



MEMORANDUM

May 19, 2006

To: RGGI Environmental & Energy Commissioners,
RGGI Staff Working Group, and
RGGI Stakeholders
From: Derek Murrow, Director - Policy Analysis
RE: Final Written Comments on the RGGI Model Rule Draft

Rockport, ME
Portland, ME
Hartford, CT
Boston, MA

These comments are submitted by Environment Northeast (ENE) on the draft RGGI Model Rule. ENE appreciates the opportunity to comment and wishes to commend the Governors, environmental and energy agencies, and in some cases legislatures of the seven signatory states plus Maryland that have agreed to develop the Regional Greenhouse Gas Initiative (RGGI) for their leadership in developing the first in the nation carbon cap and trade program. RGGI is an important precedent nationally and should serve as a catalyst for national action in the near future.

Environment Northeast is a nonprofit research and advocacy organization focusing on the Northeastern United States and Eastern Canada. Our mission is to address large-scale environmental challenges that threaten regional ecosystems, human health, or the management of significant natural resources. We use policy analysis, collaborative problem solving, and advocacy to advance the environmental and economic sustainability of the region.

The following comments on the draft model rule are aimed at improving upon a good initial draft. We have tried to be specific in our comments but welcome comments or questions you might have, as many of the issues are complicated and we have tried to address them briefly without having this document get too long.

We believe that each of the issues identified here is important and hope the state working group will incorporate them into the final draft of the model rule. However, we thought it would be helpful to highlight our priority issues, which are the following. You will note that most of ENE's comments are related to ensuring the program's initial cap level is not set higher than current emissions or inflated through exemptions and generally streamlining and clarifying elements such as price triggers and offsets.

Priority Comments:

- 1) Review and reduce the regional cap level to ~119 million tons
- 2) Remove unit exemptions (biomass and self-generators) or ensure that there is a state-by-state commitment to reduce the cap level by an amount equivalent to the emissions of units exempted
- 3) Clarify that early reduction credits are a set-aside from within the cap and not an expansion of the cap

- 4) Clarify what projects and programs are eligible for the Consumer Benefit and Strategic Energy Allocation to ensure that the allowance value is directed to activities that reduce impacts on consumers and assist RGGI meet its goals
- 5) Include the 5-point test (real, surplus, verifiable, permanent and enforceable) in describing how the project specific offsets protocols were and will be developed in the future
- 6) Simplify the safety valve and trigger mechanisms to provide stability to the offsets and allowance markets
- 7) Clarify and make detailed adjustments to the additionality test for energy efficiency and afforestation offsets and to the permanence requirement for afforestation

The following memo is organized more-or-less by section, except in cases where the issue is raised in multiple locations, in which case we have made an attempt to note relevant sections of the text.

General Issue – Regional Cap Level

- **Recommendation 1:** The regional cap level is set significantly above current emissions and the states should reduce the initial cap level to ~119 million tons CO₂, which is ~3.3% above 2004 emissions levels and is consistent with the projected rate of emissions growth from the IPM standard reference case between 2004 and 2009 (CO₂ emissions increases of ~0.7% per year)
 - Our concern is with the regional total and we believe the states should come up with adjustments to cap levels to achieve this regional reduction;
 - That being said, we note that New York and Vermont have included units in their budgets that may be exempt from the program (see discussion of exemptions below), some states budgets are as much as 9-11% above current emissions (CT, ME and NJ), and Vermont has an additional million tons due to output and future plant construction considerations. There are a number of issues and options the states should consider: (1) adjustments should be made to address exemptions, (2) a state's budget quantity is less critical to the state's regulated entities when a large percentage of allowances will be auctioned, (3) extra allowances do not need to be distributed to states to address leakage issues when this issue will be dealt with through the development of a leakage policy fix, and (4) all states that have taken a leadership roll in addressing climate change should want a program that delivers real reductions without delay. We urge the states to reach a new balance and reduce the total regional cap level.

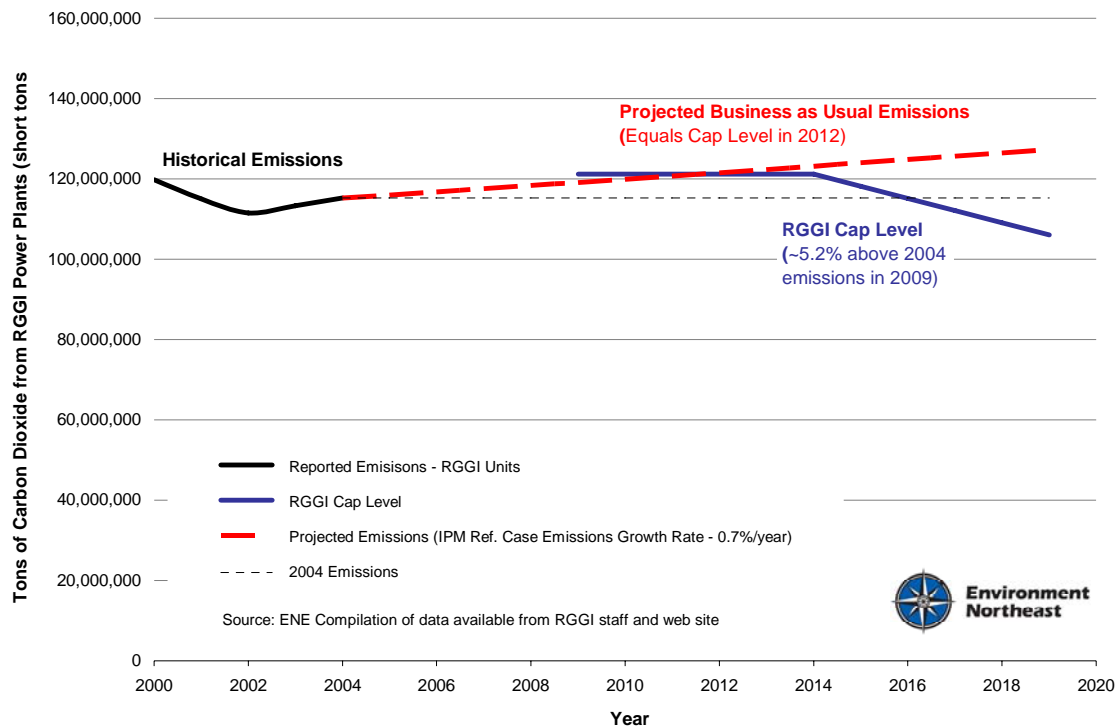
Rationale: The RGGI program needs to deliver changes in behavior within the electric sector and avoid having excess allowances in 2009. It is hard to predict the future, but an inflated cap would allow regulated entities to bank large quantities of allowances for future periods, allow them to avoid making changes in investment decisions, and potentially yield an extremely low allowance price. The states have regularly characterized the cap level as equivalent to current emissions, when in fact it is set at ~5.2% above 2004 emissions (Note: we have received updated data from the states since the May 2nd Stakeholder Meeting). At a minimum the cap should be reduced to the projected level of emissions in 2009. The following table and figure illustrate the cap level in relation to emissions over the 2000 to 2004 time period. We have examined 2005 acid rain unit data from EPA (which does not include a number of natural gas units) and find that emissions for the region are up slightly, but this may be offset by reduced utilization of natural gas units due to high natural gas prices. We remain concerned, however, that the regional cap was set without enough consideration of current emissions and that there could be an excess of allowances in the early periods of the program.

Table 1: RGGI Cap Levels v. Actual Emissions

State	RGGI Cap Level	Total Annual Emissions (Short Tons CO ₂)					2000 to 2004 Average	Cap v. 2003 to 2004 Avg
		2000	2001	2002	2003	2004		
CT	10,695,036	11,875,084	10,932,295	9,727,730	9,180,948	9,929,072	10,329,026	10.7%
DE	7,559,787	7,403,897	7,645,302	7,663,163	7,415,535	7,534,152	7,532,410	1.1%
ME	5,948,902	3,156,289	5,517,286	5,784,562	5,515,325	5,191,939	5,033,080	10.0%
NH	8,620,460	5,178,731	4,862,446	5,556,992	8,478,382	8,812,538	6,577,818	-0.3%
NJ	22,892,730	21,954,958	20,177,617	21,145,665	20,543,331	21,133,145	20,990,943	9.0%
NY	64,310,805	69,809,350	65,553,669	61,367,395	61,819,571	62,240,867	64,158,171	3.5%
VT	1,225,830	429,725	317,136	299,630	383,809	378,407	361,741	68.9%
Total	121,253,550	119,808,034	115,005,750	111,545,137	113,336,902	115,220,120	114,983,188	5.8%
Cap v. Actual		-1.2%	-5.4%	-8.7%	-7.0%	-5.2%	-5.5%	

Source: ENE Compilation of data available from RGGI staff and web site

Figure 1: RGGI Cap Levels v. Actual Emissions



Subpart XX-1, CO₂ Budget Trading Program General Provisions

- Recommendation 2:** Qualify CO₂ Allowances issued by the signing states for compliance with this regulation, based on a list of eligible states to be updated and published on an annual basis by the DEP (or equivalent) Commissioner.

Rationale: We were unable to locate a provision in the rule that allows for the use of allowances issued by other RGGI states.

- Recommendation 3:** In XX-1.4(a), clearly spell out that a *CO₂ Budget Unit* is a “fossil fuel-fired boiler, combustion turbine, or combined cycle system with emissions from fossil fuel combustion...(see next recommendation)...that, at any time on or after January 1, 2005, serves an electric generator...(and continue as worded in the draft).
Rationale: Because there are a number of definitions referenced in this section it is not immediately clear who the rule applies to. This is a minor edit that could assist the public and the regulated entities immediately understand the rule.
- Recommendation 4:** In either the definition or preferably within XX-1.4(a) define Fossil Fuel-fired as any unit that combusts fossil fuels.
Rationale: Exemptions for some fossil fuel-fired units should be allowed but dealt with differently and within XX-1.4(b) as an explicit exemption
- Recommendation 5:** The fossil fuel-fired exemption should be changed, moved to XX-1.4(b), and read: “a unit under subdivision (a) of this section may be exempt from the requirements of this part if (1) prior to January 1, 2005 the unit was operational and fossil fuel combustion comprised less than 50 percent of the annual heat input on a BTU basis during all of the prior ten years; OR (2) for units operational after January 1, 2005 have de minimus emissions of CO₂ from fossil fuel combustion not to exceed 25,000 short tons of CO₂ per year, and if at any time in the future the unit’s emissions exceed the de minimus limit they will loose this exemption.”
Rationale: A decision, based on politics and program design for other pollutants, to exempt existing biomass and waste-to-energy plants should not allow for a large loophole exempting new co-fired biomass and fossil plants. This proposal should allow an exemption for existing plants while requiring new plants using limited quantities of fossil fuels to be exempt form the program (a 25 MW plant, at an 85% capacity factor, and 25% natural gas input gets you to approximately 25,000 short tons per year).
- Recommendation 6:** All fossil fuel fired facilities should be required to report emissions following Subpart XX-8, and as described only have to retire allowances equal to the fossil fuel portion of their emissions.
Rationale: Full reporting will ensure that plants are accurately reporting emissions and prevent possible gaming of exemptions.
- Recommendation 7:** If any units are found to be exempt due to either the fossil-fuel fired exemption (for example the McNeil plant in VT and the Schiller biomass unit in NH) or the exemption for units that sell less than 10% of output to the grid (for example the Eastman Kodak and IP Ticonderoga plants in NY) then the states should voluntarily reduce their cap level by the average emissions of those units. In the case of the exemption for units that sell less than 10% of output to the grid, another option would be to remove the exemption entirely.
Rationale: As noted above, we are quite concerned about the cap level in relation to current and projected emissions for 2009. Exempting plants from the program that were included in the list of plants to be regulated further inflates the cap and should be avoided unless the states also reduce the initial cap level.
- Recommendation 8:** In XX-1.2(aa), *consumer benefit or strategic energy purpose account*, add to the end of the existing language: with the exception of administration costs, all activities and programs must (1) reduce the costs of the RGGI program to the state’s electricity ratepayers; (2) provide additional benefits for activities or projects that would not have occurred anyway and not replace existing programs or investments; and (3) support programs and activities that do not pose a significant risk to human health and the environment.

Rationale: The states should ensure that the allowance value from this allocation is not squandered and is targeted to activities that reduce costs for the region's ratepayers, support RGGI program goals, and generally receive public support by limiting potential negative impacts.

Note: Stage 1 and 2 Trigger Events are discussed in the offsets section below

Subpart XX-4, Compliance Certification

- **Recommendation 9:** The compliance certification should also address what portion of a unit's emissions are covered by allowances versus offset allowances and that they fall within the appropriate percentage based limits (see also comments on serial numbers below)
Rationale: The states will need to easily track compliance with the offset limits.

Subpart XX-5, CO₂ Allowance Allocations

- **Recommendation 10:** In XX-5.1 (b) through (e) the rule should make clear that the reduction is based on an annual 2.5 percent reduction of the budget imposed in (a) and not a percent of the previous year's budget.
Rationale: The model rule should leave no room for different calculations between the states as to what the rate of cap decline is and the MOU is explicit on the 2.5% leading to a 10% reduction by 2018.
- **Recommendation 11:** In XX-5.3(b) the rule should be changed to read "...will allocate a *minimum* of twenty-five percent..."
Rationale: This a minor edit to ensure the rule is interpreted as indicated in XX-5.3(a) and as agreed to in the MOU.
- **Recommendation 12:** In XX-5.3(b) the rule should indicate that any auction of the consumer benefit or strategic energy purpose allocation should occur on a regular basis (yearly or quarterly) to help inform the market price over time.
Rationale: Holding allocations on a regular basis ensures that sources can measure the demand for emissions credits more accurately. This will also help establish an average price for allowances used in identifying periods when a trigger price may have been exceeded.
- **Recommendation 13:** In XX-5.3(c), *Early Reduction CO₂ Allowances*, the rule should be explicit that these allowances are NOT in addition to the state's budget identified in XX-5.1 and will be allocated from the general allocation identified in XX-5.3(a).
Rationale: Units should be encouraged to invest in plant upgrades prior to the start of the program. However, the elevated cap level concern is large enough that we do not believe these allowances should be additional to the cap. A similar financial incentive can be created to encourage these investments through the allocation of allowances from within a state's existing budget.

Subpart XX-6, CO₂ Allowance Tracking System

- **Recommendation 14:** XX-6 should make clear that there should be public access to information about all RGGI trades. At a minimum, the database should include serial numbers, state of credit issue, state where credit was used for compliance, seller id, the seller name, buyer id, buyer name, when the credit was issued, if it's an allowance or an offset allowance, quantity traded, the price of the trade, the date of the transaction and the date when the trade was completed.
Rationale: This provides greater transparency, ensures that there is no gaming of the system, and is consistent with other emissions trading programs such as RECLAIM in California.
- **Recommendation 15:** In XX-6.4(c), *serial numbers*, the unique identification should include identifiers for year, state of issue, and whether it is a general allowance or an offset allowance.
Rationale: The states need to be able to identify if the allowances comes from approved states and how many offset allowances are used for compliance and this is easily done through the serial number system.
- **Recommendation 16:** In XX-6.5(d), *deductions for excess emissions*, it should be made clear that a unit must purchase within 3 months enough allowances to satisfy the 3X penalty for excess emissions and place them in their account for retirement.
Rationale: With a large consumer allocation, units may not have allowances for future years available for retirement.

Subpart XX-7, CO₂ Allowance Transfers

- **Recommendation 17:** In XX-7.1, *submission of allowance transfers*, the account representative should have to attest, under penalty of law that the price information submitted in (e) is accurate.
Rationale: The price information will be used to calculate the Stage 1 and 2 Trigger Events and has the potential for gaming of the market if this information is falsely reported. There must be some kind of legal and financial penalty for false reporting of price information. (Note: this may be better addressed in XX-6)

Subpart XX-10, CO₂ Emissions Offsets Projects

General Comment: It is important to develop a work plan and process for the development of additional offset protocols. As the MOU indicated, the development of forest management offset protocols is a priority, and given the strong interest by the State of Maine on forest offset types we urge that the Model Rule include reference to a process for approving new offset protocols. An ongoing stakeholder process like the one being developed around leakage might makes sense, or a process led by the Regional Organization, but guidance from the Commissioners would be helpful.

- **Recommendation 18:** The 5-point test (real, surplus, verifiable, permanent and enforceable) needs to be included in the model rule. Add an expanded discussion to 10.1 that says project specific performance standards have been developed in XX-10.5 that are designed to achieve the goals of having offsets that are real, surplus, verifiable, permanent and enforceable; and as section XX-10.5 is amended over time to improve the protocols or add additional offset types, these goals should also be applied.
Rationale: The MOU is not a legally binding document and it is important for policy makers and the public to understand that the 5-point test (real, surplus, verifiable, permanent and

enforceable) was used in developing the project specific offset protocols and needs to be considered if protocols are adjusted over time or new offset types are added.

- **Recommendation 19:** The role of international offsets and allowances from the UNFCCC or other cap & trade programs, discussed in XX-10.3(b), needs to be clarified.
 - These credits will need to be submitted to the state, an offsets allowance issued for their use, and a process laid out for this conversion.
 - In addition, these credits should explicitly be limited to programs that have been determined by the REGULATORY AGENCY to have established a hard tonnage cap (not an output based cap) that declines over time and have an offsets program designed to meet the 5-point test (real, surplus, verifiable, permanent and enforceable). In the near term this would be interpreted to mean EU ETS allowances and CDM credits.

Rationale: The MOU explicitly lays out the 5-point test and all offsets programs and protocols should have been designed with that test in mind. Allowing trading with another cap and trade program that has a very weak cap would dilute the RGGI program's environmental goals.

- **Recommendation 20:** The safety valve and offset-based trigger mechanisms are unnecessarily complex and need to be simplified to allow for clear market signals and a functional offsets and allowance trading market.
 - ENE recommends that the geographic extent be altered and limited during all time periods to states or countries that have implemented a carbon cap and trade program on the electric or other sectors that declines with time based on a hard tonnage cap (not an output based cap), or are participants in a UNFCCC approved trading program. This is consistent with the cap and offsets requirements for allowances and credits from other regions discussed above. The REGULATORY AGENCY should maintain a list of eligible jurisdictions or programs that met these requirements.
 - The 50% discount on out of region offsets should also be removed, assuming the geographic extent is limited. The effect of this change would be to allow any offset from other states or countries with equivalent carbon programs from the start, based on a need to ensure the offsets are real, surplus, verifiable, permanent and enforceable. Enforceability and additionality are especially problematic for out of region offsets. The two price based triggers would remain but their impact would only be to expand the allowable percentage of offsets to the 5% and 20% levels as described in the draft model rule.

Rationale: The program needs to achieve the goals of having offsets that are real, surplus, verifiable, permanent and enforceable. Without similar regulatory programs being in place there is no assurance of the offsets having met this goal. In addition, this change will stabilize the offsets market and avoid an incentive to game the market that exists when a 50% discount comes and goes based on an arbitrary average allowance price.

- **Recommendation 21:** Consider amending XX-10.3(d)(1) to read...“than the project shall not be eligible for the award of **future** CO₂ emission offset...”

Rationale: This clarification ensures that any offset credits created before the law changed will remain available.

- **Recommendation 22:** A bright line test should be adopted in the near-term for all project funding sources, but we believe a financial additionality screen should be allowed as an alternative.
 - In 10.3 (d)(2)(i), change the language to read: “Projects may not receive funding, grants, or other direct incentives, not including tax credits or tax exemptions, from the State of XXXX, the US Government, systems benefit fund, utility and utility commission

initiated efficiency programs, or funds provided through the consumer benefit or strategic energy purpose allocation required pursuant to subdivision XX-5.3(b).”

- If a project receives such funding, grants, or direct incentives, then a project could still qualify for offset credit if by submitting a Standardized Financial Additionality Test. Only the percentage of the project attributable to the offsets money should be eligible for offsets credit and the issuance of offset allowances. If this option is included in the model rule, the states would have to develop technical guidance that spelled out exactly how the additionality test should be completed and reviewed by third party verifiers. This would be consistent with the Standardized Financial Additionality Test identified in Section 1.2 of the Draft Model Rule, Cover Memo of March 23, 2006.

Rationale: The program should promote new carbon dioxide reduction and sequestration projects that would not otherwise have occurred. An initial bright line test avoids a complicated financial review and helps ensure that offset money promotes new investments, while the option of using a Standardized Financial Additionality Test would allow some projects that require multiple funding sources to partially qualify for offsets credit.

- **Recommendation 23:** Consider adjusting the project crediting period for each specific offset type.
 - The maximum project crediting period for afforestation projects should be extended to 20 years with an option to extend for two more 20 year periods (60 years total) if the project continues to meet all applicable requirements.
 - Considering rapidly evolving technology for other activities, such as end-use energy efficiency, we continue to recommend a ten year crediting period with an option for renewal for other offset types, as currently presented in the model rule.

Rationale: Some projects, in particular, sequestration (afforestation) projects require extended growth periods before the majority of the carbon is sequestered. For example, in the afforestation case, only a small amount of carbon is actually sequestered in the initial 10 years; the bulk of the carbon is typically sequestered in years 10-40. We generally want to encourage long term investments in afforestation projects.

XX-10.5 (c) Sequestration of carbon due to afforestation:

- **Recommendation 24:** Provide an alternative flexibility mechanism to ensure carbon offset permanence for the afforestation offset type, XX-10.5(c). Option 1, require that a permanent conservation easement be purchased on the land with carbon specific language (see below). ENE recommends that Option 1 be supplemented by a second option to allow for the issuance of a temporary offset allowance. Under Option 2, the temporary allowance would be valid though the 20 year crediting period. At the end of that period, the temporary allowance would be replaced by the regulated entity through the retirement of an additional allowance or offset allowance at the end of the 20 year period. Note: if this option is included in the model rule it would also require adjustments to the allowance reporting and allowance tracking sections of the model rule (serial numbers should be flagged for this temporary offset allowance’s expiration year).

Rationale: The cost burden of an easement is significant and this temporary offset allowance will give regulated entities and forest managers near-term flexibility while ensuring that a long-term permanent reduction occurs.
- **Recommendation 25:** Provide an alternative mechanism to address risk associated with permanence for the afforestation offset type in XX-10.5(c). Option 1, would apply the 20% carbon discount as written in the model rule; OR Option 2, would drop the 20% discount if the developer purchases a REGULATORY AGENCY approved insurance policy to cover natural

disturbances over a set period (at least 100 years) that includes monitoring. The insurance company would have to retire allowances equal to carbon losses on a regular monitoring and reporting schedule (i.e. five years).

Rationale: The 20% discount for potential loss makes sense, as there may be carbon losses due to natural disturbances (such as fire or pest infestations) or poor enforcement of easement requirements. However, allowing for the development of insurance based tools combined with monitoring could make projects more financially viable while encouraging the development of new monitoring and financial instruments.

- **Recommendation 26:** In XX-10.5(c)(6), conservation easements should include language specific to forest management planning and carbon retention. The conservation easement should explicitly state that a transitional forest management plan must be written with carbon-specific language that describes actions to be taken to ensure that the cumulative quantity of carbon for which carbon credit was awarded is maintained on-site in perpetuity. The easement should also indicate how the easement holder will assess the carbon sequestered through simple % stocking or other assessments. Note: sample easement language should be developed by the states and included in a technical guidance document.

Rationale: The goal of requiring an easement is ensure a permanent quantity of carbon onsite after the offset project crediting period has ceased. Conservation easements can be very specific and have highly variable goals. It is therefore critical to explicitly include carbon retention and a requirement of the easement language.

- **Recommendation 27:** Clarify the definition of “environmentally sustainable” and remove forest certification requirements under certain conditions in XX-10.5(c).
 - Remove the forest certification requirement for afforestation projects unless commercial timber harvest activities are expected to occur.
 - Clarify that afforestation projects should be developed utilizing best management practices during site preparation and planting, and should not use invasive exotic species. The use of native species and restoration of natural ecosystems should be encouraged.
 - We recommend further defining the term, “environmentally sustainable” in XX-10.5(c)(1)(iii), as this term is vague and open to interpretation. We suggest: “The project sponsor shall document that the project will be managed using best management practices and in accordance with widely accepted environmentally sustainable forest practices. Forest certification must be obtained through the Forest Stewardship Council (FSC) and/or Sustainable Forestry Institute (SFI) standards, or other similar standards as approved by the REGULATORY AGENCY), prior to any commercial timber harvest activities at the site.”

Rationale: FSC, SFI, and other forest certification programs are designed to accredit forests that are actively managed for timber harvesting. These programs are not appropriate or necessary for lands that are not being actively managed for wood products, and might create an onerous and unnecessary financial burden to project developers.

- **Recommendation 28:** Measurement of the soil carbon pool should be optional in XX-10.5(c).

Rationale: Over the length of a 20 year or longer project, the amount of soil carbon sequestered is likely to be minimal. Given this consideration, the cost of measuring and monitoring the sequestration of carbon in the soil is unlikely to add value to the project. We note that this may or may not be true for other land-use based sequestration offsets developed in the future.

XX-10.5(d) Reduction or avoidance of CO₂ emissions from natural gas, oil, or propane end-use combustion due to end-use energy efficiency:

- Recommendation 29:** In XX-10.5(d) include the code or standard adjustment directly in the baseline energy use formulas, as most of the new equipment installed will have to meet state or federal appliance and equipment standards.
Rationale: We recommend developing a clear and simple way to describe the role of codes and standards in additionality calculations. As written, the model rule is not clear and explicit (within the formulas) about how baseline energy use is calculated when a state or federal code or standard is in place for that equipment.
- Comment:** In XX-10.5(d) the market penetration requirement of 5% seems restrictive for many efficiency products for which greater market penetration would be desirable. We would be interested in discussing the rationale for this with state staff and whether the number shouldn't be in the 10 to 20% range.

XX-10.5 (e) Avoided methane emissions from agricultural manure management:

- Recommendation 30:** In XX-10.5(e) require “regional-type digesters” from multiple farms to account for transportation-generated GHG emissions based on a standardized emissions factor to transport one ton of manure, one mile. This distance is easily measured and mass is already reported, so it would not be difficult to develop emissions factors.
Rationale: The rule is clear that “regional-type digesters” are acceptable, but does not account for GHG emissions due to transporting manure to a central site. Moreover, this appears to be the only offset type that has significant emissions from O&M and we believe these emissions will be significant and should be addressed.

Thank you for this opportunity to comment on these regulations.



**Environment
Northeast**

101 Whitney Avenue, New Haven, CT 06510

203-495-8224 / www.env-ne.org

Rockport, ME / Portland, ME / New Haven, CT / Boston, MA

Derek Murrow, Director Policy Analysis, 203-495-8224, dmurrow@env-ne.org

Daniel L. Sosland, Executive Director, 207-236-6470, dsosland@env-ne.org

Environment Northeast is a nonprofit research and advocacy organization focusing on the Northeastern United States and Eastern Canada. Our mission is to address large-scale environmental challenges that threaten regional ecosystems, human health, or the management of significant natural resources. We use policy analysis, collaborative problem solving, and advocacy to advance the environmental and economic sustainability of the region.