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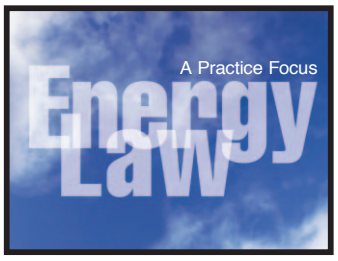
States Get Together on Greenhouse Gases

Mutual effort is praiseworthy but still needs revisions.

By Mary Anne Sullivan and Joshua P. Fershee

On April 3 a cover story in *Time* magazine warned its readers: "Be Worried. Be Very Worried" about climate change.

That same week, the Senate Energy Committee held its first and very preliminary hearing on what a mandatory greenhouse-gas regulatory program might look like. At the end of the day, Chairman Pete Domenici (R-N.M.) stressed that the issue was very difficult and said there would be no bill out of the Senate this year. A few weeks later, the House Appropriations Committee approved a resolution suggesting it might be time to begin considering regulating greenhouse-gas emissions, but the provision was dropped before reaching the House floor.



Although Washington is dragging its heels on this serious issue, a significant group of Northeast and mid-Atlantic states are moving ahead jointly to impose the nation's first caps on greenhouse-gas emissions. The states deserve applause for acting decisively to deal with this pressing environmental issue, but their plan also suffers from an undue rigidity that, unless corrected, may frustrate their laudable intentions.

Capping CO_2

In December, the governors of Connecticut, Delaware, Maine, New Hampshire, New Jersey, New York, and Vermont agreed to the Regional Greenhouse Gas Initiative, a program to cap carbon dioxide emissions from power plants within their borders. They signed a memorandum of understanding to reflect this agreement.

They also promised that a draft model rule for adoption by individual states would be issued within 90 days to explain how those caps would be achieved. The draft was issued on schedule, and the RGGI is moving forward and expanding. Under recently passed legislation, Maryland is set to join by mid-2007, and the Massachusetts Legislature is considering a directive to the governor to rejoin the effort.

The RGGI will place greenhouse-gas emissions caps on the approximately 300 fossil-fuel power plants in the Northeast that have a capacity of 25 megawatts or greater. This will force a reduction in the level of carbon dioxide emissions. The RGGI will cap regional emissions at 1990 levels, and the initial cap will remain in place until 2015. Thereafter, emissions must decline over a four-year period to 10 percent below 1990 levels.

Perhaps the most significant achievement of the plan is the specific amount of the regional initial emissions budget that would be apportioned to each RGGI state. States will decide for themselves how to allocate emissions allowances among their power plants, but at least 25 percent of the allowances must be held back and used for "strategic energy purposes" or "consumer benefits," which will be defined by each state.

Not all of the emissions reductions must be achieved directly by the covered power plants. The model rule authorizes the use of "offsets" to cover up to 3.3 percent of a source's reported emissions. This sounds modest but in fact represents roughly half of a regulated source's required reductions. Anyone is eligible to initiate an offset project, and offset allowances can be granted to projects anywhere in the United States.

Under normal circumstances, projects located outside the RGGI states will be awarded one allowance for every two tons of certified emissions reduction, and projects within the RGGI will earn offsets on a 1-to-1 basis. The power companies that need to offset their own emissions can either undertake offset activities themselves or buy offset credits from project sponsors. To mitigate potential adverse economic consequences, the project-location and allowance-per-reduction rules will be relaxed if the cost of allowances reaches certain thresholds.

The RGGI states should be applauded for their collective, decisive action. They recognize that climate change requires action now and that voluntary programs are not making even the modest gains their advocates had hoped for. They also recognize that the competitive consequences for a single state acting alone might be too great and that individual states, acting separately, would pose a compliance nightmare for regulated entities.

The RGGI gets many things right: It hews closely to the prin-

ciple that to have a real impact on levels of greenhouse-gas emissions, reductions must be verifiable, permanent, and enforceable. The RGGI also rewards early action to reduce emissions. The caps do not take effect until 2009, but the model rule allows offset credits for activities undertaken any time after the signing of the governors' memorandum of understanding in December 2005.

In addition, the RGGI states know they have to be worried about "leakage," the rise in greenhouse-gas emissions outside the region that will result if power plants reduce emissions within the RGGI by importing power from nonparticipating states. (A recent public meeting showed that the RGGI staff continue to struggle with how best to address that issue.)

Undue Rigidity

Despite these successes, the RGGI also suffers from an undue rigidity. This may result in unnecessarily high compliance costs, and it undermines the strength of the regional approach by leaving to individual states the ability to deal with some key issues in their own ways.

Much of the draft rule also seems to assume that cost-effective activities should not qualify for emissions-reduction offsets. This attitude derives from a misguided application of "additionality," a concept developed under the Kyoto Protocol, the mandatory international regime for greenhouse-gas reductions (which the United States has declined to join). Under principles of additionality, projects that represent "business as usual" cannot earn credits toward mandatory greenhouse-gas reductions.

Perhaps the best example of the undue rigidity in the RGGI is the very limited range of permitted offset projects. There are only six approved types of activity: (1) landfill gas capture and combustion, (2) methane capture from animal operations (such as dairies and poultry houses), (3) forestation of nonforested land, (4) reductions of sulfur hexafluoride emissions from electricity transmission and distribution equipment, (5) reductions of fugitive emissions (unplanned leaks or releases) from natural gas transmission and distribution systems, and (6) efficiencies in the end use of natural gas, heating oil, and propane.

Under the clean-development mechanism of the Kyoto Protocol, nine project types have been approved categorically, and more than two dozen additional methodologies have been approved for application to specific projects. Still more are under evaluation. Clearly, the kinds of projects that can produce real, verifiable reductions in greenhouse-gas emissions extend far beyond what the RGGI rule recognizes.

It is no answer to say that the administrative burden of recognizing a broader range of offsets is too great for this nascent program. Under the Kyoto Protocol, the project sponsor must obtain independent verification—using established protocols for baselining and measuring—that a project can and does achieve greenhouse-gas reductions before credits are granted. The RGGI easily could have adopted such an approach.

Although the draft rule gives individual states the flexibility to add more offset programs, the state-by-state approach takes away from the benefit of the RGGI as a regional program, and it creates a far more burdensome approach for regulators and project sponsors alike.

The RGGI also fails to deliver on its regional promise by providing no programwide incentives or rewards for efforts by electricity consumers to adopt energy-efficient practices.

Large users of electricity are best positioned to achieve the greenhouse-gas reductions the RGGI seeks by reducing their electricity consumption. But even though many efficiency measures prove cost-effective for large users over time, such measures have long suffered from low market penetration because they require upfront capital investment.

Although the RGGI pays lip service to the importance of efficiency, the only RGGI mechanism for rewarding such capital investments in efficiency is through the distribution of the 25 percent of emissions allowances the states must withhold from power plants. What efficiency measures may qualify for allowances and how are left entirely to a state-by-state determination. These allowances are likely to have many competing potential uses, including, for example, state sales of the hold-back allowances to cover the RGGI's administrative costs.

Compliance Costs

Three aspects of the draft rule illustrate the RGGI's unbending commitment to additionality and insensitivity to compliance costs.

First, the RGGI will not allow renewable-energy projects to qualify for offset allowances if they are also being used to satisfy a state's renewable portfolio requirement. (Several states, including most of the RGGI states, require that a certain percentage of retail electricity sales come from renewable sources.) The theory is that those projects would occur anyway because they are legally required.

Overlooked in that analysis is the difficulty many utilities are having in meeting the renewable requirements because so many renewable technologies are not yet cost-competitive. The RGGI would seem well advised to use its hold-back allowances to give renewable projects the extra push they need to become cost-competitive. Instead the program will just create further incentives for electricity generators to switch from renewable-fuel sources to scarce natural gas, which is both nonrenewable and needed for home heating.

Second, the RGGI effectively penalizes companies for participating in a voluntary federal program to reduce greenhouse gases. A reduction in emissions of methane, a powerful greenhouse gas, from natural gas systems is one of the few authorized offset activities under the RGGI. The Environmental Protection Agency also operates the Natural Gas STAR program, which likewise seeks to reduce greenhouse-gas emissions from fugitive methane.

Yet the RGGI draft model rule provides that natural gas companies that participate in the EPA program cannot receive the RGGI offset. The RGGI reasons that such companies have found the EPA program cost-effective and, for them, the "best management practices" that the EPA has fostered represent "business as usual" and are thus ineligible.

It is hard to imagine a clearer message to those participating in any voluntary greenhouse-gas reduction efforts: You participate at your competitive peril.

Third, although efficiencies in the end use of natural gas,

propane, and heating oil qualify for offsets, after 2008 they will only qualify until they reach a 5 percent market penetration or meet other specific efficiency standards.

Market penetration of 5 percent hardly represents the "business as usual" that would elsewhere be disqualifying under the RGGI. Indeed, energy-efficiency technology becomes most cost-effective at high levels of market penetration, when it can be produced in volume. The RGGI would reject such measures long before that. By comparison, clean-development mechanism projects under the Kyoto Protocol qualify for carbon credits if they are in the top 20 percent of efficiency for a particular use.

These problems reveal how the RGGI reflects some questionable choices about how to tackle climate change. And it is likely that the program will face litigation, including a challenge under the commerce clause and a claim of federal pre-emption of greenhouse-gas regulation.

Nevertheless, the RGGI is an important response to a critical environmental issue. It is likely to help inform and shape the federal mandates that are almost certainly just down the road.

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