



September 20, 2005

TITLE FIRST LAST  
AGENCY  
ADDRESS 1  
ADDRESS 2  
CITY, STATE ZIP

Dear SALUTATION LAST:

I am writing on behalf of the New England Power Generators Association, Inc. (NEPGA) to express our serious concerns with the proposed Model Rule of the Regional Greenhouse Gas Initiative (RGGI). We believe that global climate change is a serious issue deserving attention from policy makers, industry and individuals. However, it is equally important that the RGGI process "get it right". Specifically, the manner of implementing and conducting any RGGI program will impact both consumers and the electric industry, and hence the overall health and sustainability of the region's economy. If these broader implications are appropriately considered, the northeast model could serve as a framework for other regions as they evaluate options for curbing CO2 emissions. If not, the RGGI program could result in severe economic harm to the northeast consumers with no discernible environmental benefit.

The RGGI process has been underway for approximately two years, with considerable focus by the environmental regulatory community. Aspects of the current direction of the RGGI effort however suggest that it has not benefited from a more complete discussion regarding its impact on overall energy and economic policy. As such, we are concerned that the RGGI Staff Working Group and the region's environmental agency heads not rush to a formal proposal to present to the region's Governors prior to careful and complete consideration of the potential costs and benefits of the Model Rule by energy industry participants, regulators, policy makers, and business and industry with significant electric consumption.

In addition to our concern that the proposed Model Rule is not yet fully developed, we are concerned that the proposed allocation methodology of CO2 allowances will create serious market dislocations within the RGGI region and will create additional competitive disadvantages for business in relation to other neighboring non-RGGI regions.

NEPGA's primary concern relates to the manner in which CO2 allowances will be allocated under the program. Specifically, there is currently a debate within the RGGI process as to whether all of the available carbon allowances should be allocated to affected generating units, or whether some or all of the allowance pool should be subject to a public auction. NEPGA and its members strongly support the allocation of all CO2 allowances to affected units to ensure their ability to economically produce needed energy. We believe that any other approach would lead to higher electric prices for consumers and yield other unwanted and undesirable reliability and market cost impacts. For example, the use of allowance auctions in which affected sources must purchase allowances may threaten both the viability of existing sources in the region and undermine the already questionable incentives that developers have to construct and maintain needed megawatts in the region. This will ultimately affect all electric consumers through both higher electricity prices and possible supply shortages. It is important to note that the successful cap and trade programs for NOx and SO2 included 100 percent allocation of allowances to emission sources. Further, the European Union's cap and trade program for CO2 allocated all allowances to emission sources.

The current Model Rule recommends that five percent of a state's total allowance budget be set aside to generate revenue for a Strategic Carbon Fund. At a minimum, this would mean that affected generators (all fossil units over 25 MW) would have to purchase at least five percent of their allowance needs and then attempt to recover those costs in wholesale market prices for energy. The Model Rule also proposes to set aside an additional twenty percent of allowances that would be made available for sale to generate revenue for energy efficiency or other types of public benefit programs. NEPGA strenuously objects to these proposed set-asides. These set-asides are essentially a direct tax on one group of generators (those who operate large fossil fueled facilities) to fund energy conservation or other similar types of programs. Even if the potential benefits associated with those programs outweighed the additional costs ultimately charged to consumers, funding them through a tax on one segment of the electric generation industry is an unfair and undesirable policy.

Under such an approach, there are two possible outcomes: either the suppliers who bear the tax will be successful in passing their increased cost of doing business through to consumers, or they will not. If they are successful, consumers will pay more to fund these programs than if they funded them directly. If the suppliers are not successful, the cost impacts of public benefit programs will fall on private enterprises, and will further threaten the already tenuous financial condition faced by suppliers of critical electricity supply. Either outcome yields undesirable outcomes and fails to balance broader electric market impacts with environmental benefits.

The RGGI Model Rule provides some guidelines, but requires individual states to seek state legislative and/or administrative approval to implement the allowance allocations. In practice, this is likely to result in differences between the states both in timing of implementation and in the manner of allocation. Any such differences would clearly create anti-competitive results within the ISO New England market

and between New England and neighboring market regions. Even if the nine RGGI states achieved perfect coordination of timing and allocation protocols, inter-regional distinctions (between RGGI and non-RGGI areas) would competitively disadvantage generation supply for those within the RGGI states. The increased cost of producing energy under the RGGI proposal will create pressure to import additional energy from outside the region, raising the cost of energy and simply increasing CO2 emissions in the rest of the Mid-Atlantic, Midwest or beyond. Such “leakage” between regions is particularly problematic, since it harms the local economy and undermines the program’s goals.

Despite the fact that fuel-adjusted wholesale power prices have continued to decline since the advent of competitive markets, there is no changing the reality that consumers in New England have always had higher electric prices than the rest of the country due to our lack of indigenous fuel supplies. If the northeastern states adopt RGGI without a comparable program in the rest of the country, it will put substantial additional pressure on businesses and consumers in the region, further harming our global competitiveness. To put the costs of RGGI in perspective, if generators were forced to purchase all of their allowances, it could result in an immediate wholesale price increase up to \$5/MWh during peak hours and up to \$10/MWh during off-peak hours, depending upon the market price of allowances. Further increases in costs to the region will result if the program threatens the viability of existing and prospective generating capacity. For this reason, we request state commissioners to require support for any RGGI program to be conditioned on the allocation of allowances to generators to avoid this consequence.<sup>1</sup>

At present, RGGI hopes to have a final proposal submitted to the region’s Governors as soon as the end of this month. Given the potential economic impact of this issue and the complex multi-state effort, NEPGA strongly encourages state utility and environmental commissioners to become actively engaged in the RGGI discussion to ensure that the ramifications of the proposals are fully understood, and are appropriately coordinated with overall energy policy in support of reliable and affordable energy supplies and a vibrant and competitive economy.

Sincerely,



Peter D. Fuller  
Chairman, New England Power Generators Association, Inc.

---

<sup>1</sup> NEPGA would be interested in discussing a workable method of assuring that RGGI does not increase electricity prices through a well designed allocation to generators.