



MIDWEST GENERATION EME, LLC

An EDISON INTERNATIONALSM Company

TO: Jesse Heier, Midwestern Governors Association
CC: Brad Crabtree, Great Plains Institute
FROM: Matthew Most, Managing Director- Environmental Policy & Strategy
DATE: May 14, 2010
SUBJECT: Design Recommendation and Model Rule Comments

Midwest Generation is a merchant electricity generator, with 5,471 MWs of coal, 305 MWs of oil/gas peaker and 343 MWs of wind capacity in the MGA footprint. We are adding a new 240 MW wind facility in Illinois that will be completed in late 2010.

Midwest Generation is grateful for our selection as a member of the Midwestern Greenhouse Gas Reduction Accord (MGGRA) Advisory Group. As the only independent power producer on the MGGRA we have sought to be a constructive participant throughout the process.

As an Edison International (EIX) company, Midwest Generation is a strong supporter of national action to address climate change given the unique jurisdiction of the Federal government. Only the Federal government can eliminate interstate issues such as "leakage", where emissions from one state are capped, causing emissions in others to increase, eliminating environmental benefits. Working with organizations such as the Edison Electric Institute, EIX was an early public supporter of HR2454 the American Clean Energy and Security Act of 2009, cosponsored by Congressmen Waxman and Markey. The U.S. Congress is on a course to address climate change, and we have viewed the MGRRA as an important means for the Midwest to add its voice to the debate. The leadership of MGA should be a considerable force in the effort to implement an effective national strategy on climate change.

Appropriate State Action

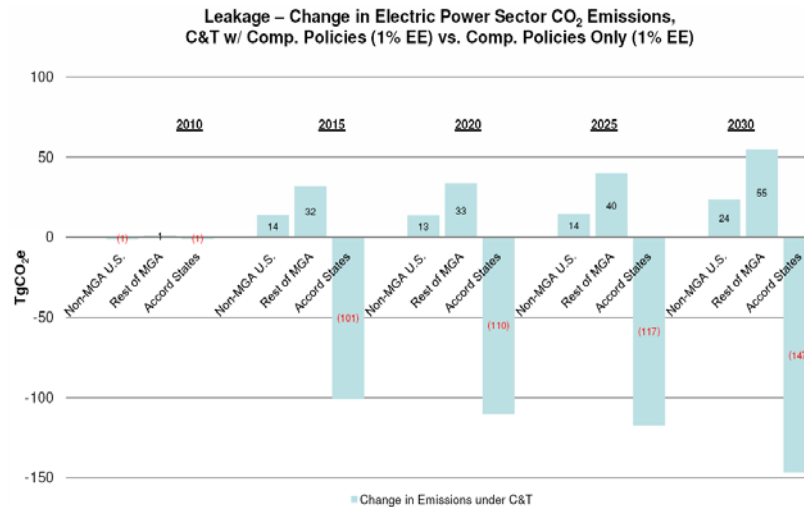
That said, we agree that states also can play an important role by complementing federal programs with sustainable initiatives of their own. For example, Midwest Generation generally supports many elements of the MGGRA to address climate change, such as participation in the Climate Registry with whom EIX is a founding reporter as well as renewable electricity generation, energy efficiency and carbon capture and storage (CCS) initiatives.

Each of these proposals is a step toward addressing climate change with contributions from all sources of greenhouse gases. The problem of climate change is so large that no one emitting sector can solve the problem, and a diversified portfolio of strategies is required to achieve success.

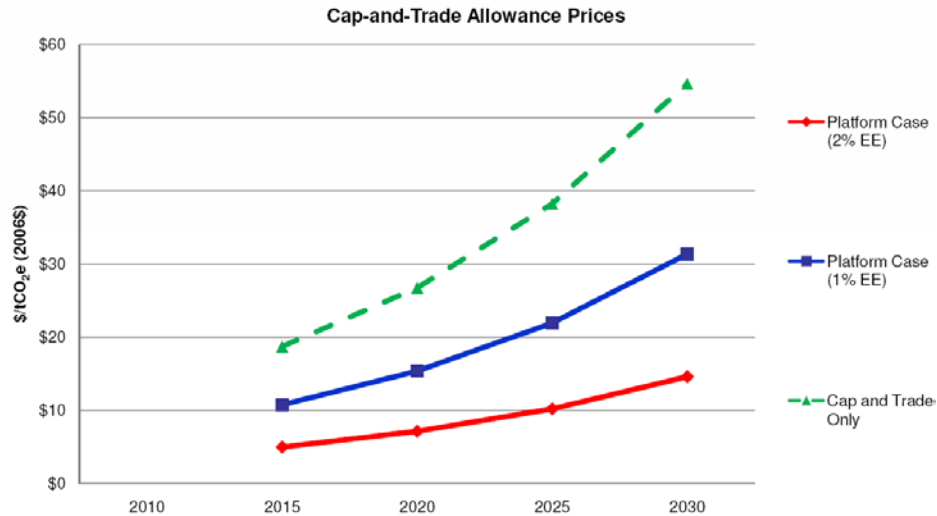
Cap & Trade

As we have consistently stated, there are some activities, such as the proposed MGA cap & trade program, which we and numerous other industry and labor stakeholders in this process believe will harm the Midwest economy, risk good union jobs and chill the development of new electricity generation in the region without delivering environmental benefits.

Unilateral regional action creates cost discrimination against Midwest companies who compete in a regional electricity market, with no mechanism to control leakage of emissions. The imposition of carbon costs on power generators in six states -- absent a uniform federal program -- will simply reduce power generation in those states, and migrate that generation to similar power stations outside the MGRRA region who have no carbon costs. The MGGRA modeling demonstrated this effect by calculating that approximately 50% of the reduced power emissions in the MGGRA states was replaced by emissions outside the MGGRA states. Slide 28 from the 5/7/2009 ICF presentation shows that in 2015, MGGRA emissions is reduced by 101 TgCO₂e but emissions outside the MGGRA increase 46 TgCO₂e. This exporting of power generation business will result in higher electricity rates to MGA consumers and loss of MGA jobs without creating carbon emission reductions.



The chart above only describes the leakage associated with adding a cap and trade program to the “complementary policies” contemplated by the MGA. In the event that these complementary policies were not completely realized, allowances prices in the cap & trade program would be much higher, greatly increasing the leakage of jobs and electricity generation from the trading region. Slide 74 from the 5/7/2009 Modeling presentation shows the much higher allowance prices associated with the cap & trade only scenario. This increase in allowance prices will further disadvantage local power generators, forcing even more power generation outside of the MGRRA footprint. Based on review of ICF data file “resultscompare_090506v2_compatible.xls”, emissions in the cap & trade only case are reduced by 95 MM tons in 2015, but emissions outside the MGA increase by 63 MM tons, a leakage rate of 67%.



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A regional level cap & trade policy is inherently a false promise costing jobs and tax revenues without delivering environmental benefit since power generators outside the region will simply increase output and contribute more carbon emissions to the global pool. **A federal cap & trade program is the only way to eliminate leakage and ensure environmental benefits.** We encourage the Governors to focus precious state resources on appropriate in-state activities that will stand the test of time, rather than a cap & trade program which will distract from attainable goals, be eclipsed by Federal action and fail to deliver environmental benefits.

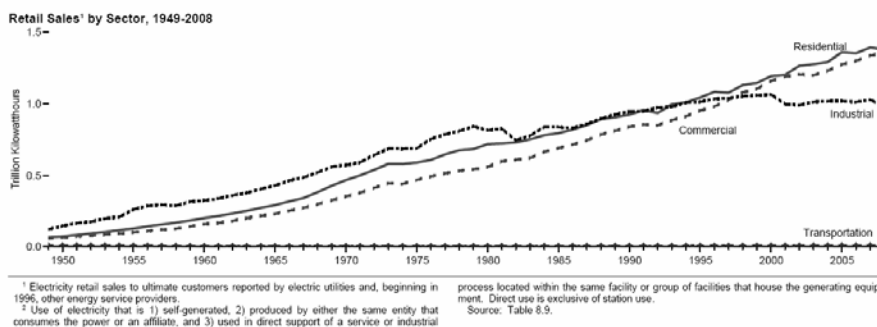
Program Design

In general, Midwest Generation fundamentally opposes greenhouse gas cap & trade efforts that are not implemented uniformly across the entire United States. Additionally, Midwest Generation has the following concerns with the MGGRA design recommendations.

- The MGGRA Design Recommendations rely extensively on a “First Jurisdictional Deliverer” or FJD approach to partially address the economic advantage of imported electricity over electricity generated in the MGGRA region by applying the carbon cost to both power generated within the region and power imported from outside the region. Even if legal, the question of how to implement such a policy in the MGGRA where three regional transmission organizations operate (SPP, MISO and PJM) each with its own market rules is baffling. These questions of practicality and legality were not resolved in the MGGRA process and raises material questions about the potential to implement such a policy. Even if the FJD approach was legal and implementable, it does nothing to protect jobs currently associated with exporting electricity from the MGA states. The cost of producing these exports would increase due to carbon compliance cost making current exports unattractive to out of state buyers. These exports would simply being replaced by out of state generators, resulting in lost jobs without environmental benefit.

- MGGRA Design Recommendations state a preference to link a MGGRA cap & trade program with those proposed or operating elsewhere, such as the Western Climate Initiative, Regional Greenhouse Gas Initiative and the European Emissions Trading Scheme. Midwest Generation strongly questions that such linkage could be economically positive for the Midwest. RGGI and WCI are much less coal intensive than the MGGRA and thus have much higher emission abatement costs. This is due to lesser coal to natural gas fuel switching opportunities in WCI or RGGI compared with MGGRA. As a result, linkage would increase demand for allowances in the MGGRA region driving up costs for MGA companies.
- The MGRRA REMI modeling identified negative economic consequences from the cap & trade program. The March 12 slide presentation only provided two slides out of a fifty-two slide presentation on the industrial employment impacts of the program. More detail on job implications of the MGGRA trading program need to be disclosed, including detailed data on all industrial categories and job impacts over all time ranges studied, rather than just 2030.
- The Platform Case modeling results rely heavily on a few critical assumptions, none larger than the energy efficiency assumption. The MGGRA platform calls for complementary policies to reduce electricity demand annually by 2%. This is a dramatic and historically unprecedented policy aspiration. Regardless, the MGGRA assumes this reduction in demand can be achieved every year for only 3 cents/KWh. Midwest Generation questions to potential to produce such reductions every year through 2030. This assumption results in a massive reduction in electricity demand over time without consideration for the likely massive cost and technological innovation required to achieve it. The concept of such a dramatic annual reduction is hard to envision given the historical context of annual steady growth of electricity sales, as detailed by EIA (below). In fact, the Electric Power Research Institute (EPRI) found in its study “Assessment of Achievable Potential from Energy Efficiency and Demand Response Programs in the US” that although a reduction in electricity demand is technically feasible, it cannot be reduced indefinitely. In fact, even “economically potential” energy efficiency efforts still result in an annual increase in electricity demand. The unrealistic 2% assumption masks the true costs of implementing the policy platform.

Historical Electric Demand (EIA)



Energy Efficiency Potential (EPRI)

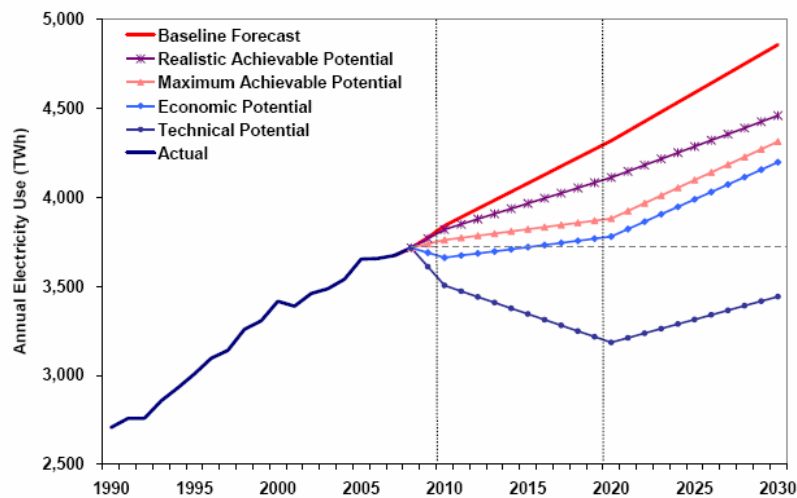


Figure 4-3
Energy Efficiency Potentials in Context of Baseline Forecast

- The MGGRA Design Recommendations heavily restrict use of offset credits, which represent emission reductions created outside the MGGRA trading region and/or its covered sectors. The recommendations do not allow use of offsets from outside the MGGRA region until the second trading period. The proposed rules also incorporate a new system of governing bodies and certification rules which will be cumbersome and bureaucratic. Finally, the program allows only 20% of a firm's compliance obligation to be met with offsets that have been certified to meet all the requirements of the MGGRA, rather than the 30% allowed under both the Waxman-Markey and Kerry-Lieberman bills. The net result of these restrictions is to unnecessarily increase compliance cost in the MGGRA region, increasing the flow of jobs and economic activity out of the Midwest. This policy approach restricts one of the Midwest's key assets, the ability to produce offset emission reductions for sale from the region's vast agricultural resources. This sends a message to Washington that the MGA is not serious about developing a key industrial export in a future carbon constrained economy.
- There was broad consensus in the MGRRA discussions that Federal action on climate change is preferable to state action. Problems such as leakage and cost containment are much better managed at the Federal level. Operating both Federal and Regional trading programs simultaneously will create duplicate compliance costs for those entities in both programs. For this reason, we request the MGA include a provision to sunset any cap & trade program in the event that a Federal cap & trade program is enacted to address greenhouse gases.

Meeting the challenge of climate change requires sacrifice and creativity in equal measure. We need to work together to make the smartest investments to get the maximum emissions reduction possible. This will be accomplished through careful evaluation and focusing our efforts on activities best suited to each level of government. We look forward to working with you to implement a suite of effective state policies. We also urge you to engage at the Federal level to design a national cap & trade program that does not discriminate against the Midwest while taking a powerful stand to address anthropogenic climate change.

Thank you for the opportunity to comment on the proposed MGGRA cap and trade program. I respectfully request that this letter be posted to the MGGRA website. Midwest Generation will continue to be a constructive voice in the MGGRA process and looks forward to working with you to develop sustainable and impactful climate change policies for the Midwest.