

TO: RGGI Environmental and Energy Agency Heads
FROM: Northeast Regional Greenhouse Gas Coalition
cc: RGGI Staff Working Group
DATE: October 20, 2006
RE: **Comments on RGGI Final Model Rule**

The Northeast Regional Greenhouse Gas Coalition (GHG Coalition) is pleased to submit this memo to the RGGI Agency Heads and Staff Working Group on the final RGGI Model Rule that was released on August 15, 2006.

While the final RGGI Model Rule is a significant milestone for the RGGI process, the GHG Coalition has remaining concerns and questions regarding certain aspects of the model rule. This memo outlines these concerns and questions and provides recommendations for consideration. The specific areas included in this memo are as follows:

- the offset memorandum of understanding (MOU) requirement for out of RGGI region offset projects,
- the changes to the safety valve/trigger provisions,
- the change in definition of fossil fuel fired from the draft rule to the final rule,
- consumer benefit or strategic energy purposes allocation, and
- electricity imports and emissions leakage.

Carbon Offsets MOU Requirement

While the GHG Coalition welcomes the elimination of the 2:1 discount on offset projects undertaken outside of RGGI participating states that was contained in the March 23,

2006 draft model rule, the GHG Coalition contends that the MOU provisions are unnecessary, will introduce a major element of uncertainty into the development of high quality offset projects, and will result in a reduced supply of offsets.

The RGGI Model Rule states the following:

XX-10.3 (a)(2) Offset project locations. Eligible offset projects may be located in any of the following locations:

- i. in any participating state; and*
- ii. in any state or other United States jurisdiction in which a cooperating regulatory agency has entered into a memorandum of understanding with the REGULATORY AGENCY to carry out certain obligations relative to CO₂ emissions offset projects in that state or U.S. jurisdiction, including but not limited to the obligation to perform audits of offset project sites, and report violations of this Subpart.*

First of all, this MOU requirement necessitates negotiation and administrative processing among the RGGI states and offset project host states, which will only serve to significantly delay implementation of new offset projects. This will increase the regulatory uncertainties faced by project developers and CO₂ Budget Sources. As a result, the MOU requirement will reduce the number of eligible states in which offset projects can be located and therefore reduce offset supply.

Secondly, the MOU requirement stems from the perceived lack of authority of the RGGI regulatory agencies to audit (through a site visit) offset projects outside their jurisdictions to determine compliance with RGGI requirements. In fact, an audit/compliance assurance function will be in place already with the RGGI requirement contained in the Model Rule (see below).

For the following reasons the GHG Coalition's view is that the audit/compliance assurance concern will be effectively addressed by the design of the RGGI offset provisions, without the need for MOUs.

1. RGGI states have clear enforcement powers over project sponsors (see section XX-10.3(h) of the Model Rule). If the project sponsor does not comply with the offset requirements then the RGGI state may revoke the offset allowances associated with that project in the project sponsor's account.
2. The RGGI offset project standards require certification by an independent RGGI-accredited certifier. The application is first required to be certified by an independent RGGI-accredited certifier prior to its submission. The offset project monitoring and verification plan as well as the project's regular (in most cases annual) reports are also required to be certified by an independent RGGI-accredited certifier. Furthermore, third-party certification could involve not only a "desk review" of project data but also periodic site visits that should satisfy the compliance assurance concerns.
3. CO₂ Budget Sources bear the compliance risk and will make every effort to ensure that the offsets they purchase meet the RGGI offset requirements. The 3:1 penalty provisions provide direct motivation for CO₂ Budget Sources to diligently track their offset investments.

Based on the three points noted above, the MOU will provide no needed additional oversight controls and will introduce unnecessary complexities and uncertainty into program implementation and the emerging carbon offset market in the U.S.

Safety Valve/Trigger Provisions

Given the restrictions on the use and geographic origin of offsets for compliance with the RGGI program, the GHG Coalition views some level of cost controls designed to protect ratepayers as attractive. However, the revised safety valve triggers as outlined in the Final Model Rule still do not provide real price certainty for either CO₂ budget sources or offset project developers.

Instead of providing straightforward price certainty, the RGGI triggers unnecessarily complicate the offset provisions of the program and by extension the entire RGGI program. In addition, they create regulatory uncertainty because, even if triggered, they will be reset in subsequent compliance periods.

The GHG Coalition also remains concerned with the trigger methodology especially the 14-month market settling period. The 14-month market settling period and the 12-month rolling average design of the triggers means that the earliest in a compliance period that RGGI will make a determination that the triggers have been reached will be after 26 months into a 36-month compliance period. This is far too late into the compliance period to have the intended impact on the costs of complying during that compliance period. As such, the GHG Coalition continues to feel that the 14-month market settling period should be eliminated.

Definition of Fossil Fuel Fired

The GHG Coalition disagrees with the change in the definition of fossil fuel fired in the final RGGI Model Rule. The definitional change represents a departure from the goals identified at the outset of RGGI, and was made without the benefit or opportunity for public comment.

The original definition of fossil fuel fired in the March 23, 2006 draft model rule stated:

With regard to a unit: the combustion of fossil fuel, alone or in combination with any other fuel, where the fossil fuel combusted comprises, or is projected to comprise, more than 50 percent of the annual heat input on a Btu basis during any year.

The definition of fossil fuel fired in the final RGGI Model Rule states:

1. *With regard to a unit that commenced operation prior to January 1, 2005, the combustion of fossil fuel, alone or in combination with any other fuel, where the fossil fuel combusted comprises, or is projected*

to comprise, more than 50 percent of the annual heat input on a Btu basis during any year.

2. *With regard to a unit that commences operation on or after January 1, 2005, the combustion of fossil fuel, alone or in combination with any other fuel, where the fossil fuel combusted comprises, or is projected to comprise, more than 5 percent of the annual heat input on a Btu basis during any year.*

The GHG Coalition is concerned that new waste-based, renewable energy facilities (including biomass facilities) would likely be regulated as fossil-fuel fired facilities using this definition. New waste-based, renewable energy facilities, including biomass fired facilities, would likely be required to operate selective catalytic reduction (SCR) equipment to reduce NOx emissions. Due to the need to cool the flue gas to remove other air pollutants, this pollution control technology requires the use of natural gas to reheat a facility's flue gas prior to use of the SCR to remove the NOx. The amount of natural gas required would likely result in a facility exceeding the 5 percent threshold in the revised RGGI Model Rule definition.

There already is precedent in federal and state environmental rules to determine when a facility would be subject to rules governing fossil fuel combustion. Under New Source Performance Standards for Industrial-Commercial-Institutional Steam Generating Units (40 CFR Part 60, Subpart Db), Section 60.44b (c), (d) and (e), biomass (wood, MSW, etc.) facilities are subject to the NOx limitations "unless the affected facility has an annual capacity factor for coal or oil, or mixture of these fuels with natural gas of 10 percent (0.10) or less and is subject to a federally enforceable requirement that limits operation of the affected facility to an annual capacity factor of 10 percent (0.10) or less for coal, oil, or a mixture of these fuels with natural gas."

This trigger allows the facilities up to 10% of their annual capacity factor for using fossil fuel. This amount should be sufficient to operate the required pollution control equipment. To maintain consistency with federal requirements, the GHG Coalition

recommends that the Model Rule definition incorporate an applicability trigger of “more than 10 percent of the annual heat input on a Btu basis during any year.”

Additional Definitions

The GHG Coalition is also concerned about a few other definitions in the RGGI Model Rule. The first definition is “excess emissions” which is defined in the Model Rule as follows:

Any tonnage of CO₂ emitted by a CO₂ budget source during a control period that exceeds the CO₂ budget emissions limitation for the source.

The definition, as written, would technically not allow a CO₂ budget source to emit more than its budget limitation and cover emissions with allowances or offset allowances. This is of obvious concern because if a budget source has excess emissions then the owners and operators of a CO₂ budget source will be penalized 3:1 in allowances and pay a fine.

The GHG Coalition suggests changing this definition to reflect the true intentions of the program which is for CO₂ budget sources to cover their reported CO₂ emissions with adequate allowances. If and only if CO₂ budget sources do not have sufficient allowances to cover their reported emissions during the true up period should they face excess emission penalties and fines.

The other two definitions that are of concern to the GHG Coalition include “eligible biomass” and “renewable energy.” Each of the RGGI states have developed their own definitions of these terms that are the result of significant state legislative and regulatory stakeholder dialogue. Both definitions vary somewhat from state to state within the RGGI region. Therefore, the GHG Coalition urges that the Model Rule defer to existing state definitions of eligible biomass and renewable energy, rather than imposing a

separate and inconsistent definition that is unique to the RGGI program. Deference to state defined terms will ease and streamline RGGI implementation.

Consumer Benefit or Strategic Energy Purpose Allocation

The GHG Coalition remains concerned with the consumer benefit or strategic energy purpose allocation – including the percentages that states end up allocating, the method with which the allowances are allocated, the frequency of the allocation, and who has access to the allowances. The final RGGI Model Rule is largely silent in the areas.

The following questions are still outstanding:

1. How and when will the CBA allowances be made available to CO₂ budget sources?
2. Who will have access to the allowances?
3. If allowances are auctioned, who will be the administrator(s)?
4. If allowances are auctioned, will it be at the regional or state level?
5. If allocated to entities other than CO₂ budget sources, how will they be allocated?

The GHG Coalition recognizes that the establishment of detailed approaches to allocating/auctioning the consumer benefit or strategic energy purpose allowances is complex. As such, the GHG Coalition endorses the road map outlined in Resources for the Future's summary of the July 20, 2006 auction workshop in New York City. RFF listed the important next steps that should be taken by RGGI as follows:

1. Articulate the goals of the allowance auction.
2. Identify basic auction designs that are consistent with goals.
3. Identify a range of relevant auction parameters.
4. Solicit input from stakeholders and independent experts.
5. Develop a short list of potentially appropriate designs.

6. Test auction designs with laboratory experiments.
7. Develop proposed auction rules.

Imports and Leakage

The GHG Coalition remains concerned over the issue of electricity imports and emissions leakage. Tackling this issue will be critical to RGGI's success and the potential future expansion of RGGI to additional states and regions of the U.S.

The GHG Coalition's consensus position throughout the RGGI process has been that the RGGI program should be designed so as to solve or mitigate "leakage" associated with imported power. The Signatory States should have rules in place to address imports and leakage at the outset of the program. The GHG Coalition would have liked to have seen at least a placeholder in the RGGI Model Rule to incorporate agreed-upon imports and leakage provisions recommended by the I&L Work Group. Furthermore, the GHG Coalition questions why the I&L Work Group has held only one public meeting in June and has not engaged stakeholders since.