Independent Power Producers of New York, Inc.

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Comments on the RGGI Draft Model Rule

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The Independent Power Producers of New York, Inc. (IPPNY) is a trade association representing the competitive power supply industry in New York State, including companies involved in the development of electric generating facilities; the generation, sale, and marketing of electric power; and the development of natural gas facilities. IPPNY Members generate almost 75 percent of New York's electricity using a wide variety of generating technologies and fuels including hydro, nuclear, wind, coal, natural gas and biomass.

IPPNY submits these comments on the Draft Model Rule for the Regional Greenhouse Gas Initiative (RGGI), which the Inter-State RGGI Staff Working Group (SWG) provided for public comment on March 23, 2006. IPPNY appreciates the cooperative working relationship that we continue to have with RGGI decision-makers, especially the willingness of New York State environmental and energy agency heads and staff to listen to our concerns and suggestions for ways to improve the structure of the RGGI and the modeling which informs decision-making. IPPNY's comments are intended to ensure that competitive disadvantages and unintended fuel diversity and reliability consequences do not result from a RGGI Model Rule that is designed and drafted with unworkable provisions.

I. IPPNY's Overall Position on the RGGI

IPPNY is participating in good faith in the review of the RGGI's development, to help New York State environmental and energy agency heads and other RGGI decision-makers develop a workable framework for a regional greenhouse gas cap and trade program that can serve as a template for a potential national program and to avoid the anti-competitive impacts that would result from a New York State-only approach or an approach limited to a small subset of states.

II. Executive Summary

Our comments address topics, such as:

- If the set-aside allowances are auctioned, it must be kept in mind that no previous cap and trade program has auctioned off more than 9 percent of the cap so the auction should be regarded as an experiment. If any individual states approve the auction or distribution of allowances for specific purposes and if it will not result in negative fuel diversity and energy reliability impacts, the amount of allowances to be auctioned or distributed for specific purposes must be capped at no more than 25 percent.

- Early reduction allowances should be in addition to the cap (consistent with all previous cap and trade programs) and available for total shut-downs.
- It does not make environmental sense to limit offsets in terms of amounts, types, geographic location or discounts on their allowance value based upon location.
- The RGGI SWG should coordinate with the investment community to ensure that offset projects will be able to survive additionality tests and still obtain financing.
- New units should be exempt from the program until they can receive a full allowance allocation.
- The RGGI modeling and cap should be adjusted for changes in state participation and to account for emissions from New York's Advanced Clean Coal Power Plant Initiative.
- The RGGI Draft Model Rule must not be finalized at the regional level, until leakage is evaluated fully.
- Energy and environmental regulators should evaluate the cumulative impact of the RGGI and other state and federal regulations on the region's fuel diversity and energy reliability.

III. IPPNY's Comments on the RGGI Draft Model Rule

A. Amount for and Tentative Approach to Potential Allowance Auction

If approved by individual states, an auction should be regarded as an experiment, because the potential pool of allowances (even up to 25 percent) is so much larger than any prior cap and trade program implemented to date. The Draft Model Rule should describe how the up to 25 percent of allowances contemplated to be sold or distributed for specific purposes will be available for use by generators to comply with the program. Because of the potential impacts on fuel diversity and reliability, the New York State Reliability Council, the Northeast Power Coordinating Council, the New York Independent System Operator, the New England Independent System Operator, and PJM must certify and monitor that the auction will not have negative impacts on fuel diversity and reliability. If an auction is approved, it must include flexibility in the areas of timing, price and bidding. If any individual states approve the auction or distribution of allowances for specific purposes and if entities responsible for ensuring fuel diversity and energy reliability determine that negative impacts will not result, then the amount of allowances to be auctioned or distributed for specific purposes must be capped at no more than 25 percent.

B. Early Reduction Allowances

All past cap and trade programs have permitted early reduction credits as a supplement to any established cap, and early reduction allowances should be available for total shut-downs.

C. Offsets

(1) Offsets in General

The RGGI program must ensure the availability of a broad supply of offset projects. Given the lack of readily available back-end control technologies, offsets are essential to the ability of the RGGI program to achieve the desired emission reductions cost-effectively and for the successful implementation of the program. Moreover, the goal of the RGGI program, as IPPNY understands it, is to maximize the reduction in greenhouse gases. Offsets, by their nature, foster that goal and should be encouraged to the maximum degree possible. The RGGI SWG should establish a carbon offsets panel to recommend a cost-effective, streamlined, robust, and standardized RGGI carbon offset component. It makes no environmental sense to limit offsets in terms of amounts, types, geographic location or discounts on their allowance value based upon location. Also, the methodology and data used by the RGGI SWG to estimate the quantity and quality of offsets available must be better understood by all RGGI program participants.

(2) Offsets and Additionality

The RGGI SWG should coordinate with the investment community to ensure that offset projects will be able to survive additionality tests and still obtain financing. At most, regulatory additionality, in combination with the submission of monitoring and evaluation reports that are approved by accredited certifiers, should be sufficient for offset projects. In order to provide needed investment certainty and ensure access to financing, investments that meet a regulatory additional test when project financing is obtained should remain eligible for at least a ten-year period, even if a law or rule is changed to make an approved project ineligible going forward. Otherwise, the level of uncertainty could be so large, as to discourage the investment community from funding any offset projects. The RGGI should not exclude projects, which already are receiving other sources of funding, from eligibility as offset projects. Restrictions such as the size of the project or market penetration levels are irrelevant to whether a project is viable, and RGGI investments which help projects to be executed should be encouraged. The requirement that project sponsors must transfer the legal rights to any attributes credits except RGGI offsets should be deleted from the Draft Model Rule. Also, offset credits should be provided to participants in voluntary greenhouse gas programs.

(3) Safety Valve

Additionality, which results in the reduced ability to invest in offset projects, jeopardizes or hampers the operation of the safety valves, given that there could be an insufficient amount of offsets to access if the valves are triggered. Also, the safety valves are too complicated and do not accomplish their intended price mitigation. IPPNY originally proposed a much simpler safety valve approach. In addition, the RGGI SWG may wish to consider adding a true price mitigation mechanism.

(4) Specific Offset Projects

Afforestation projects should not be subject to an upfront 20 percent discount of credited carbon to account for potential catastrophic losses, because the discount discourages investments; permanence could be addressed by other mechanisms, such as CO2 substitution clauses in contracts or insurance policies.

Natural gas end-use efficiency projects should include improvements in carbon efficiency as well as energy efficiency of the combustion system; these end use efficiency projects should be extended to all sectors of the economy and not limited to merely the residential and/or commercial sectors.

For the natural gas transmission and distribution offset projects, the RGGI SWG should develop performance standards with the Interstate Natural Gas Association of America (INGAA), taking into account the provisions of the EPA Natural Gas STAR program; these details should be developed and released as draft provisions for public comment, prior to final agreement on the text of the Draft Model Rule. Also, the Draft Model Rule should include provisions for the addition of other offset project categories, without needing to change the Rule.

D. Applicability

New units should be excluded from the program, until the new unit is able to receive a full allocation of allowances. The RGGI should treat all renewable or non-emitting generation technologies equally. Emissions resulting from the "parasitic load" of environmental control equipment (mercury, NOx, SO2, cooling towers, etc.) should be exempt from regulation. The Draft Model Rule should include an exemption for facilities with long term contracts that lack a compliance cost pass-through mechanism. In regards to the biomass credit, the definition of eligible biomass fuel should be broader and should include all types of waste streams recycled as energy. The Draft Model Rule also should provide credit for the conversion of a unit to 100 percent biomass. Regarding the "behind the meter exemption, the capacity market part of the demand response program also should be exempt; states should be required to implement this "behind the meter" exemption in State-specific RGGI regulations. The exemption for units with electrical output to the electrical grid restricted by permit conditions should be a mandatory exemption, not an optional exemption.

E. Modeling Issues / Cap Size

The RGGI SWG should update modeling for the program to account for the inclusion of Maryland and the exclusion of Rhode Island and Massachusetts and to reflect the construction of new facilities under Governor Pataki's Advanced Clean Coal Power Plant (ACCPP) Initiative. Also, the RGGI cap may need to be increased to reflect accurately additional emissions.

F. Imports & Leakage Working Group

The RGGI Draft Model Rule must not be finalized at the regional level, until the issue of leakage is evaluated fully and before stakeholders have the opportunity to comment on the final report to be submitted to RGGI Agency Heads. Under the current timeline, the RGGI Draft Rule is scheduled to be revised this July; yet, the final report is scheduled to be submitted in December of 2007. The conclusions of this report will have direct bearing on the provisions of the Draft Model Rule, which cannot credibly be finalized before January 2008. This Working Group should look at NOx, SO2, and mercury emissions, as well as CO2, and at AEP's transmission line from the coal country corridor to New Jersey. The Group also should develop a tracking mechanism to confirm the extent to which leakage undermines the integrity of the program.

G. Need to Coordinate RGGI Rule with other State and Federal Rules

The RGGI Staff Working Group should look at the Draft Model Rule in the context of DEC's Draft NSR Rule and recent other State and Federal rules and ensure that these rules, taken together, can all work well and will not result in either fuel diversity or reliability issues. IPPNY continues to urge energy and environmental regulators to evaluate the cumulative impact of these regulations on the ability of the energy system to continue operating in a reliable manner.

H. Monitoring and Reporting of Emissions

Emissions, monitoring and reporting should not require separate submission of two Electronic Data Report (EDR) files, and, overall, recordkeeping requirements should be limited to five years.

I. Penalties

The three-to-one penalty structure is onerous. The RGGI Draft Model Rule should provide the Regulatory Agency flexibility and discretion in the implementation of penalty provisions, especially if circumstances beyond a company's control result in excess emissions. Also, the definition of excess emissions (EM) should be defined as the difference between total emissions (TE) and the sum of allowances (A) and offset (O) deductions used to cover those total emissions less any CO2 emissions attributable to burning biomass (B).

Thank you for the opportunity to provide these comments.

Please review details for our comments in Attachments 1 through 9, as itemized below.

ATTACHMENT 1

Amount for and Tentative Approach to Potential Allowance Auction

1. Auction in General

The Draft Model Rule includes the following provision on allowance allocation: "A general account would be established by the Consumer Benefit or Strategic Energy Purpose Fund Administrator from which allowances will be sold or distributed in order to provide funds to encourage and foster the following: promotion of energy efficiency measures, direct mitigation of electricity ratepayer impacts attributable to the implementation of the CO2 Budget Trading Program, promotion of renewable or non-carbon-emitting energy technologies, stimulation or reward of investment in the development of innovative carbon emissions abatement technologies with significant carbon reduction potential, and/or the administration of "Name of Relevant RGGI State" component of the CO2 Budget Trading Program."

The RGGI Memorandum of Understanding (MOU) states that "Each Signatory State may allocate allowances from its CO2 emissions budget as determined appropriate by each Signatory State, provided each Signatory State agrees that 25% of the allowances will be allocated for a consumer benefit or strategic energy purpose." IPPNY interprets the MOU's provisions to mean that, if individual states approve an the allocation of any allowances at all for a consumer benefit or strategic energy purpose, then no more than 25 percent of the allowances may be used for these purposes. The MOU does not provide the basis for some stakeholders to argue for an increase in the amount allowances to be used for these purposes, even to an incredible 100 percent.

IPPNY appreciates that the RGGI SWG plans to conduct a specific workshop on the allowance auction issue, and this workshop should examine the efficacy and impact of the auction approach for allocating allowances and solicit the advice of energy marketing traders and allowance traders. A working group should be established to develop an auction process to ensure that any auction, if approved by individual states, may be practically, efficiently and fairly administered. To help provide consistency, the Draft Model Rule could contain some optional language on auctions for consideration by states in deciding whether an auction should be done.

If approved by individual states, an auction should be regarded as an experiment, because the potential pool of allowances is so much larger than any prior cap and trade program implemented to date. If at all, no more than 25 percent of the allowances should be allocated via an auction approach, because of the significant risk to electricity prices. If allowances are set-aside, they should be made available to the market immediately and only available for generators to bid on. If any, set-side allowances should be made available to affected generators prior to the first compliance period, so that market liquidity is not adversely affected and companies have adequate time to plan least cost compliance strategies.

The RGGI Draft Model Rule should include provisions for how allowances allocated under the program would be transitioned, if the RGGI program is replaced by a national program. These transition provisions are needed to maintain the integrity of existing and ongoing energy deals.

2. Generators Need Flexible Access to Allowances

Requiring generators to purchase a significant number of allowances will raise the price of electricity in the region. Customer costs would be less if allowances are allocated to generators for free, because of the reduced market risk to generators, including timing, cash-flow and long-term contracts. In addition, the retention of a significant number of allowances by a public entity could result in market distortions and larger consumer price impacts.

It is unclear how much of the 25 percent of allowances proposed by the Draft Model Rule to be sold or distributed for specific purposes actually will be available for use by generators. Since there is no existing CO2 control equipment with which to retrofit power plants and increasing demand and fuel prices make it less practical to switch fuels or reduce operations, the ability to obtain sufficient allowances is a primary compliance tool with the RGGI program requirements.

Specific language should be included in the Draft Model Rule with regards to how the states will "release" any yet-to-be-approved consumer benefit allocations to the emission trading market. The language should specify how long the state may be allowed to hold onto the allowances and what specific distribution mechanisms will be considered. Specific language is needed, so that speculators and other third parties are not allowed to participate in this allowance market until the needs of generators are satisfied. Generators should have the right of first refusal for the 25 percent of allowances, before these allowances are available for sale or disbursement. IPPNY suggests that, if an auction is approved, it should be done at the regional level; however, if auctions are done at the state level, then generators within that state should have the right of first refusal for their share of the 25 percent allowance pool. If allowances are allocated directly for specific consumer benefit or strategic energy purpose, entities who receive those allowances must be required to execute an agreement for sale of the allowances within 30 days of their allocation. This approach is needed to ensure that generators can get the full complement of allowances needed for program compliance and in order to maintain the reliability of the energy system.

3. Allowance Auction Subject to Approval by the NYSRC, NPCC, NYISO, ISO-NE, and PJM

The potential auction of 25 percent of allowances under the RGGI poses a threat to the reliability of the electric system, because the requirement for the purchase of allowances would most adversely impact generators at coal and dual-fueled (oil / natural gas)

facilities. These facilities are part of the core of New York's fuel diversity, which is the foundation of our reliable electric system.

Reliability will be threatened, since some units will face instantaneous financial impacts as a result of this policy. Facilities owned by generators have many operating limitations in wholesale day-ahead and real-time electricity markets, such as minimum generation levels, minimum run times and minimum down times. In some instances, generators are required to use a minimum amount of fuel oil for reliability reasons, such as under the requirements of the New York State Reliability Council's (NYSRC's) Reliability Rule I-R3. Also, a significant number of existing generating facilities are subject to long-term contracts. Because these facilities have no way to recoup the additional costs of the auction approach, the resulting financial consequences could be severe, causing units which are essential to New York's fuel diversity and reliability to face shut-down decisions.

Because of the potential impacts on fuel diversity and reliability, the ability to do the auction must be subject to approval by the NYSRC, the Northeast Power Coordinating Council (NPCC), the New York Independent System Operator (NYISO), the New England Independent System Operator (ISO-NE) and by PJM. These entities must be required to certify that the auction will not have negative impacts on fuel diversity and reliability and must monitor continuously the impacts of the auction on fuel diversity and reliability.

4. Auction Key Flexibility Elements

If individual states decide to do an auction to allocate allowances and after the NYSRC, NPCC, NYISO, ISO-NE, and PJM certify that the auction will not adversely affect fuel diversity and energy system reliability, the auction must be implemented in as flexible a manner as possible. At a minimum, the auction process must include the following flexibility provisions:

A. Timing

If at all, the auction should be done on the regional level. Since one auction will increase risk for bilateral deals in the electricity marketplace, the RGGI may need to conduct a series of auctions, such as on a monthly basis but no less frequently than quarterly. Otherwise, if bilateral contracts are long-term, such as seven-year deals, sources will not be sure that they have enough allowances. The auction should provide a ten-year stream of allowances.

The RGGI should develop and apply an allowance tracking system well before any auction date, in order to give auction participants as much information as possible about the market to determine bid prices.

The timing of the auction could result in longer carrying of the cost of allowances on company books, which would not be in the best interest of energy consumers.

B. Fixed price

Because of the impacts that the allowance auction could have on fuel diversity and reliability and on costs, if approved, allowances should be sold at a fixed price. Based upon ICF's energy modeling dated December 21, 2005, this fixed price should be set at $1 or $2 per ton. The allowances should be sold on a first-come first-served basis. Specifically, bids should be required to be submitted within a specified time span (e.g., within a specified week / month). All bids received within that time should be considered to be submitted simultaneously. If the pool of allowances is not used up by the bidding parties, each bidder would receive the allowances they purchased. However, if the pool of allowances is oversubscribed, then the available pool of allowances should be prorated by the number of allowances for which each entity bid.

C. IPPs and merchant facilities must be preferred bidders

Arguably, the auction should be restricted to IPPs and merchant facilities, in order to help increase the likelihood that electric system reliability can be maintained. However, if the auction process is structured to allow anyone to buy allowances, IPPs and merchants must be allowed to obtain written agreements from auction officials stating that they have first priority. These guarantees, which would be awarded on a first-come, first-served basis, would enable IPPs and merchants to assure lenders or investors that they have access to allowances needed to build and / or operate units. Each bid from anyone who is not a generator should include a certified check or letter of credit for the total bid cost. Also, an entity that is knowledgeable and experience with auction processes should conduct the auction.

D. Auction process should maintain reliability

If at any time the NYSRC, NPCC, NYISO, ISO-NE or PJM determine that the auction of allowances could have or is having negative impacts on fuel diversity and reliability, the auction must be stopped, and the remaining allowances must be allocated directly to generators at no cost.

ATTACHMENT 2

Early Reduction Allowances

The Draft Model Rule states that "The Regulatory Agency may award early reduction CO2 allowances (ERAs) to a CO2 budget source for reductions in the CO2 budget source's CO2 emissions (inclusive of all emissions from CO2 budget units at the CO2 budget source) that are achieved by the source during the early reduction period (2006, 2007, and 2008), subject to the requirements of this subdivision. Total facility shutdowns shall not be eligible for ERAs."

All past cap and trade programs have permitted early reduction credits as a supplement to any established cap. Not only does this tried and tested approach reward companies for their early efforts to meet future targets, but it also facilitates compliance in the critical first years of the program.

The most obvious method of avoiding emissions is for a facility to shut-down, and early reduction allowances should be available for total shut-downs. We understand that that regulators do not want to provide a public policy incentives for facilities to shut-down; however, the RGGI program is a policy that seems to be aimed at turning over the electric sector's fossil fleet in order to achieve greenhouse gas reductions. Crediting unit shutdowns would help the market more quickly turn over the fleet in the most efficient manner possible.

Providing companies with credit for shut-downs after the baseline dates would help with the additional cost burdens associated with any CO2 program. The offsets or allowances generated from emission reduction credits (ERCs) from shut-downs could then be used by a company for RGGI or other state compliance requirements or sold to other facilities to meet requirements. If a shut-down is located outside the RGGI region, then the CO2 reductions associated with the shut-down should be considered as offsets.

Unit shut-downs only are given credit under the Draft Model Rule's provisions for early reduction allowances; this approach limits their value to the period prior to January 1, 2009. Unit shut-downs should get credit for a longer period of time, such as ten years, for their CO2 emission reductions, since those reductions are permanent. Also, those unit shut-downs after January 1, 2009 also warrant a mechanism for credit.

In order to qualify for early reduction allowances, a facility has to improve its CO2 emission rate as well as its total tons. Since cap and trade programs are based on absolute tons, no justification exists for the use of an emission rate. The driver for facility total reductions (market forces, voluntary unit curtailments, etc.) is irrelevant from the environment's perspective. Therefore, any reductions in total (absolute) tons prior to January 1, 2009 should count as an early reduction allowance.

Indeed, since a ton of CO2 reductions, regardless of location or timing, provides the same environmental benefit for addressing global climate change, all early actions should be treated equally. Early action dates in the RGGI are too restrictive and should go back to 1990, when companies invested in voluntary early reductions.

ATTACHMENT 3

Offsets

1. Offsets in General

A. Need Broad Supply of Offsets

The preliminary IPM energy modeling results that were completed in December of 2005 project that the seven states might be able to achieve the RGGI cap limits, primarily through expansion of both natural gas and renewable generation. We continue to believe that the RGGI analyses significantly underestimate natural gas prices and have very optimistic assumptions that seriously deflate CO2 prices and emission reduction possibilities.

Among these problematic assumptions are the following provisions:

- The RGGI limits offset usage to less than 4 million tons per year (3.3 percent of a source's total reported emissions);
- Henry Hub natural gas input assumptions of $6.90/MMBtu (2003$) in 2006 dropping rapidly to $4.79/MMBtu (2003$) in 2015;
- Regional firm electric power prices also would decline with natural gas prices, dropping from $53.84/MWh (2003$) in 2006 to $47.39/MWh by 2024;
- No new coal or nuclear plant construction;
- New regional wind projects could supply over 9,000 MW and 25 TWh of new generation; and
- Energy efficiency programs could significantly reduce load growth (assumes that power reduction savings will more than offset the higher energy prices).

These fundamental assumptions translate into a projection that all needed offset credit projects could be completed for less than $2.50 per ton.

It is essential that the RGGI Draft Rule be crafted in a manner that minimizes competitive disadvantages and does not reduce energy system reliability. Given the absence of a technology alternative at this time and for the foreseeable future, it is a major leap of faith to assume at this point that the RGGI cap can be met by generators without the need to rely extensively on emission reductions from offset projects; indeed, RGGI documents, as well as stakeholders, have stated previously how essential offset projects are to the program's implementation.

Generators will need to make difficult choices about how to stabilize emissions during the first phase of the cap and then reduce them by 10 percent, especially as electricity demand continues to rise, fuel prices are at record or near record highs, and New York State and the rest of the RGGI region will need to add capacity to meet electric system reliability requirements. The NYISO, ISO New England, and PJM each project the need

for the RGGI region to add generating capacity and increase fuel diversity in order to avoid reliability risks, one year prior to when the RGGI is scheduled to start. Generators also have other State and Federal requirements with which they must comply and still be able to operate economically in the competitive electricity marketplace.

In order to compete in the wholesale electricity market, many generators already have made the necessary operational changes to optimize heat rates and hence the efficiency of their units. Also, fuel switching is an expensive and unpredictable option, given the price of fuels and the expiration of New York's power plant siting law in 2002, which facilitated repowering. Fuel switching could increase our over-reliance on natural gas and exacerbate fuel diversity concerns. It is unclear that the region will have enough natural gas supply to support the projected needed facilities, given public opposition to pipelines and LNG facilities.

An RGGI program that arbitrarily limits the use of offset projects to 3.3 percent of a source's total reported emissions, discounts the value of offsets in an unreasonably restrictive manner, and proposes to auction at least 25 percent of the program's allowances will place further undue economic burdens on generating facilities, which are the very facilities on which we rely in New York to maintain fuel diversity and system reliability.

B. Offsets Expert Panel

The RGGI should establish a carbon offsets panel to be charged with evaluating and recommending a cost-effective, streamlined, robust, and standardized RGGI carbon offset component. This panel should include experts from existing offset trading programs and private sector users and generators of offsets.

Offset rules need to be reasonable, simple, and flexible in order to develop a robust offset market that promotes the availability of offsets. The RGGI should be designed to maximize options for reducing emissions and to encourage investments from multiple sources that bring viable offset projects (and their emission reductions) to realization as quickly as possible. Also, the Draft Model Rule should have flexibility to allow for more offsets to be added without the need for a change to the regulations.

A simple offsets approach will help keep consumer prices low, while enabling regionally important base-load facilities to continue to operate. If offset rules are simple and reasonable, then the RGGI program will not only be balancing environmental needs, but also it will remain consistent with the states' desire to maintain fuel diversity, which, in turn, contributes directly to keeping energy prices low and the grids stable and reliable.

C. Offset Values Should Not Be Discounted

It makes no environmental sense to limit offsets in terms of amounts, types, geographic location or discounts on their allowance value based upon location. The restrictive provisions of the RGGI MOU and Draft Model Rule are unworkable and render offset

projects unusable. Unless provisions for offsets are redrafted to be more reasonable, offsets projects will not be able to provide needed additional liquidity in the market in place of the role that back end controls (which are unavailable for CO2 emissions) typically play in cap and trade programs.

D. Offset Supply Curves for Stakeholder Comment

We appreciate that the RGGI SWG finally has provided stakeholders with more detailed information on the potential supply and cost of offsets, which the RGGI SWG reviewed as the basis for their proposal on offsets. A separate conference call should be organized to allow stakeholder to review and comment upon those materials. The methodology and data used by the SWG to estimate the quantity and quality of offsets available in the region must be better understood by all RGGI program participants.

2. Offsets and Additionality

Offsets are a key component of any greenhouse gas (GHG) program, since GHG reductions cannot be accomplished easily through a conventional cap and trade program (due to a lack of emission control equipment). The design of offset programs should not be complicated or include excessive theoretical considerations (e.g., financial additionality[1]) that have little or no bearing on companies selecting the most appropriate emission reduction or offset strategy. IPPNY supports straightforward and standardized offset creation procedures with appropriate safeguards.

To generate GHG offsets, the project should be:

- Real: A discrete reduction of actual greenhouse gas emissions resulting from specific and identifiable actions;
- Quantified: Calculated using real data and a transparent and replicable methodology;
- Verified: A third party must authenticate the action and calculations of the Seller and attest to the validity and quantity of reductions;
- Surplus: Reductions must be excess of any emissions reductions that may be required of the source by existing regulations in place at the time, and
- Unencumbered: The Seller must have clear ownership of the emission reductions.

A. Regulatory Additionality

At most, regulatory additionality, in combination with the submission of monitoring and evaluation reports that are approved by accredited certifiers, should be sufficient for offset projects; as long as they occur from a project that already is not required by existing law or regulation, the RGGI should encourage emission reductions from any offset projects.

[1] Additionality is the principle that offset credit should apply to actions that are "in addition" to what is otherwise required. Historically this has been based on regulatory requirements, but some have suggested a financial component as well.

The Draft Model Rule includes the following regulatory additionality provisions:
"CO2 emissions offset allowances shall not be awarded to a project or CO2 emissions credit retirement that is required pursuant to any local, state or federal law, regulation, or administrative or judicial order. If a project receives a consistency determination under section XX-10.4, and subsequently the project is required by local, state or federal law, regulation, or administrative or judicial order, then the project shall not be eligible for the award of CO2 emissions offset allowances after the effective date of the local, state or federal law, regulation, or administrative or judicial order."

Regulatory additionality should not have retroactive applicability after an investment in a pre-approved project is made. In order to provide needed investment certainty and ensure access to financing, investments that met a regulatory additional test when project financing is obtained should remain eligible for at least a ten-year period, even if a law or rule is changed to make an approved project ineligible going forward. The project sponsor's allowances should not be truncated to receipt of allowances only for the offset reductions that occurred before the law or rule change, as this impacts anticipated revenue sources that are the basis for project financing. After the initial ten-year period, the project applicant could re-apply for access to allowances, and project eligibility could be re-evaluated at that point; also, the applicant should have the opportunity to update or adapt the project at the point of applying for renewal. Furthermore, a ten-year crediting allocation with an extension for one ten-year period may be too short to justify project financing. Also, the Draft Model Rule lacks an appeals process for the "consistency determination" of offset projects in general.

Retroactive regulatory additionality would inject much uncertainty into the value of offset projects; indeed, the level of uncertainty could be so large as to discourage the investment community from funding any offset projects. The RGGI Staff Working Group should consult with the investment community on how the Draft Model Rules many restrictions on offset projects will affect their investment attractiveness and viability in the marketplace. Unless offset projects are redesigned to be attractive investment opportunities, the RGGI program will not be able to be implemented and the goals of the program will not be attained.

B. Regulatory Plus Additionality

The RGGI should not exclude projects, which already are receiving other sources of funding, from eligibility as offset projects. Indeed, as in the case of projects funded by the New York State Energy Research and Development Authority (NYSERDA), projects which have co-funding often are considered better investments than those that do not. Regardless of the availability of co-funding, the RGGI should encourage projects that are implemented because of an investment related to the RGGI. Restrictions such as the size of the project or market penetration levels are irrelevant to whether a project is viable, and RGGI investments which help projects to be executed should be encouraged.

Projects that receive funding or other incentives, such as from any state System Benefits Charge (SBC) or Renewable Portfolio Standard (RPS) program or from funds provided through any yet-to-be-approved RGGI consumer and strategic purpose allocation, should receive RGGI offset credits.

The requirement that project sponsors must transfer the legal rights to any attributes credits (except RGGI offsets) to the Regulatory Agency or its agent (such as the regional registry) should be deleted from the Draft Model Rule. Renewable Energy Certificates (RECs) are separate attributes from CO2 offsets. Indeed, the Massachusetts Technology Collaborative (MTC) already has determined that RECs under that state's Green Power Partnership Program are a separate attribute from CO2 emission reduction credits; this precedent should be expanded to the treatment of CO2 offset credits. CO2 projects should be allowed to simultaneously generate CO2 emission reduction credits (ERCs) and Renewable Portfolio Standards (RPS) RECs. The RGGI SWG should issue a policy statement which indicates that CO2 ERCs from offset projects and RECs are separate and collateral regulatory commodities, which may provide incentives for further renewable development.

Another area of concern is that offset credits may not be awarded to participants in any voluntary greenhouse gas program. We urge the RGGI SWG to strike this concept from the Model Rule. Companies that have participated in these voluntary programs should be credited for their efforts and not penalized for being "trailblazers" in this field. These companies are often Environmental Leaders, and their participation and leadership in voluntary programs should be applauded. The current language discourages current and future activities by companies and only benefits the firms that have not been engaged in proactive measures. Sufficient "controls" (e.g. verification by third party and certification by the Responsible Company Official) can be incorporated into the Model Rule to guard against "double dipping" from a single project under a voluntary program.

C. Financial Additionality

It is unclear what types of projects would be able to survive the financial additionality test that the RGGI SWG is contemplating and still be able to obtain financing.

The overall goal of the RGGI is to reduce emissions. Financial additionality would seem to exclude economic investments for which developers are more likely to obtain financing. Requiring offset projects to be above standard market practice or beyond those that are attractive investment opportunities in the current marketplace are unreasonable, subjective and impractical provisions for meeting the goal of emission reductions. If financial additionality is applied to offset projects in the manner that the RGGI is contemplating, investments by energy market participants would be limited to those that are speculative or currently uneconomic.

RGGI documents state that additionality is a key criterion for ensuring that offset projects result in real emissions. Emission reductions already would be considered real, if they are verifiable and permanent; it is unclear why financial additionality is needed to ensure

otherwise that emission reductions are real. Reductions are verifiable, when they are measured against a baseline or performance standards. They are permanent, when offset projects are completed and the resulting emission reductions are secured. Furthermore, monitoring and evaluation reports would ensure that emission reductions from offset projects are verifiable and permanent. The RGGI already proposes to have these reports approved by accredited certifiers, and this level of rigorous review should be sufficient for offset projects.

The imposition of financial additionality would reduce the types of offset projects in which energy market participants could invest, especially when generators cannot make changes substantial enough at their facilities to comply with RGGI requirements. This restriction could have the detrimental result of reducing the fuel diversity of New York State's electricity system, which is the foundation for our reliable supply. The ability to obtain an allowance for an offset project should not be treated as a special incentive or subsidy but, instead, as a necessary way of securing lower emissions.

D. Restrictions on Offsets Hamper Operation of Safety Valves

The inability to viably invest in offset projects jeopardizes or hampers the ability of the safety valves to operate, given that there could be an insufficient amount of offsets to access if the valves are triggered.

The Draft Model Rule should contain more specific language on the threshold calculations and the exact sources of price information. Both allowance and offset prices should be considered in the calculation. The 2 percent adder in the Stage 2 Threshold formula is arbitrary and should be eliminated. The 12 month period in addition to the 14 month market settling period appears to mean that this trigger cannot be hit until 26 months have transpired. Twenty-six months is too long a period to wait, before the CO2 cost adder impacts on fuel diversity and consumer prices can be mitigated. The threshold prices simply should be based upon a 12-month rolling weighted average. Transactions, between (a) affiliates, subsidiaries, or otherwise related companies or (b) that are part of fossil fuel and /or electricity contracts, should be excluded from the methodology, as they necessarily may not represent market prices. If an offset trigger event eliminates the 2:1 geographic discount and expands the geographic area of eligible offsets, then no reset should be required in the following compliance period. Otherwise, the potential for reset and the corresponding offset value discount may make the financing of such projects impossible, especially if the compliance period is not extended.

Also, the mechanism for the safety valve is too complicated and does not accomplish its intended purpose of price mitigation. The design for accessing more allowances based upon price triggers lends a great deal on uncertainty and provides too little price relief when it may be too late. More price relief and certainty would be provided, if offsets projects were to be made available upfront without constraints.

In regards to the safety valve, IPPNY originally proposed a much simpler approach. The safety valve would serve to stop further implementation of the potential program, in order

for a "reality-check" assessment to be completed of the root causes of any difference between reality and the projected modeling results and for any needed adjustments to the program to be made, including relaxing or suspending the cap. The safety valve should be triggered when allowance cost levels exceed twice the estimated allowance cost of the final modeling package case on a year-by-year basis. Additionally, the Draft Model Rule should include provisions that require states to monitor potential implementation and to modify, slow, or stop the program, if there is any indication that the program is having, or potentially could have, negative impacts on reliability, economic competitiveness, electricity markets, fuel infrastructure, or the ability of needed capacity to be built. The RGGI program relies upon the region being able to support a substantial increase in its reliance on natural gas fired generation. The Draft Model Rule should include provisions that require the states to monitor whether the fuel delivery infrastructure, such as pipelines or liquefied natural gas terminals, is being added at a rate that is sufficient to provide reliably for the demand of the projected growth in natural gas fired generation.

The RGGI SWG may wish to consider adding a true price mitigation mechanism, such as an alternative compliance payment, to the MOU and Draft Model Rule. This approach is supported by The National Commission on Energy Policy, which has "addressed concerns over potential impacts on energy costs, economic growth, and competitiveness" by endorsing the use of a true safety valve. This safety valve explicitly would cap program costs, which effectively guarantees that the costs of emission reductions will not increase above a pre-specified price. As stated by the Commission, "…policies with a safety valve limit costs and allow emissions to adjust in the face of adverse events… By (balancing) … cost certainty (and) … environmental certainty, the Commission's proposal explicitly caps costs, while at the same time producing significant annual emission reductions." This policy mechanism is no less valid in the context of RGGI, especially since back-end emissions controls for CO2 are not available and a surrogate for this type of price control is needed. Therefore, the SWG should provide for cost certainty in the MOU and the Draft Model Rule.

3. Specific Offset Projects

A. Afforestation Projects

Afforestation projects should not be subject to an upfront 20 percent discount of credited carbon to account for potential catastrophic losses. If at all, the discount should be applied only at the time of verification and after an incident of fire or disease has occurred. Certifiers of monitoring and reporting will know if a catastrophic event has occurred, and the offset project should not be penalized in advance in terms of allowance value. Since projects are not being "front-loaded" or given GHG credits prior to the reduction occurring, a 20 percent discount does not make economic sense. The upfront discount would discourage investments, given that project sponsors would not finance a project that begins with a negative 20 percent return.

Any uncertainty about permanence could be addressed by other mechanisms, such as CO2 substitution clauses in contracts or insurance policies, which could provide for substitution of "offset credits" from other projects instead of monetary payments. When the amount of carbon sequestered is replaced, the project should not subject to the 20 percent discount on the value of allowances.

The market should be allowed to best cover this type of risk at the least cost, and a risk mitigation approach should not be dictated. Should an event such as a forest fire take place, then the market will cover the risk appropriately by obtaining equivalent reductions or sequestration elsewhere, while the same environmental benefits are ultimately achieved. Likewise, if this type of event never takes place, the market is not over-investing, and market efficiency is maintained.

In addition, the legally binding permanent conservation easement is overly stringent, considering that offset credits would be issued only for a relatively small time period (10-20 years). Either the conservation easement should be limited only to the period of offset credit generation, or the offset allowances should be permanently valuable.

B. Natural Gas Projects

Additional details should be included in the Draft Model Rule for conversions to natural gas for residential and commercial boilers and for natural gas transmission and distribution.

Fuel switching of commercial, residential and fleet entities from coal, oil, gasoline or diesel to more carbon efficient natural gas fuel can significantly contribute to lower emissions in the region and increase the availability of offsets for compliance.

End-use efficiency should include improvements in carbon efficiency as well as energy efficiency of the combustion system. Offset projects should include eligibility for switching from oil to natural gas, even if energy efficiency is not improved; improvements to carbon efficiency alone should be eligible.

End use efficiency projects should be extended to all sectors of the economy and not limited to merely the residential and / or commercial sectors. Also, the requirement to limit the market penetration rate of eligible projects only to 5 percent should be deleted from the Draft Model Rule; otherwise, many projects which have emission reduction benefits would be excluded.

C. SF6 Projects

Averaging what companies are doing in the Partners Program would be arbitrarily penalizing companies. Companies who acted early should not be penalized and should receive credit for their early actions and investments.

The requirement to weigh each individual cylinder is very burdensome, along with the requirement to keep a log with every cylinder. At most utilities, SF6 equipment is monitored 24 hours a day, 7 days a week with alarm systems, which activate when operating pressure falls below specifications. "Work orders" are issued, and crews respond to the alarms. The weighing of every cylinder requires scales at every substation or in every truck of all potential personnel that could be called to answer the alarm. Severe weather conditions also can make weighing of cylinders difficult. Knowing in advance the exact equipment that will alarm is not possible; therefore, logs for cylinders with matching equipment numbers is not reasonable requirement. In lieu of weighing bottles (those used in reclaiming or filling of new equipment), they are lifted currently by the substation personnel and recorded as "partial" or "full." Weighing of cylinders is done as part of certain procedures at utilities, but not in every case.

The SWG needs to consider the practical aspects and have an understanding of the finer issues associated with SF6 management. For example, alternatives may be available to the "weighing each bottle" methodology proposed. Through the "work order" process of SAP or other business management systems, a fairly accurate inventory of SF6 can be tracked and leakage estimates developed. Therefore, we recommend that the SWG considers a workshop on SF6 to get input from a variety of transmission and distribution stakeholders, in order to reflect and take into account current industry practices along with alternative methodologies for determining baseline and on-going inventory calculations.

D. Development of Standardized Offset Criteria for the Natural Gas Transmission and Distribution Category

The RGGI Staff Working Group should work with the Interstate Natural Gas Association of America (INGAA), the American Gas Association (AGA) and interested stakeholders to develop standards for this offset category. The details for this offset category should be developed and released as draft provisions for public comment, prior to final agreement on the text of the Draft Model Rule.

In general, performance standards could be established for various projects. Anything above those standards would then be eligible. Spatial boundaries, temporal periods and stringency levels are the key factors to be considered in the development of performance based standards. The EPA Natural Gas STAR program provides a wealth of data to initiate the development of such standards. The following list is not comprehensive but is derived from the highly successful EPA Gas STAR program.

Current Standard	Offset Standard
Replace Gas Turbine Starters – turbine and gas engine application	Install electric or compressed air powered starters
For recip. comp. – vent compressor piping after shutdown	Install gas recovery system
Replace comp. cylinder unloaders	Install efficiency no bleed unloaders with multiple seals on shaft
Use of standard flat face recip comp. packing	Install low emissions packing
For recip. engines operating w/o A/F ratio controller	Install A/F controller that is mapped to minimize fuel burned
Vent or blow down line to weld connection for new customer	Eliminate vented emissions by utilizing a hot tap for in-service connections
Vent or blow down line to cut out section of pipeline due to damage	Utilize pump down to lower gas line pressure before maintenance
Vent or blow down line to cut out section of pipeline due to damage	For "smaller" exterior pipeline damage, utilize composite wraps thus eliminating need to vent any gas
Use of gas assisted glycol pumps	Replace with electric or instrument air driven

Monitoring and quantification of GHG reductions for the gas transmission sector can follow the principles laid out in the INGAA GHG Emissions estimation guidelines. Monitoring and reporting of GHG reductions from the gas distribution sector will need to use a combination of existing estimation guidelines, since there is not a specific distribution protocol available. Since any offset would need appropriate third party verification employing appropriate protocols, the RGGI SWG can be assured that the offsets would be of high quality and real.

Several standardized protocols currently exist which contain the emission factors and calculations necessary for quantifying CO2 equivalent greenhouse gas emissions from the natural gas transmission and distribution sector. Those include:

- Gas Research Institute (GRI) and US Environmental Protection Agency (EPA). *Methane Emissions from the Natural Gas Industry*, Volumes 1 through 13, GRI-94/0257 and EPA-600/R-96-080, June 1996. www.gastechnology.org; and

- Interstate Natural Gas Association of America, (INGAA), Greenhouse Gas Emission Guidelines for Natural Gas Transmission and Storage: Volume 1 – Emission Estimation Methodologies and Procedures, Revision 2, September 28, 2005. http://ingaa.org/environment/Climate.htm.

E. Other Sources of Offset Projects

Based upon the operation of the safety valve, the RGGI MOU allows the use of offset projects located anywhere in North America or from international trading programs. The language of the Draft Model Rule provides that offset projects may be located in State (within the United States), Mexico or Canada.

The Model Rule needs to include text that any projects certified under international Clean Development Mechanism (CDM) projects and the European Union (EU) program should be able to be used automatically as an offsets project under the RGGI. Other currencies from around the U.S, such as those from the Chicago Climate Exchange, Oregon, and other programs, also should be included in the RGGI program.

Any category of offset project that is real and verifiable should be included in the RGGI program, such as unit shut-downs, coal-bed methane recapture, and management of coal combustion products.
The RGGI MOU and Draft Model Rule should explicitly include reductions of any of the six major greenhouse gases, particularly since their climate change potential is often several times that of CO2.

ATTACHMENT 4

Applicability

1. Treatment of New Units

The region's three Independent System Operators each have identified the need to expand capacity for fuel diversity and reliability purposes, just before the RGGI program is scheduled to start. The addition of these needed facilities could result in significant increased emissions in relation to the current size of the cap. With the help of a working group on this topic, the Draft Model Rule should be revised to contain specific standard provisions for new units that allow these needed units to be built, without affecting the ability of essential existing units to operate under the cap.

A set-aside for new units will be inadequate. New units should be excluded from the program, until the new unit is able to receive a full allocation of allowances. New units could be required to do monitoring and reporting, but they should not be required to reconcile their emissions, at a minimum, during the first three-year control period following the start of commercial operation.

2. Non-emitting generation

The RGGI should treat all renewable or non-emitting generation technologies equally.

3. Need to exclude "parasitic load"

Emissions resulting from the "parasitic load" of environmental control equipment (mercury, NOx, SO2, cooling towers, etc.) should be exempt from regulation. Significant capital, operation, and maintenance expenditures are required for emission control equipment that will increase "parasitic load" used at the facility, which is not energy supplied to the regional electric grid. Unless these considerations are factored into the design of the RGGI program, a well-controlled unit will receive significantly fewer allowances than a less controlled unit. The power needed to run air emission control equipment should be added to the unit's net energy output in allocation determinations.

4. Contracted Plants

Some facilities with long term contracts do not have a compliance cost pass-through mechanism and should have the opportunity to provide a clear demonstration of the lack of compliance pass-through to the appropriate designated regulatory agency. Possible solutions to address this issue include: (1) the power off-taker is responsible for CO2 requirements; (2) contracted plants are exempted from RGGI requirements during the life of the contract; or (3) contracted plants are provided with a full allowance allocation, until the contract expires.

5. Biomass Fuel Credit

Under the Draft Model Rule, if a source burns biomass for more than 50 percent of its total fuel, then it would not be subject to the program. The Draft Model Rule defines eligible biomass to include technologies that use unadulterated and non-construction and demolition debris fuel stocks, which includes: brush, stumps, lumber ends and trimmings, wood pallets, bark wood chips, shavings, sawdust and slash; energy crops; biogas and liquid biofuels.

The definition of eligible biomass fuel should be broader and should include the emerging technology of gasification of municipal solid waste to produce synthetic gas, since it not only contributes to fossil fuel displacement but also avoids methane formation. All types of waste streams recycled as energy should be eligible, including but not limited to, source separate, unadulterated construction and demolition fuel stocks, coal bed methane, manufactured biomass fuel (such as Enviro-Fuel Cubes) and natural gas / oil by-products (NOBs). This approach would be in the best interest of the environment, since (1) waste streams otherwise would end up in landfills and / or create greenhouse gas emissions and (2) landfill space and recycling co-benefits are important issues in the RGGI states.

The Draft Model Rule covers biomass *co-firing* but not the conversion of a unit to 100 percent biomass. Providing credit for the conversion of a unit to 100 percent biomass should be a legitimate and encouraged compliance mechanism, and the unit should be treated as being fossil-fired for its entire life cycle. As for biomass co-firing, CO2 emissions from 100 percent biomass firing should be considered to be CO2 neutral.

6. "Behind the Meter" Exemption

The Draft Model Rule includes a "behind the meter" exemption as an *optional* provision for states to consider adopting. This exemption provides that, if a unit supplies less than 10 percent of its electrical output to the grid, then it could apply to be exempted from the program. This exemption should be a *mandatory* provision, and states should be required to implement this exemption in state-specific RGGI regulations.

In regards to the 10 percent threshold for the "behind the meter" exemption intended to encourage participation in the demand response program, the capacity market part of the demand response program, which obligates a response if capacity is needed, should be exempt as well from the applicability of the Draft Model Rule.

ATTACHMENT 5

Modeling Issues / Cap Size

1. RGGI Modeling Must Be Updated

The RGGI should update its modeling to account for the inclusion of Maryland into the program and the exclusion of Rhode Island and Massachusetts from the program.

The program and its modeling also should be updated to account for the clean coal facilities which are encouraged to be built in New York, as a result of Governor Pataki's Advanced Clean Coal Power Plant (ACCPP) Initiative.

2. RGGI Cap Should be Changed

Also, the RGGI cap may need to be changed to allow for the building of coal facilities, as contemplated by this ACCPP Initiative. Indeed, according the ICF modeling of the highest emissions case to date, it could be argued that the regional cap should be around 180 million tons.

The RGGI cap may not be sufficient to account for expected load growth between the baseline years and what emissions are expected to be in 2009, when the RGGI program is contemplated to start. New York State and the rest of the RGGI region will need to add capacity and increase fuel diversity to meet electric system reliability requirements.

The RGGI program assumes that all existing nuclear facilities will be relicensed; yet, environmental groups and public officials constantly are calling for the closure of nuclear facilities such as Indian Point 3. The RGGI cap does not take into account the potential for increased emissions, if some nuclear facilities need to be replaced with emitting facilities. As a result, the RGGI Draft Model Rule should include language that endorses a policy of relicensing all existing nuclear facilities.

The ten percent reduction requirement proposed by the MOU and Draft Model Rule may be unrealistic, as the time period is not long enough to accomplish fleet turnover that would be needed to meet this requirement.

ATTACHMENT 6

Imports & Leakage Working Group

The RGGI MOU provides for the establishment of a multi-state Imports and Leakage Working Group to consist of representatives from the energy regulatory and environmental agencies in the Signatory States. The Working Group would consider potential options for addressing leakage and issue its findings and conclusions by December 2007.

The RGGI Draft Model Rule must not be finalized at the regional level, until the issue of leakage is evaluated fully and before stakeholders have the opportunity to comment on the final report to be submitted to RGGI Agency Heads. Under the current timeline, the RGGI Draft Rule is scheduled to be revised this July; yet, the final report is scheduled to be submitted in December of 2007. The conclusions of this report will have direct bearing on the provisions of the Draft Model Rule, which cannot credibly be finalized before January 2008.

In considering potential options, the Group will consult with a panel of experts, stakeholders and representatives of the regional transmission organizations. In addition to representatives from energy and environmental RGGI state agencies, from the three regional ISOs and academia with market and legal expertise, the Group should include Commerce Clause experts and representatives from the private energy sector.

The Group should look at NOx, SO2, and mercury emissions, as well as CO2. Looking at all four emissions will be important for the CAIR, CAMR, and BART State Implementation Plan processes. Also, leakage should be examined as part of the State Administrative Procedure Act environmental impact analysis.

The Group should look at AEP's transmission line from the coal country corridor to New Jersey, as a sensitivity study to leakage issues. This transmission line will encourage more coal facilities to be built, and more emissions will come into the RGGI region from West Virginia and Ohio.

The Group should develop a tracking mechanism to confirm the extent to which leakage undermines the integrity of the program. That effort would necessitate defining what results would be regarded as undermining the program and the means that will be used to determine if any increase in imports is due to increased demand or to RGGI costs imposed on other sources.

ATTACHMENT 7

Need to Coordinate RGGI with PSD / NSR Rule and Other Rules

The RGGI Rule needs to be coordinated with PSD / NSR requirements in terms of heat rate improvements, and questions about modification and routine maintenance need to be clarified.

The RGGI SWG should look at the Draft Model Rule in the context of DEC's Draft NSR Rule and recent State rules (6 NYCRR 204, 6 NYCRR 237 and 6 NYCRR 238) and Federal rules (CAIR, CAMR, Title IV and BART) and ensure that these rules, taken together, can work well and will not result in either fuel diversity or reliability issues. At the very least, the DEC should ensure that the Draft PSD / NSR program should be implemented in a manner that better coordinates with these rules and the RGGI and does not impinge on the ability of companies to comply with these rules. For example, the DEC Draft NSR Rule is inconsistent with the requirements for the improved energy efficiency of facility operations contained within the RGGI and 6 NYCRR Parts 204, 237 and 238. Also, the DEC Draft NSR Rule may affect the ability of facilities to improve their heat rates (which are not O&M costs) under the RGGI, and RGGI compliance could involve major or minor modifications.

IPPNY continues to urge energy and environmental regulators to work more closely with each other and to look seriously at the cumulative impact of these regulations on the ability of the energy system to continue operating in a reliable manner.

ATTACHMENT 8

Emissions, Monitoring and Reporting

Emissions, monitoring and reporting should not require separate submission of two Electronic Data Report (EDR) files. The proposed requirement would create burdens for non-acid rain units. Some acid rain units already submit CO2 records to the EPA, but non-acid rain units do not report CO2 emissions. Data requirements under the Draft RGGI Rule do not fit into the EDR structure. Also, the monitoring plan would be different for the RGGI than for existing programs.

Recordkeeping requirements should be limited to five years, like under the current Title V program. If the compliance period is extended for up to six years, then the RGGI could require additional recordkeeping at that point.

ATTACHMENT 9

Penalties

In the case of excess emissions, the Draft Model Rule requires that the Regulatory Agency or its agent deduct allowances (excluding offset allowances) in the amount of three times the number of the source's excess emissions. In addition, the source's owners and operators remain liable for any fine, penalty, or assessment and may be required to comply with any other remedy. Each day in the control period constitutes a day in violation, and each ton of excess emissions is a separate violation.

The three-to-one penalty structure is onerous, and regulatory experience elsewhere does not suggest that the extent of the penalty is a critical factor in assuring program integrity. A facility with a minor overage in emissions versus available allowances would be unable to use offsets to make good the excess. Further, upon entering into the penalty regime, non-offset allowances would be drawn from the facility's account first. As offsets are disqualified, the magnitude of the offence is increased, not simply by a factor of a three-to-one ratio but against a base of the number of offset credits used. This structure is fundamentally a demand cap on the emissions allowance market. Demand caps of any form that are independent of the price signal are greatly vulnerable to unintended consequences, and must inherently corrupt the ability of the market to function in setting a price for carbon. Instead of implementing a three-to-one ratio, the penalty assessments should be the same as in the NOx / SO2 regulations.

The RGGI Draft Model Rule should provide the Regulatory Agency some flexibility and discretion in the implementation of these penalty provisions. For example, if a facility experiences problems with emissions monitoring equipment or if other circumstances beyond a company's control result in excess emissions, the Regulatory Agency should have the flexibility to work with the company to correct these emissions, without being compelled to impose full penalties. As is the case with some existing programs, the company should have the opportunity to cure the excess emissions and the reason they were produced or to implement a community benefit project instead. The full penalty would be imposed, when the company does not make a correction that is within its ability or if it does not implement a community benefit project that offsets the amount of excess emissions produced.

Also, the definition of excess emissions (EM) should be defined as the difference between total emissions (TE) and the sum of allowances (A) and offset (O) deductions used to cover those total emissions less any CO2 emissions attributable to burning biomass (B). In other words: $EM = [TE – (A + O)] – B$. To remain in compliance, a unit must have EM in the formula above equal to zero or less. If emissions were above the amount of zero, then those emissions would be subject to requirements for excess emissions.

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