company should be entitled to recover its reasonable costs in carrying out the auction and plan; moreover, distribution of proceeds based on an approved plan would insulate the company from a later determination of imprudence.
- Allowances could be allocated to the distribution company accounts annually with $\frac{1}{4}$ auctioned every quarter based on the three year plan approved by the PUC (investment plan for a three year period with quarterly auctions);
 - Regular auctions will significantly aid the market in terms of price discovery and assessing the price of allowances in relation to the program's trigger prices.
 - We believe the state PUCs have existing authority to oversee this kind of process and determine how the allowance value should be used.

(3) Development of the Regional Organization

Connecticut and other states should move quickly to create and staff the Regional Organization (RO) to support the technical support work going forward. The smaller states are especially likely to need support during their state rulemakings and having the RO up and running would be an important asset. The RO will likely need qualified staff to develop support documents, interpret and present modeling results, conduct legal analysis, interface with NESCAUM and the developers of the regional registry, supervise and assist in the development of new offset protocols, among other activities, and we encourage the states create this organization and assemble the team of people before the end of this year.

(4) Voluntary Renewable Energy Market Set-Aside Allocation

Connecticut should include the optional set-aside for voluntary renewable purchases in their state rulemaking process (RGGI section XX-5.3(D)). For each control period, states can set aside some carbon credits and retire them at a set rate when it is verified that voluntary renewable energy purchases were made. Environment Northeast believes that Connecticut should retire these credits to support the voluntary renewable market and to ensure that marketers can continue to claim that the program is reducing carbon emissions. It is our understanding that this set aside and retirement of credits would only represent a tiny fraction of the allowance budget. In Connecticut, which has a robust voluntary clean energy program, this voluntary requirement would comprise less than 1% of CT's allocations.

Thank you for your continued work and support of climate change action in the region. Please let us know if you have questions about this letter, which we hope provides some additional ideas to policy makers on next steps for RGGI. We look forward to working with the states to implement the RGGI rule in all the Northeastern states.

Sincerely,



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