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Regional Greenhouse Gas Initiative (RGGI): April 2007 Update

NINE NORTHEASTERN STATES have begun implementing a program to control and reduce the emission of greenhouse gases.[1] This Regional Greenhouse Gas Initiative ("RGGI" or the "Initiative") is similar in many aspects to the schemes developed pursuant to the Kyoto Protocol. RGGI will cap CO_2 emissions from electric power plants, allow for trading of allowances, and create a mechanism for fostering other projects that will offset CO_2 emissions to create additional allowances. (California has recently enacted legislation that establishes requirements to reduce greenhouse gas emissions, but how it will be achieved has been left to state regulatory agencies. A cap and trade system is being discussed, and reductions will not be limited to electric generating facilities. Several Congressional proposals that have been discussed resemble or complement RGGI, although others do not.)

RGGI is designed to be a first step, impacting limited sources of carbon dioxide emissions, with the hope that the experience gained from this program will allow for further expansions going forward. RGGI will initially apply only to electric generating power plants larger than 25 megawatts, excluding biomass facilities (such as wood waste, waste-to-energy, and other such facilities). The RGGI participating states agreed to a level of carbon dioxide emissions that will be allowed in each state. This standard is initially set at a level roughly equal to the actual average tons of carbon dioxide emitted annually from these plants during 2000 through 2004.[2]

Each allowance grants the right to emit a ton of carbon dioxide. Each participating state will be assigned these emission allowances. A state can allocate only up to 75% of that plant's average yearly emissions.[3]

At least 25% of a state's emission allowances are to be allocated for public benefit purposes. This means that these allowances will be distributed in a way that is to support energy conservation, fund the RGGI Initiative itself, foster renewable energy, mitigate ratepayer impacts, or similar objectives. Most likely, these allowances will be auctioned and the proceeds utilized to fund various types of these activities. Some allowances may also be held in reserve for new power plants.

Power plants subject to these requirements will need to demonstrate that, two months after the end of each applicable three-year compliance period, they have been allocated or have acquired sufficient carbon allowances to match their carbon emissions.

In other words, a power plant will have to accomplish some combination of either: (a) buying allowances from either the state or from other plants who do not need all of their credits, or from third parties who otherwise have acquired emission allowances; or (b) reducing emissions so that the plant does not need additional allowances.

In addition, power plants and other unrelated parties can "create" new carbon allowances (called "offsets") by undertaking verified and accredited projects that reduce the release of carbon dioxide into the atmosphere. There are limits to the number of these "offset" allowances that can be utilized by a power plant to meet its emissions cap, so as to avoid the creation of too many allowances.

A word about offsets. Offsets are, for the most part, not renewable energy projects.[4] Offsets are projects that, in and of themselves, cause the amount of carbon dioxide being released into the atmosphere to be reduced. At the moment, these include only a few specific projects, such as capturing landfill gas that otherwise would be emitted into the atmosphere, eliminating leaks in natural gas distribution systems and propane systems, reducing methane from farming operations, and certain forest plantings.

Renewable energy projects such as wind turbines do not create carbon offsets, because they do not directly result in a reduction of carbon that would be emitted into the atmosphere. Obviously, a wind turbine can offset electricity that would otherwise be generated from a carbon-emitting power plant.

The effect, if it were to be undertaken by the owner of a coal-fired plant that needs to acquire carbon allowances, would simply be to reduce the hours the coal plant is operating and reduce the number of carbon allowances that this plant would have to acquire, but the wind turbine does not create new allowances that can be traded.

The goal of the offset program is to create allowances that can be freely traded regardless of the source - each state's allowances should be tradable in any other state, and allowances created through the offset program will be freely tradable across states that are signatories to RGGI and interchangeable with other carbon allowances. Offset allowances can also be created from projects in non-RGGI states that have agreed to enforce certain requirements.

The general terms of RGGI are reflected in a Memorandum of Understanding (MOU) executed by the various state governors. Model regulations were adopted in the summer of 2006. Each state is now in the process of adopting these uniform rules. Obviously, it is critical that there be sufficient uniformity between the states such that allowances, and especially offsets that will be certified and created in each individual state, will be freely tradable.

RGGI will take effect in 2009. The level of carbon emission allocations for each of the states will be at a stable level through 2015. Between 2015 and 2020, a 10% reduction in allowance (emissions) will be imposed.

There are various trigger mechanisms in the Initiative that are designed to relax restrictions on the use of allowances created from offset projects if the prices of the allowances exceed certain levels (and thereby result in too great an increase in electric prices).

Several of the RGGI states have announced that 100% of their allowances will be auctioned (instead of 75% being allocated to plants for free as allowed in the MOU). The states' economic analysis indicates that the value of even a "free" allowance would be included in the price at which electricity is sold, and might represent a windfall for power plants. With a 100% auction, the states will realize this windfall in revenue, which must be used for public benefits, or could reduce price increases to consumers.

The economics underlying RGGI is the idea that power generated from plants that emit high levels of CO_2 will cost more and will be penalized in the marketplace, and therefore less power will be generated from these plants. If that happens, CO_2 emissions will be reduced. However, the flip side is that consumers will pay more.

Some studies have suggested that conservation efforts will offset the price effects of RGGI, but that remains to be seen. In addition, concerns have been raised with whether power from bordering, non-RGGI states will simply be imported into the region, thereby circumventing emission reductions, and simply penalizing in-region power producers.

COMPARISON TO KYOTO

In many ways, this scheme is similar to the Kyoto Protocol. However, under Kyoto, for industrialized countries, the initial emissions are capped at an estimated 1,990 levels, and so there will be an immediate reduction required. Also, the emission limits apply to many more industrial facilities in addition to power plants. Each country has allocated its assigned emission allowances to various industries in various percentages, reflecting that country's desire to cushion certain industries from potential price effects.

Kyoto also has several mechanisms for creating new carbon credits through projects that reduce carbon emissions in developing countries. In addition, several countries - most notably Russia and the Ukraine - have many excess Kyoto allowances that could be traded, because their carbon outputs in the early 1990s were significantly greater than they are today.

A market in the trading of government-issued allowances (EU allowances) is already in place. Allowances initially traded for as much as 20-30 Euros; however, at the end of the first reporting period it became clear that emissions had been overestimated. Too many allowances were created, and thus the price collapsed.

Many offset projects that will qualify for the production of carbon credits have been approved, but there is still substantial backlog in the approval process. The executive board created under UNFCCC (the governing framework for the Kyoto Protocol) is working hard to address this issue. The upside is that once a project methodology has been approved, it is publicly available and can be utilized by the general public to develop more projects based on the same methodology.

SUMMARY

The Regional Greenhouse Gas Initiative is a bold and pioneering step on the part of American entities in the absence of federal leadership. In its present form, it only impacts power generation facilities. However, the states involved intend this to be a starting point for regulation of all significant sources of carbon dioxide emissions.

In addition, it is no secret that it is hoped that RGGI will become a very broad-based program to fill a perceived vacuum regarding global warming on the federal level -- and to be a program that could transition easily into a nationwide regulatory scheme if there are policy shifts at that level.

Companies are well advised to become informed and involved in the early stages of this program, both to ensure that specific concerns are addressed in the details of the regulations that are being developed, and to be able to intelligently anticipate the program's consequences on the company's long-range plans. Details that are made a part of this regional program could well shape what ends up in any federal program that is enacted.

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1 The ratifying states are Connecticut, Delaware, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island and Vermont. Maryland and the District of Columbia have given indication that they may join. The Initiative is designed to allow for a fairly seamless addition of these and other states in the future.

2 While it does not seem that any reduction in emissions is being mandated during the first years of this Initiative, remember that the baseline period represented a downturn in the economy, electricity usage was lower and natural gas prices were low - which increased use of that fuel leading to reduced CO_2 emissions. Also, a significant number of allowances have been allocated to Vermont, but Vermont has no sources that need allowances. (Most of Vermont's power comes from the Vermont Yankee nuclear plant or Hydro-Quebec.)

3 The mechanism for a state's assigning emission allowances to a facility is to be determined on a state by state basis, and could be allocated free of charge, or auctioned, or distributed by using some other mechanism. For example, New York, Massachusetts and of course Vermont (since Vermont has no sources to allocate allowances) have proposed to auction 100% of their allowances.

4 Except perhaps landfill gas recapture and methane capture at farms, which can include generation of electricity.

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