



Governor’s Action Team on Energy and Climate Change
State of Florida

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DRAFT MEETING SUMMARY
Cap-and-trade
Technical Working Group Meeting #10
August 8, 2008

Action Team Members and TWG Appointees Attending:

Greg Munson WRScompass	John Cahill Chadbourne & Park LLP	Randy LaBauve for Armando Olivera Florida Power & Light
Jim Vick Southern Company	Kathy Viehe Gainesville Regional Utilities	Terry Murphy Miami-Dade County Commission
Jerry Karnas Environmental Defense	Michael Hewett Publix Supermarkets	Buzz Hoover Gate Biofuels, LLC
Michael Kennedy Progress Energy Florida	Laura Crouch Tampa Electric Company	Robert Reedy Florida Solar Energy Research Center
Robert Kaufman Georgia-Pacific	John Hewa Talquin Electric Cooperative	
Called In Debbie Harrison World Wildlife Fund	Called In Tim Devlin Public Service Commission	

Governor’s Energy Office: Brenda Buchan, Matt Stamatoff

Center for Climate Strategies (CCS): Jeff Wennberg

Members of the Public: Bob and Jan Krasowski (Florida Alliance for a Clean Environment), Paul Messerschmidt (Grace Financial), Paul Lewis (Progress Energy), Jennifer Fisher (Seminole Electric), Susan Fernandez (Consensus Communications, Inc), and Katie Travis (CDM Environmental Consulting), Devon Higgins

1. Introductions—Jeff Wennberg from CCS introduced himself and called roll for the members of the Cap-and-Trade Technical Work Group (TWG). The members of the public were asked to introduce themselves and identify their affiliation. Sixteen TWG members and 8 members of the public either were in attendance or identified themselves over the phone.
2. Purpose and Goals—Under Executive Order 07-127 Governor Crist charged the Action Team to develop a comprehensive Energy and Climate Change Action Plan that will fully achieve or surpass his Executive Order targets for statewide greenhouse gas reductions

specified in Executive Order 07-127. The following recommendations were voted on and approved in Phase I:

The Action Team recommends that Florida pursue a market-based policy of “cap-and-trade” by creating tradable emissions allowances as the preferable means meeting the utility sector emissions cap and the statewide emission reduction targets directed by Governor Crist in Executive Order 07-127.

The Action Team recommends a market design process for Florida’s tradable allowances market as a vital component of the Florida’s Energy and Climate Change Action Plan development process to occur in 2008. This design process should result in final recommendations for several considerations, including but not limited to

- An allowance allocation process,
- Economic and emergency safety valves,
- The creation and use of emission offset credits,
- A “leakage” strategy regarding the migration of emissions into surrounding states,
- Trial periods, and
- Timeframes for full implementation.

The design process should consider linking a Florida-based allowances trading market with other regional or international markets.

In the meeting today we will discuss the responses to the Cap-and-trade survey and, when possible, vote out those issues where we have agreement. The members discussed the procedure and any dissent will be so noted in the summary of each option.

3. Review and Approval of the Call #9 Summary—Several members stated that there were more questions and doubts expressed on the economic modeling than is reflected in the Call #9 Summary. The summary was approved without modification.
4. Discussion Regarding Additional Economic Analysis—There was a discussion on how the policy needs to drive the modeling and not the other way around, but the costs and economic impacts need to be better understood before final decisions are made. Several members supported the belief that the economic analysis should be front and center. They want the best possible data to pass on to the legislature. It was pointed out that the recommendations from the Action Team will advise the DEP, which will in turn initiate rulemaking. The rulemaking process will provide the detailed economic analysis before rules are finalized, and the legislature will review the proposed rule and the analysis supporting it before the rule can be put into effect. There was a suggestion of a preamble statement within the Action Team cap-and-trade recommendations that summarizes the need for this more in-depth economic study before a final decision is made. A member stated that such a study was needed, but that it must include not only the cost of the program but also the cost of

environmental damage resulting from inaction. There is a cost associated with inaction and analysis of both is necessary for policy makers to have a balanced picture of all costs.

5. Review and Discussion of Key Questions Survey—The response to the survey by the C&T TWG members was excellent. Fourteen out of nineteen members responded. The document on the web does not include TWG member comments at this time, but we can include them if preferred. There was no strong opinion either way.
6. Discuss/Decide Key Design Recommendations – General Agreement by Survey—The discussion proceeded with Jeff raising those issues where there was the greatest amount of agreement indicated by the survey. Items in **BOLD** indicate consensus agreement, conditioned by the discussion described in 4 above.
 - Sector Coverage—One member stated that he is opposed to making any decisions without detailed economic analysis and with information that is ‘immature’ from regional climate initiatives. His utility has had to raise rates on several instances recently and they are concerned about the impact of those rate increases on their customers.

Another member expressed concern that the transportation sector needs to be included in any discussion on reducing carbon dioxide emissions. Dade County is one of the largest purchasers of fuel in the state (needed to run their municipal vehicles) and they are already taking action on reducing their emissions by participating in the Chicago Climate Exchange. The public sector needs to be involved in this process.

A recommendation would be to include the electric sector now, but that transportation fuel, energy extraction, industrial sources and residential and commercial fuel should be considered in the rule making process or if we join another climate initiative. Counties and cities could join the Chicago Climate Exchange, which requires third party verification.

Transportation fuel has not yet been included in an operating climate initiative, although the Western Climate Initiative intends to include this and residential and commercial fuel use beginning their second compliance period, in 2015.

An economy wide approach is preferred by most TWG members, and as soon as possible, but to begin with there is agreement the program should start with the electric sector. Some other sectors do not lend themselves to a cap-and-trade system and they should be studied for use of an alternative approach in the future.

There was discussion about the EPA plan to regulate GHGs under the clean air act. This would likely include a combination of measures and could include a national cap-and-trade, but the prospect of this happening in the near future is extremely low.

In a second phase of the Florida C&T program, process industrial stationary sources could be included, however there are relatively few sources, and to some extent industries would already be participating and paying via higher electric prices.

There was a suggestion that forestry, agriculture and waste management not be regulated under a cap-and-trade program due to issues associated with reporting, verification and the need to look to these sectors for offset opportunities. Regulated sectors are generally not allowed to participate in the offset market.

The regulation of greenhouse gas emissions should be economy wide and commence as soon as possible; however a cap-and-trade program may only apply to a limited number of sectors. Sector inclusion in the cap-and-trade program should be guided by administrative efficiency, overall reduction potential, experience by other jurisdictions and whether alternative policies are preferred. The Florida cap-and-trade program should include the electric sector at the beginning. Rulemaking consideration should be also given to including 1) industrial stationary source emissions; 2) residential and commercial fuel use; and 3) energy extraction, processing and transportation, but these may be better candidates for inclusion in a subsequent phase. The transportation sector could also be considered through rulemaking, but it is not well understood. Transportation should be studied further and considered for inclusion in a subsequent phase or determined to be better suited for regulation through non-cap-and-trade market mechanisms. While these and other sectors may not be included in the cap-and-trade program or otherwise regulated at the program start, they should be included or otherwise regulated as soon as possible.

Other sectors may need alternative methods of regulation over time based on the factors listed above. If forestry, agriculture, and waste management are regulated under the cap-and-trade program then they could not participate in the offset program.

- **De minimis Exemption—There should be a de minimis exemption. The exemption could vary by sector.**
- **Use of Allowance Value—The cap-and-trade program should strive to be revenue neutral to consumers as much as possible. There are four broad purposes to which allowance value (either the allowances themselves or proceeds from their sale) should be applied. These are not in any priority order:**
 - **Promote energy efficiency investments;**
 - **Mitigate impacts on ratepayers/consumers with particular attention to low income consumers;**
 - **Promote renewable or non-carbon technologies.**
 - **Mitigate impacts of climate change, i.e., fund adaptation strategies.**

It is our strong recommendation that if any revenues are generated from the sale of allowances they should never be used to supplement general revenues to the State of Florida.

- Offsets Limitation—RGGI allows regulated entities to use offsets for 3.3% of their compliance obligation and WCI proposes to allow 10%. A member suggested no limits on offsets but strict quality control. Another member cautioned that if you allow 100% offsets you will miss the investment in technological innovation that we seek. Strict quality control is crucial, but offsets help keep the consumer's costs down if there is no limit.

The cap-and-trade program should allow offsets without limits; however, the offset program must ensure rigorous quality standards. Within any offset program, Agriculture, forestry and waste should have their emissions included in life cycle costs before they could be offered as an offset.

- Banking—Unlimited banking is supported by the survey. This feature helps to mitigate market price fluctuations. There was a question asked, that if over-allocation occurs does it cause problems with banking? The EU experience indicated that disallowing banking between phase 1 and 2 caused the allowance value to go to zero.

The cap-and-trade program should allow unlimited banking.

- Safety Valve Price Limit—Some members objected to a safety valve that could violate the emissions cap. The concern is a set price will discourage emission reductions investments that may exceed that price in future years. Members were willing to accept a negotiated decision here. This seemed to work with the SO₂ program but with SO₂ sources knew how to control emissions; that is not the case for CO₂. Maybe there is a way to tilt the slope of the cap, and not make it so steep, but not raise the cap. A safety value could be a transition mechanism to help utilities and consumers through the uncertainty of implementing a cap-and-trade program at the start. The price cap could move up over time, and become irrelevant in later years. This mechanism offers some protections for overall economic impacts. This issue should be studied further.

The cap-and-trade program needs an appropriate allowance price containment mechanism, especially in early years. Further study is needed before the specific mechanism can be recommended.

- Reporting—U.S. EPA is required to propose rules for a GHG reporting requirement. It is hoped that Florida and EPA would use a common reporting system. EPA is talking to the Climate Registry, which is who Florida is using for electric generation reporting.

The cap-and-trade reporting system should be consistent with any national requirement. Every effort should be made so that regulated entities are required to complete only one report for both the state and the national efforts. The reporting system should be as broad as possible given administrative and cost concerns.

- Regional Programs—It is agreed that the best approach would be a strong national program. It is important that as Florida moves ahead with a cap-and-trade program, it should continue to serve as a liaison to other Southeastern states. There is a desire to move ahead quickly, perhaps following a sequential process, i.e., join an existing regional

program now but continue to work to encourage a program within the Southeast, or bring Southeastern states into other regional programs.

First and foremost, a strong national cap-and-trade program is the preferred method for addressing the reduction in greenhouse gases, and Florida should advocate for a national program.

As the federal government deliberates on a national program, Florida should join a regional program to advance its greenhouse gas reduction goals. Toward that end, Florida should further examine the economics of joining a regional program, and should not join a regional program where the analysis indicates that Florida would be disadvantaged.

Initial analysis indicates that Florida would benefit from joining the Northeast Regional Greenhouse Gas Initiative (RRGI). Because RGGI begins on January 1, 2009, and has a three year compliance period, the earliest Florida could join would be in 2012. This will give ample opportunity to conduct further economic analysis and observe the early operation of RGGI. Florida may seek ‘observer’ status with RGGI to closely monitor progress and prepare for membership if it is desired.

Initial analysis indicates that Florida would benefit from joining the Western Climate Initiative (WCI). Because the earliest WCI expects to begin is January 1, 2012, this will give ample opportunity to conduct further economic analysis and observe the early operation of WCI. Florida may seek ‘observer’ status with WCI to closely monitor progress and prepare for membership if it is desired.

These two regional programs may not be mutually exclusive. Florida should explore the economics and potential obstacles, complications and benefits associated with joining both.

At the same time Florida should reach out to the other Southern states in the hope of collaborating with our neighbors to 1) jointly influence the development of a national cap-and-trade program, 2) explore the potential for multiple Southern states joining one or more regional programs, and 3) explore the creation of a Southern regional climate initiative to reduce greenhouse gas emissions, stimulate the development of renewable energy sources, reduce our dependence on imported fuels and stimulate the creation of industries specializing in energy efficiency, renewable energy and carbon mitigation technologies.

Finally, we strongly recommended that Florida should not pursue a one-state cap-and-trade program.

7. Discuss/Decide Key Design Recommendations – No General Agreement by Survey—This next section provided discussion on those survey questions where the responses showed no general agreement by the members.

- **Goals and Caps**—In the last meeting someone asked how close would Florida come to meeting the Florida state goals if Florida joined RGGI. As a matter of clarification, Florida’s goals are set for 2017 and 2025, but have been interpolated to achieve a reduction date of 2020 consistent with the Climate Initiative target date. At a trading price of \$1.00, under the RGGI program, Florida’s electric sector would reduce its Business-as-Usual GHG emissions by 31.92% by 2020, which is close to Governor Crist’s state goal (34.82%). At a trading price of \$7.00, under RGGI’s program, Florida would reduce its GHG by 34.72% in 2020, which would almost exactly meet the Governor’s goal. Under the WCI program, as it is currently designed (incorporating about 80% of emissions from all sectors), in 2020 Florida would reduce GHG emissions by 35.18% from Business-as-Usual (BAU), as compared to the state goal of 39.34% for these sectors. One member expressed the concern that we should not tie emission reduction goals to 1990 levels because the utilities don’t have as reliable data from that year.

Florida’s greenhouse gas reduction cap-and-trade program should be designed to achieve the emission reduction goals set forth in the Governor’s Executive Order 07-127. However, as directed in Executive Order 07-127 and the recently enacted Florida Climate Protection Act, Florida should evaluate the conditions under which the state could cost-effectively link its trading system to the systems of other states or regions such as the Regional Greenhouse Gas Initiative (RGGI).

If Florida joins a regional climate initiative, Florida should accept the regional goal as long as it is consistent with the state’s GHG reduction goals. Current modeling indicates that RGGI should bring Florida’s electric sector to the state goal; however, if it does not, additional policies and measures would be required to reduce greenhouse gas emissions to meet the state goal.

- **Sector Phase-in**—These issues have been addressed under “Sector Coverage,” above.
- **Allowance Distribution Method**—This issue addresses how allowances should be distributed, either through free allocation, auction or some mixture of the two. With RGGI, a state may choose between zero and 100% auctioned; it is up to the state. But RGGI requires at least 25% of the allowances must be dedicated to ‘consumer benefit’ or to ‘strategic energy purposes’ (such as Carbon Capture and Sequestration). Most RGGI states are auctioning 100% of their allowances and have dedicated 25% or more of the revenues to energy efficiency programs. All RGGI states have some level of deregulated electricity markets, except for Vermont. If the generator is deregulated the value of a freely allocated allowance typically accrues to the benefit of the owners, as was the case in the EU. If the generator is regulated as in Vermont and Florida, the PSC can direct the economic benefit resulting from freely allocated allowances to the ratepayers through rate setting.

There was a concern expressed by some utilities that the program imposes two layers of costs, one to mitigate emissions to get to the cap, and a second to purchase the allowances. In contrast, some believe an auction is the most efficient way to allocate emission allowances. One utility stated that they have been investing in clean energy for

a while so their customers are already paying the cost associated with lower greenhouse gas generation. At least one utility supports 100% auctioning of allowances. The argument was made that with EPA's recently vacated Clean Air Interstate Rule, utilities with lots of dirty plants received more allowances than utilities that chose to build clean plants. If allowances are given away for free, customers of utilities that have not invested in clean technologies receive a benefit.

One non-utility member was concerned about having to pay higher fuel cost, but maintained that due to competition they can not pass those costs onto their customers. It was agreed that at least some regulated sectors should not be involved in auctions.

There was a concern expressed that speculators should not be allowed into the auction. Economists typically argue markets need speculators to help determine the price, but they should be allowed to exercise too much market power. RGGI decided to allow any party to participate in the auction but conduct auctions quarterly and limit the amount of allowances any one purchaser can buy. RGGI maintains that many concerns about auctions can be addressed through good auction design.

It was asked by a member that we not put the cooperative and municipal utilities in the position where they can not purchase an allowance so they would not be able to deliver power to their customers. One member was concerned that anything to do with an auction will have a cost impact on their customers. Some believe that a system can not be truly revenue neutral unless all costs are given back to customers.

It was asked if the utilities who have invested in coal could transition out of coal to other forms of generation over time. The answer is yes, but that timeline may be 10 to 15 years.

After extended discussion it did not seem that a consensus statement could be crafted. To test this and clarify where the TWG stood, it was decided that the TWG would vote on the following question: "Could you support the use of auctioning for allowance distribution to some degree, i.e., from 1% to 100% of all allowances?" **The vote was 7 in favor of some use of auctioning to 5 opposed to any use of auctioning.**

It was decided that the policy recommendation would provide the issues and arguments on all sides, stressing the concerns particular to Florida, and present the results of the vote.

- Offset Purpose—These issues have been mainly addressed under "Offset Limitation," above.
- Borrowing—The various concepts of a borrowing provision were discussed, including limits by regulated entity, time limits, and interest requirements. The question was asked, what is the purpose of an interest charge attached to borrowing? The answer was so that there is a cost to the borrower for delaying investments in mitigation, as opposed to investing in reduced emissions up front. It creates a disincentive for back loading the costs and reductions. One member stated that borrowing was a powerful cost containment

mechanism, and if Florida wanted to help customers save money then it would not make sense to limit borrowing. Neither RGGI nor WCI will allow borrowing. But both have a three year compliance period, which means the sources may “borrow” within that period since compliance is only required at the end. Warner Lieberman would allow borrowing up to 15% of the source’s compliance obligation.

Borrowing is an important cost containment mechanism and should be allowed, but agreement was not reached on what conditions (Warner-Lieberman-type limits by emitter, time limits, interest, etc.) should be imposed.

- Leakage—Under a national cap-and-trade program there would be no problem with leakage. How would Florida regulate emissions from a non-member state? Under RGGI, leakage is studied but not addressed in the initial program design. WCI uses “First Jurisdiction Deliverer” (FJD), which is all emissions from in-region generation plus emissions from out-of-region imports. If an entity imports power from outside the region then the importer is responsible for compliance based on the emissions associated with the imports. Historically, a small percentage of Florida’s electricity generation has come from out of state sources, and the quantity of imports has changed over time. It is critical that the program baseline include these out of state sources and their changes over time to accurately define the reduction requirements under the current generation mix. If out of state sources are not regulated, there is the potential that these sources may increase generation (and emissions) in response to the program price signal, thereby negating the desired emissions reductions and exporting investment.

With the exception of the panhandle, Florida’s geography limits the opportunities for leakage. Historically, imports have been a minor portion (~8%) of total consumption, so leakage may not prove to be a major concern for a Florida cap-and-trade program, but further study and analysis should be undertaken and if a program is adopted leakage should be carefully monitored.

- Trial Period—Time did not permit us to get to this issue.
8. Discussion of ESD-10 Grace Period for Replacement of Carbon-Intensive Units—Time did not permit us to get to this issue.
 9. Review of Next Steps—After the August 8 meeting Jeff and Brenda will take the decisions and develop paragraphs to outline the agreed upon policy. The product from this meeting will be a list of policy recommendations with reasoning and context, including obstacles identified and, in the event of something less than unanimous consent, the barriers to agreement. In addition to policy decisions recommended, the group may also decide on a set of issues that the group does not want to delve into. Those would be left to a future date.
 10. Agenda, Date, and Time for Next Meetings—The next full meeting of the Action Team will be Friday August 22 in St Petersburg, Florida. The next scheduled teleconference meeting of the Cap-and-Trade TWG will be August 15, from 2 pm to 4 pm.

11. Public Comments—Bob Krasowski stated that he became interested in climate change issues when SB 888 was proposed and included waste incineration. He believes that carbon taxes should be called fees and assessed like a fee earmarked to clean energy purposes. On page 5 under allowance value and distribution, Mr. Krasowski believes the whole effort should provide for policies and practices that transition the state from polluting energy to clean energy production. Regulated utilities should have a fire under them to be incentivized to make changes. He will provide the TWG with letters that highlight best practices for clean energy. On the second page of his letter he calls for an International meeting in Florida. In addition, Mr. Krasowski will provide a 2007 letter written prior to *Serve to Preserve* that mentions five key points including a comprehensive profile of our options, but we need to see a cradle to grave assessment of power options. Then develop a hierarchy, to determine which to do first. The process is so complex that we need to take time to review and make sure that haste does not make waste.

12. Announcements—The meeting ended at 3:00 pm.