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### **Environment Northeast's Comments on New York's Rule To Implement the Regional Greenhouse Gas Initiative**

Environment Northeast is a nonprofit research & advocacy organization focusing on the Northeastern U.S. 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 region's environmental and economic sustainability.

Environment Northeast (ENE) is part of the 24 member Stakeholder Group which was selected by the Regional Greenhouse Gas Initiative (RGGI) states to represent electric generator, environmental, consumer, and other affected interests in the Northeast and Mid-Atlantic regions. We are very supportive of RGGI and look forward to working with New York as it moves forward with the RGGI rulemaking process. ENE believes that RGGI is an essential policy tool to get New York and the region on the proper greenhouse gas emissions trajectory. RGGI uses market forces to guide an orderly, phased transition away from dirty, inefficient electricity generation and achieves emission reductions in the most cost effective way possible. ENE commends the Governor and agencies for committing New York to participate in RGGI, as this will position the state's industry and consumers to succeed in an economy that increasingly places a price on carbon. RGGI must be rolled out in a manner that demonstrates how a successful cap and trade program for CO<sub>2</sub> can be designed and implemented, as you are creating a model for a national program.

Our comments will focus on several aspects of the Part 242-CO<sub>2</sub> Budget Trading Program that was issued by the New York State Department of Environmental Conservation (DEC) and the 21 NYCRR Part 507-CO<sub>2</sub> Allowance Auction Program that was issued by the New York State Energy Research and Development Authority (Authority) and we will provide additional comments about the RGGI process based on our involvement in other states.

#### **DEC PROPOSED REGULATIONS: PART 242-CO<sub>2</sub> BUDGET TRADING PROGRAM**

1. Subpart 242-5 CO<sub>2</sub> Allowance Allocations Budget Trading Program
2. Subpart 242-5.3 (a) Energy Efficiency and Clean Energy Technology Account
3. Subpart 242-5.3(b) Early Reduction CO<sub>2</sub> Allowances
4. Subpart 242-5.3(C) Voluntary Renewable Energy Market Set-Aside Allocation
5. Subpart 242-5.3 (D): Long-Term Contract Set-Aside Allocation

6. Subpart 242-8.7 CO2 Budget Units that Co-Fire Eligible Biomass and Subpart 242-1.2 (34): Definition of Eligible Biomass
7. Subpart 242-10: CO2 Emission Offset Projects

#### NYSERDA PROPOSED REGULATIONS: PART 507-CO2 ALLOWANCE AUCTION PROGRAM

8. 507.3: Multi-state Auctions
9. 507.4: The Energy Efficiency and Clean Energy Technology Account
10. 507.6 (c) Frequency
11. 507.6 (e) Reserve Price
12. 507.7 Auction Formats
13. 507.8: Participant Eligibility

### **1. Subpart 242-5 CO2 Allowance Allocations Budget Trading Program**

ENE is concerned that the base budget for the New York State CO<sub>2</sub> Budget Trading Program is defined in the regulations without any opportunity for adjustments over time. New information on energy use, preliminary emissions data, and industry news reports have led ENE to be concerned that the RGGI cap level has been set too high.

The original modeling conducted to develop the RGGI cap level and framework indicated that under business as usual scenarios carbon dioxide emissions from the region's power plants would continue to rise, primarily due to increasing demand for electricity. However, more recent emissions information obtained in the past few years indicates that this has not been the case. In fact, these data indicate that carbon emissions have declined significantly from a high in 2005. Both 2006 and 2007 emissions appear to be significantly below the originally projected carbon trends and are thus below the regional RGGI cap level. ENE has been carefully tracking emissions trends and has compiled available data from US EPA through the third quarter of 2007, which appears on the following pages. As you will see in the figures below, EPA data include a majority of the emission sources (some natural gas plants do not report to EPA) and are a good indicator of emissions trends. Based on these data, ENE estimates that the emissions levels in 2006 and 2007 could be as much as 17% and 11% below the RGGI cap level. (We note that higher dispatch of natural gas plants may reduce this difference slightly once all data are available).

There are a number of factors that seem to be leading to this reduced level of emissions, including: mild weather, economic growth trends, reduced energy consumption, lower natural gas prices, and increased capacity factors at nuclear plants.

Lower emissions are undoubtedly a good thing. However, as with any commodity regulated by a cap and trade system, a positive price on carbon will only occur if there is some degree of scarcity in the marketplace. Without such scarcity, our region will not see changes in investment choices for power plant generation, or electrical equipment and systems that are a fundamental objective of the RGGI policy. These changes in investment will be necessary if we are to achieve long-term emissions reductions and transition to a sustainable low-carbon economy in New York and the region.

If actual emissions in the early years of RGGI turn out to be significantly below the cap level, as the data suggests, new clean tech companies may not receive new financial support and we may well see energy companies continue to invest in or at least dispatch old dirty power plant technologies fueled by coal and oil. Allowances will also be banked in early years, eliminating the environmental benefits of the RGGI program.

The potential impacts of having a starting cap that is above actual emissions in the early years of RGGI include:

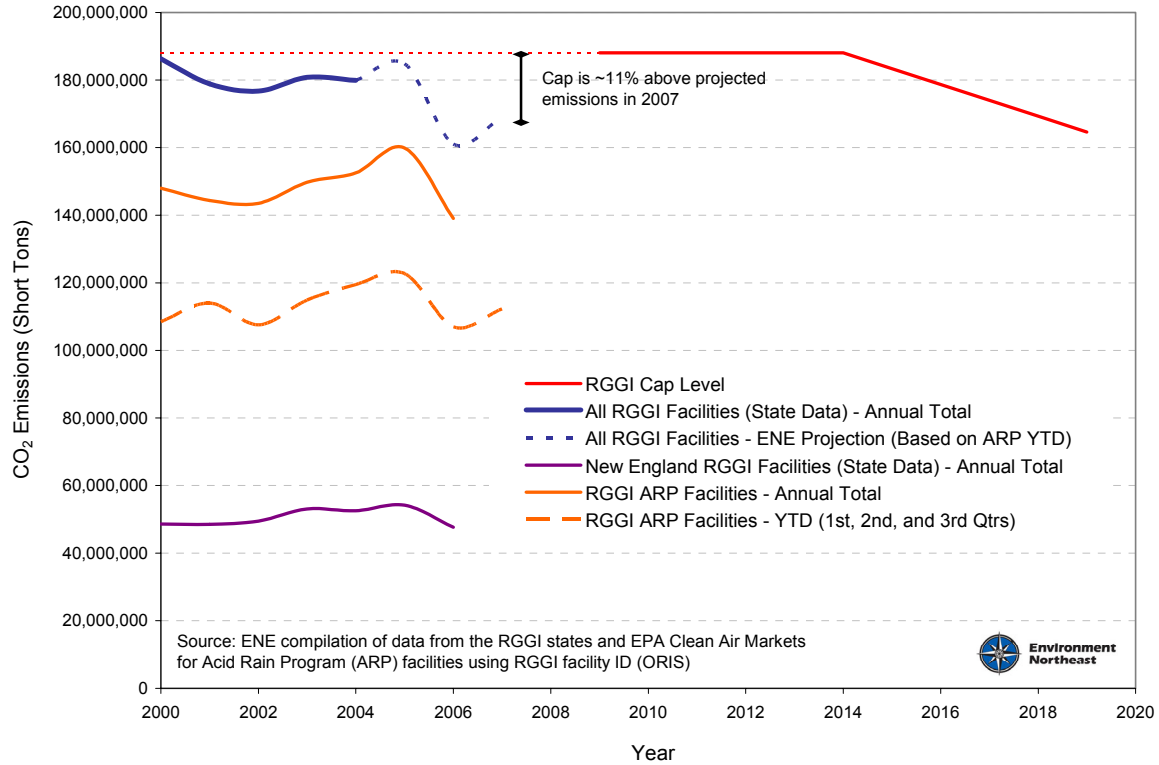
- no market for RGGI allowances,
- no change in our power plant dispatch,
- delay of any shift in the way we make power away from dirtier, inefficient sources to cleaner, more efficient sources
- failure to position our regional economy to take advantage of expected carbon regulations from the federal government
- loss of money for new efficiency and other investments

We recognize that the negotiation of the RGGI cap level and program design was arduous and that most of the states are currently in the process of issuing or finalizing their regulations. However, we would recommend that the states commit to two RGGI policy decisions now to ensure that RGGI is a success:

- (1) establish an auction reserve price mechanism with allowances permanently retired or withheld in a contingency account, and**
- (2) make a collective commitment to review the status of the RGGI cap level beginning at the start of 2010 with necessary adjustments made at the beginning of the second compliance period to ensure reduced emissions across the region.**

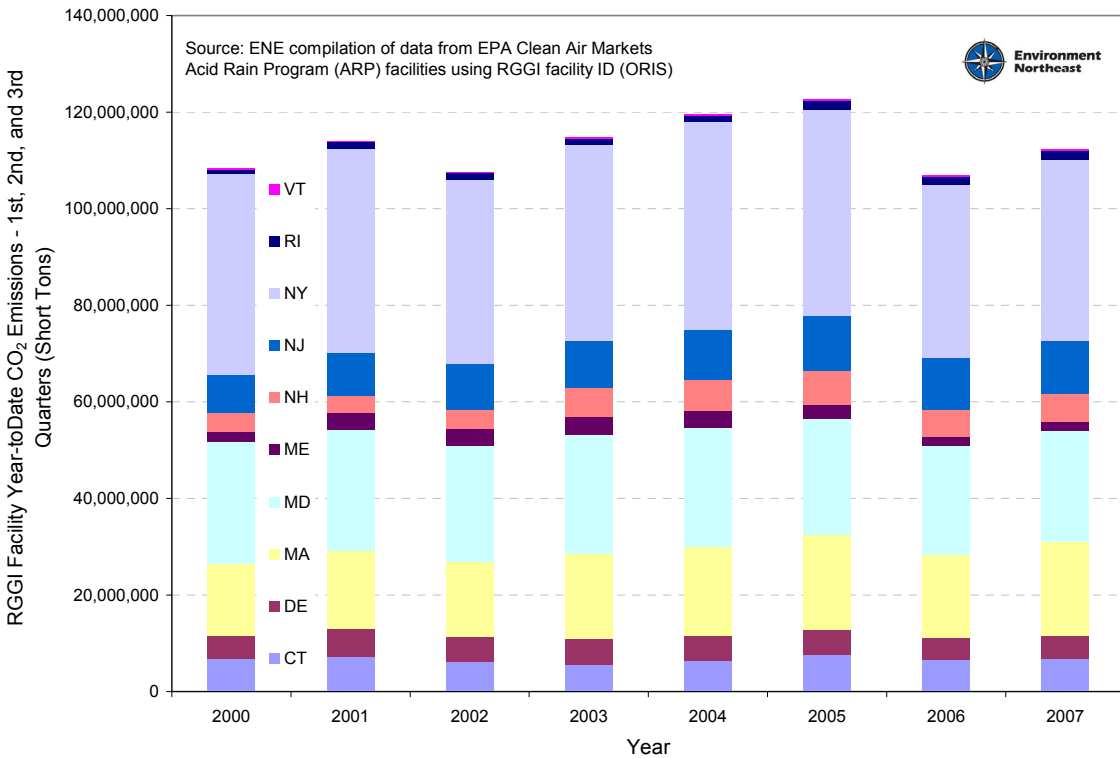
The following figures illustrate the emissions trends from RGGI facilities based on state data where it has been compiled and from EPA acid rain program (ARP) data. ENE welcomes a discussion of any questions that this analysis may raise.

**Figure 1: Comparison of the RGGI Cap Level to Recent RGGI Facility CO2 Emissions**



**Figure 2: Year-to-Date RGGI Facility CO<sub>2</sub> Emissions (Acid Rain Program Facilities Only)**

Total for 1<sup>st</sup>, 2<sup>nd</sup>, and 3<sup>rd</sup> Quarters of Each Year



ENE believes it is advisable for the states to signal that an adjustment to the cap may be necessary down the road and also to use the auction design to establish a mechanism that will ensure RGGI delivers at least a modest price on carbon.

### ***Auction Reserve Price with Retirement or Contingency Account***

A reserve price is a very common element of auction design and we support inclusion of this mechanism in the RGGI auction rules. The reserve price accomplishes three essential goals: 1) it ensures that the states do not give away a commodity below its value to society (the program goal is to deliver a reduction in emissions which requires the allowances to have a price), 2) it guards against collusive behavior, and 3) it gives developers and financiers of new technologies a higher level of certainty as to the value of carbon, reducing their development risks.

The reserve price should be set at a level that reflects the low-end of society's willingness to pay for carbon emissions reductions and what it will take to induce a gradual shift to cleaner and more efficient technologies in the marketplace. Current information indicates that the low-end price of carbon should be at least \$3/ton CO<sub>2</sub> and, as the market develops, the reserve price should transition to being about 80% of the current spot market price or the \$3/ton limit, whichever is higher.

Allowances not sold through the reserve price mechanism should be removed from the market and permanently retired or held in a contingency account to be released only if the price in the previous quarterly auction exceeds \$20/ton CO<sub>2</sub>. All price based mechanisms should be indexed to inflation plus have an additional percentage increase to reflect our willingness to pay more for carbon mitigation over time.

The states should agree regionally to these and other auction design elements through an amendment to the regional MOU.

### ***2010 Review of the Regional Cap Level***

There is clearly uncertainty about what will happen with emissions between now and the start of the RGGI program. However, the states would be well served to indicate that if the cap level has, through nobody's fault, been set too high it will need to be adjusted down. Signaling the states' intentions in advance will be very important to the market, which will be trying to place a long-term price on the value of allowances.

With the program start date approaching and given the time consuming process required for making changes to state regulations, we believe the best course at this time is to commit to reviewing the cap level in 2010 and making necessary adjustments at that time. The states should be clear and public about their intentions, and the best way to do this would be to amend the MOU and indicate when the review will happen and what adjustment would likely to be made. We would encourage language such as the following:

***Beginning in January 2010 the states shall jointly review current emissions in relation to the regional RGGI cap level. If necessary, the cap level in the second compliance period (starting in 2012) and subsequent compliance periods will be adjusted down to ensure that RGGI delivers a 10% reduction in emissions from the current regional average by 2020.***

This commitment is important to ensure that RGGI will deliver an environmental benefit, and it will also provide increased clarity to the market in terms of the changes in emissions that will be required by the program.

The RGGI states have acted together to ensure a successful program that requires the cap level to constrain emissions over time. That coordinated action will be needed should the cap levels be greater than actual emissions. Only then will a good precedent be set and investments made in the RGGI states that position the region's companies and economy at a competitive advantage. Under a future federal carbon cap and trade program, those regions of the country that use energy efficiently and have a lower emissions profile will bear a lower financial burden while at the same time building up their clean tech sector for future growth.

## **2. Subpart 242-5.3 (a) Energy Efficiency and Clean Energy Technology Account**

ENE is supportive of NYSERDA establishing and administering the energy efficiency and clean energy technology account. We are supportive of DEC's decision to "best achieve the emissions reduction goals of the CO2 Budget Trading Program by promoting or rewarding investments in energy efficiency, renewable or non-carbon-emitting technologies, and/or innovative carbon emissions abatement technologies with significant carbon reduction strategies."

For more discussion on the use of auction revenues, see our comments regarding NYSERDA's Part 507.4 below.

## **3. Subpart 242-5.3(b) Early Reduction CO2 Allowances**

ENE does not believe that DEC should adopt the early Reduction Allowance provisions of the model rule since this will allocate allowances directly to the generators for free. This is problematic since the early reduction allowances are in addition to the cap. Since there may be an over allocation of carbon credits, this provision will inflate the cap even more. Auctioning of allowances also increases the incentive companies have to make plant improvements early.

## **4. Subpart 242-5.3(C) Voluntary Renewable Energy Market Set-Aside Allocation**

Environment Northeast supports the inclusion of the set-aside for voluntary renewable purchases in the state rulemaking process which are similar to the optional provision of the RGGI Model Rule (RGGI section XX-5.3(D)). ENE believes that retiring these credits to support the voluntary renewable market will ensure that the marketers can continue to claim a reduction in carbon emissions. However, we do not believe that there should be a cap set on the number of allowances that are permanently retired to support the purchase of qualified renewable energy. Unless voluntary renewable energy purchases and the emissions reductions they provide are accounted for, generators burning fossil fuels can just produce more electricity - even for sale outside the state/region negating the benefits of those voluntary purchases. Having a cap might hinder the expansion of the voluntary energy market and a large voluntary market will only help the region achieve its emissions reductions faster.

## **5. Subpart 242-5.3 (D): Long-Term Contract Set-Aside Allocation**

ENE does not support the long-term contract set-aside allocation provision and believes it goes against previous statements from the DEC in response to the IPPNY Concerns of NY going to 100% auction which concluded:

Long-term contracts do not warrant special regulatory treatment. Certain generators have suggested that long-term contracts prevent them from passing on the cost of the allowances to the purchaser of the power under the contract.<sup>1</sup> After discussions with experts in the industry involved in the negotiation of such long-term contracts, the

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<sup>1</sup> Despite repeated requests, however, no generator has come forward with a long-term contract to give the Department an opportunity to determine whether the contracts in fact contains no provision that would allow the generator to pass on the cost of emissions allowances under new programs.

Department has learned that it is not uncommon for a supplier to negotiate for a “re-opener” or “change-in-law” provision in such contracts that would enable the supplier to renegotiate the price or pass on unforeseen costs incurred because of a change in law like RGGI. In cases where no such re-opener is included in the contract, it is likely that the supplier of the electricity under the contract has assumed the risk of any change in law that occurs during the term of the contract. Indeed, placement of risk between two parties is a central theme in any long-term power contract negotiation and change-in-law is a central risk in an industry like electric generation where the regulatory environment has always been a changing factor.<sup>2</sup>

Environment Northeast believes that 100% of allowances should be auctioned and used to reduce consumer costs (once the allocation for voluntary renewable credits has been set aside as is in the Voluntary Renewable Energy Market Set-Aside Allocation).

To reiterate our previous comments which we submitted in March 2007 on the draft pre-proposal, the rational and fair decision is to auction 100% of the allowances and use the allowance value to reduce the cost of the program on the region’s ratepayers.

Some large industrial consumers and regional electric utilities are calling for 100% auction of RGGI allowances.

- A letter and white paper from National Grid supports 100% auction or allocation to consumers with the money used for rebates or expanded energy efficiency investments.<sup>3</sup>
- The Connecticut Industrial Energy Consumers state, *“Energy prices in Connecticut currently are significantly higher than the national average. And, consumers have experienced dramatic increases in the past several years. Consistent with Connecticut’s goal of reducing the price of electricity, the State should mitigate the impact of RGGI on the price of electricity by auctioning all of the RGGI air emissions allowances, to the maximum extent possible, and utilizing all of the auction proceeds as a credit on retail electricity consumers’ bills on a kilowatt-hour basis.”*<sup>4</sup>
- Large industrial groups like New York’s Multiple Intervenors are saying, *“All RGGI Emissions Allowances Should Be Auctioned and The Proceeds Should Be Applied As A Per-kWh Credit To Retail Electric Distribution Rates.”*<sup>5</sup>

No persuasive reason has been presented for why allowances should be allocated to electric generators for free. On the other hand, economic and fairness issues clearly support a complete or large and growing auction of allowances, with generators having to purchase them and the proceeds used to reduce the cost of the emissions programs on electric ratepayers.

The arguments for an auction and against free allocation of allowances are strong:

- Air quality and the world’s climate are a public good that polluters do not have a right to spoil – the purchase of allowances is consistent with the ‘polluter pays’ principle with payment for pollution rights being a cost of production.
- Previous cap and trade programs, created prior to electricity restructuring, did not face the same issues, as cost of service regulations allowed excess profits to be returned to ratepayers; the electric markets are very different today than when the SO<sub>2</sub> and NO<sub>x</sub> programs were first created.

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<sup>2</sup> New York Department on Environmental Conservation response to concerns from IPPNY 11-26-06.

<sup>3</sup> National Grid comments submitted to the RGGI process: [http://www.rggi.org/docs/national\\_grid\\_whitepaper.pdf](http://www.rggi.org/docs/national_grid_whitepaper.pdf)

<sup>4</sup> Connecticut Industrial Energy Consumers comments submitted to the RGGI process: [http://www.rggi.org/docs/ciec\\_comments.pdf](http://www.rggi.org/docs/ciec_comments.pdf)

<sup>5</sup> Multiple Intervenors (New York) comments submitted to the RGGI process: <http://www.rggi.org/docs/mi.pdf>

- Most generators, and all economists we are aware of, agree that an allowance, whether allocated for free or purchased, has an opportunity cost as it can be used for compliance, banked, or sold to others.
- Allowances are assigned the market value (opportunity cost) by generators and that cost is built into their marginal costs or O&M costs that determine their bid prices in the marketplace.
- Because costs are built into bid prices, whether generators get an allowance free or have to pay for it, these costs are passed on to consumers – while making that expense to consumers larger than necessary.
- Because electric consumers will bear the very modest cost of the RGGI program, we see no reason for generators to profit at their expense.
- As a part of utility restructuring, part of the deal with moving to competitive markets was that generators took on regulatory risk in exchange for a significantly freer and less regulated market.
- This is consistent with the idea of competitive and free markets – let the markets work.
- In any case, New York consumers are already paying generators very significant and amounts of money in the form of capacity payments – states should not add free allowances to this already very significant stream of payments.

Economists, consultants, and government agencies that have looked the issue of allocation are increasingly in agreement that allowances should be auctioned to avoid windfall profits and avoid market distortions. This has been increasingly clear in the European Union where recent experience with its carbon dioxide cap and trade program has indicated that some companies are reaping very large windfalls because allowances were allocated to them for free (see references below).

In an April 25, 2007 Congressional Budget Office (CBO) Economic and Budget Issues Brief called *Trade-Offs in Allocating Allowances for CO<sub>2</sub>* the CBO stated that “...the cost of holding the allowances would generally be reflected in the prices that producers charged, regardless of whether those producers had to buy the allowances or were given them for free.” This means that producers would pass on the value of the allowances as a cost on to their consumers either way since they allowances have an opportunity cost. “That result was borne out in the cap-and-trade programs for sulfur dioxide in the United States and for CO<sub>2</sub> in Europe where consumer prices rose even though producers were given allowances for free.”<sup>6</sup>

While it may seem at first glance that generators will be forced to pay the full costs of compliance with RGGI; in reality the costs associated with purchasing allowances are passed on to electricity consumers. The good news is that since these costs will be distributed among millions of customers, the impact on individuals’ electric bills will be small while the benefits to public health and the environment will be large.

- The projected direct electricity cost impacts due to RGGI would be modest under the best estimate and range from 0.3% to 0.6% in 2015 resulting in a bill increase in the range of \$3-\$16 per average household annually in 2015.
- In addition, designing expanded energy efficiency programs into the RGGI framework or providing direct rebates to electricity consumers from the sale of emissions allowances would reduce consumer costs and lead to improved job and economic growth.

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<sup>6</sup> Trade-Offs in Allocating Allowances for CO<sub>2</sub> Emissions, April 25, 2007  
<http://www.cbo.gov/ftpdoc.cfm?index=8027&type=1>

- Studies have shown that investments in end-use energy efficiency programs, as a result of, or in conjunction with RGGI are projected to be so effective in reducing total electricity usage by households, that they will mitigate any cost increase associated with RGGI.

In addition, while RGGI may have a very small impact on the regional economy (as measured by Gross Regional Product, Real Personal Income, and Private Sector Jobs), RGGI modeling has shown that the impact is projected to be a **positive** one (primarily due to the benefits of investment in energy efficiency technologies) – ranging from a one hundredth to two-hundredth of one percent change (0.01% - 0.02% positive change in economic growth).

For additional background on the issue of allocation of emissions allowances, please refer to the following documents:

- Åhman, et al, 2006-forthcoming, *A Ten-Year Rule to Guide the Allocation of EU Emission Allowances*. Accepted for publication in the Journal of Energy Policy, April 2006.
- Boemare, C., and P. Quiron, 2001. *Implementing Greenhouse Gas Trading in Europe: Lessons from Economic Theory and International Experience*. Report for the Interact project, DG Research of the EU Commission, Centre International de Recherche sur l'Environnement et le Development. [www.centre-cired.fr](http://www.centre-cired.fr).
- Burtraw, et al, K. 2006. *CO2 Allowance Allocation in the Regional Greenhouse Gas Initiative and the Effect on Electricity Investors*, The Electricity Journal, 19 (2): 79-90 (March).
- Burtraw, D., 2001. *The Effect of Allowance Allocation on the Cost of Carbon Emission Trading*, Resources for the Future Discussion Paper 01-30 (August).
- Burtraw, D., and K. Palmer, 2003. *Economic Efficiency and Distributional Consequences of Different Approaches to NOx and SO2 Allowance Allocation*, Prepared for the U.S. Environmental Protection Agency. <http://www.epa.gov/air/clearskies/econ.html> (accessed June 8, 2005).
- Burtraw, et al, 2002. *The Effect on Asset Values of the Allocation of Carbon Dioxide Emission Allowances*, The Electricity Journal, June 2002, Vol. 15, No. 5, pp. 51-62.
- Burtraw, et al, 2001. *The Effect of Allowance Allocation on the Cost of Carbon Emission Trading*, Resources for the Future Discussion Paper 01-30 (August).
- The Carbon Trust, 2004, *The European Emissions Trading Scheme: Implications for Industrial Competitiveness*, CT/2004/04
- Carlson, et al, 2000. *SO2 Control by Electric Utilities: What are the Gains from Trade?* Journal of Political Economy, 108:6, 1292-1326.
- CEEP, 2005, *Evaluation of CO2 Emission Allocations as Part of the Regional Greenhouse Gas Initiative*, Center of Energy, Economic, and Environmental Policy, Rutgers University
- Congressional Budget Office, 2003, *Issues in the Design of a Cap-and-Trade Program for Carbon Emissions*, Economic and Budget Issue Brief, November 25, 2003
- Cramton, P., and S. Kerr, 2002. *Tradable carbon permit auctions: How and why to auction not grandfather*, Energy Policy, 30, 2002, pp. 333–345.
- Electrowatt-Ekono Oy, 2004, *Emissions Trading and European Electricity Markets: Conceptual Solution to Minimise the Impact of the EU Emissions Trading Scheme on Electricity Prices, for The Alliance of Power Intensive Industries*, 60K04817.01-Q060-001

- Hamal and Madian, 2005, *Allocation of Emission Allowances for the Regional Greenhouse Gas Initiative*, White Paper for National Grid
- IPA Energy Consulting, 2005, *Implications of the EU Emissions Trading Scheme for the UK Power Generation Sector*, to: Department of Trade and Industry (DTI)
- Standard & Poor's, 2006, *Gas And CO2 Prices Fuel Profits For Electric Utilities In Europe's Deregulated Markets*, Standard & Poor's Credit Ratings - Commentary & News, 6 April 2006
- Stavins, R., 1998. "What Can We Learn from the Grand Policy Experiment? Lessons from SO2 Allowance Trading," *Journal of Economic Perspectives*, 12:3 (summer), 69-88.
- Sijm, et al, 2006, *CO2 cost pass-through and windfall profits in the power sector*, *Climate Policy*, 6 (1): 49-72
- Sijm, et al, 2005, *CO2 price dynamics: the implications of EU emissions trading for the price of electricity*, Energy Research Center of the Netherlands, ECN-C--05-081
- Tietenberg, T., 2001. *The Tradable Permits Approach to Protecting the Commons: What have we Learned?* Nota di Lavoro 36.2002, Fondazione ENI Enrico Mattei (FEEM).
- UBS, 2005, *CO2 – The Windfall Has Arrived*, UBS Investment Research, ETS Update, 7 June 2005

## **6. Subpart 242-8.7 CO2 Budget Units that Co-Fire Eligible Biomass and Subpart 242-1.2 (34): Definition of Eligible Biomass**

### ***A. Eligible Biomass***

Eligible Biomass is defined in Subpart 242-1.2 (34) similarly to how it is defined in the regional Model Rule, which requires that eligible biomass be sustainably harvested and available on a renewable or recurring basis. We endorse this definition of biomass, as it allows certain generation plants co-firing biomass with fossil fuels to make CO2 deductions from their compliance obligation. Draft Rule, Subpart 242-6.5(b); Model Rule Subpart XX-6.5(b)(1) (providing that regulated units may deduct from their total CO2 allowance obligation "any CO2 emissions attributable to the burning of eligible biomass...").

It is true that units burning biomass emit significant quantities of CO2 from their smokestacks. Nonetheless, CO2 deductions for Eligible Biomass are allowed on the premise that the amount of carbon emitted from the combustion of a quantity of biomass is essentially the same as the amount of carbon that will be taken out of the atmosphere in the future and stored, during the process of photosynthesis, in biomass that regrows on land where the old biomass was harvested. This premise holds true only so long as:

- the land on which the biomass was harvested is not converted to a use that prevents regrowth of a new generation of biomass, and
- the harvest methods ensure future regrowth of an equivalent amount of biomass in a reasonable time period and avoid significant depletion of carbon in the forest soils.

Examples of practices that would prevent sufficient regrowth on a given area of forest land include conversion of the land to development (such as a parking lot, a housing complex, or a road) or employing harvest practices that significantly inhibit future productivity, such as repeated high-grading, excessive soil compaction, or whole-tree harvesting without replenishing soil nutrients. Soil carbon can

be depleted either through direct disturbance during harvesting, or indirectly in the long-term through excessive removal of harvest residues and other woody debris.

Consistent with the above reasoning, the Draft Rule provides that:

Eligible biomass includes sustainably harvested woody and herbaceous fuel sources that are available on a renewable or recurring basis (excluding old-growth timber), including dedicated energy crops and trees, agricultural food and feed crop residues, aquatic plants, unadulterated wood and wood residues, animal wastes, other clean organic wastes not mixed with other solid wastes, biogas, and other neat liquid biofuels derived from such fuel sources. Sustainably harvested will be determined by the department.

6 NYCRR Part 242, CO2 Budget Trading Program, Subpart 242-1.2(34), emphasis added.

This definition tracks the language of the RGGI Model Rule at Subpart XX-1.2(ag).

### ***Sustainable Harvesting***

For the sole purpose of implementing RGGI, “Eligible Biomass” could be handled in New York by adding further specificity to the definition of the terms “Sustainably Harvested” and to the reporting requirements for units co-firing eligible biomass in the Draft Rule or by providing some type of formal guidance in a companion document from the Department. ENE strongly recommends that the definition of eligible biomass should be left in to maintain consistency with the Model Rule. If the Department feels that a detailed definition is premature, Subpart 242-1.2(34) (“sustainably harvested will be determined by the department”) already allows for the development of a companion document at a later date.

ENE recommends including further specificity in the Draft Rule itself. Consistent with the criteria regarding land conversion and harvest methods noted above, and without comment on the standards that should apply to non-woody biomass, we recommend incorporating the following elements for a new definition of “sustainably harvested”:

Subpart 242-1.2(34)(b) (NEW) “Sustainably Harvested Woody Biomass” means woody biomass that the CO2 budget source demonstrates has come from forested land that is not being converted to a non-forest land use and is not otherwise harvested in a manner incompatible with the capacity of that forest to regrow at a rate that is not less than the rate of carbon accumulation prior to the harvest, as determined in accordance with Subpart 242-8.7 of this Rule.

The most practical approach to tracking sustainably harvested wood is to use documentation from existing programs. For this reason, we recommend using certification programs, and in the case of smaller landowners, current use tax programs, as proxies for sustainability. These programs require long term management plans and in some cases penalties for land conversion. We have not been able to identify specific New York state regulations that would facilitate tracking wood that comes from land clearing operations, as we have done in other states<sup>7</sup>. If these do exist, they should be incorporated into the following reporting requirements in order to strengthen them.

To adequately regulate implementation of this defined term, it is important to add further definition and guidance in the reporting requirements of Subpart 242-8.7:

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<sup>7</sup> For example: Under section 8883 (b) of the Maine Forest Practices Act, harvest notification requires information on whether forest land is being converted to another use within two years. Harvests in Massachusetts that are not part of land clearing require an approved long-term cutting plan as defined by the Massachusetts Forest Cutting Practices Act regulation 304 CMR 11.04. Land clearing of a certain size in Maryland is covered by their Forest Conservation Act (Natural Resources Article Section 5-1601 through 5-1613).

Subpart 242-8.7 (a)

(11) for each shipment of woody biomass received and claimed to be eligible biomass, the following information shall be tracked and entered into a database:

- (i) name of driver and shipping company
- (ii) quantity of woody biomass being claimed as eligible biomass in this shipment;
- (iii) location of the timberland or industrial source of all woody biomass being claimed as eligible biomass;
- (iv) name of the business or person that owns the timberland or industrial source of the shipment
- (v) method claimed for demonstrating that eligible biomass was sustainably harvested as provided in subpart 242-8.7(e).
- (vi) whether the harvest was part of a land clearing operation subject to local grading and clearing permits.

(12) the name and business address of all timberland owners or industrial sources from which shipments were received during the quarter, the total quantity of sustainably harvested woody biomass from each owner or source;

(13) evidence of certification, including certification number, or evidence of tax status and for any timberland that was the source of sustainably harvested woody biomass during the year

(NEW) Subpart 242-8.7(e). Woody biomass will be deemed sustainably harvested for the purposes of calculating compliance obligation deductions under Subpart 242-6.5(b) [Model Rule Section XX-6.5(b)] if the CO<sub>2</sub> budget unit claiming to have co-fired eligible biomass provides complete, timely reports for subparts 242-8.7 (a)(11) and (12) of this subsection and an annual report to the Department indicating the total eligible biomass fuel input (tons) from each timberland or industrial source, by location, with the proper documentation, referred to in subpart 242-8.7 (a)(13) sufficient to demonstrate the following:

(1) wood chips, trees, cord wood, tree limbs, woody debris, or tree tops delivered to the CO<sub>2</sub> budget unit came from timber harvest activities not related to land clearing (i.e. not requiring an application for a clearing or grading permit); and

(i) certified, prior to the harvest, in the Forest Stewardship Council (FSC), Sustainable Forestry Institute (SFI), American Tree Farm System (ATFS) group certification program; or

(ii) for harvests within the state of New York, if the landowner owns less than 500 acres, compliance may be alternately satisfied with enrollment in Section 480-a of the Real Property Tax Law prior to the harvest.

(b) wood residues are unadulterated and have been shipped to the CO2 budget unit from industrial operations, including lumber or paper mills, provided that

(i) if mills have chain-of-custody certification from FSC or SFI, residue that results from the production of 100% certified material (SFI Certified Sourcing Label, FSC Pure) will receive 100% deduction and residue that results from the production of mixed certified and non-certified product (SFI Percent Content Claim, FSC Mixed) will receive a percent deduction based on the percent certified material produced by the mill;

(ii) if the mill does not have chain-of-custody certification, a default percentage deduction will apply to each ton of biomass CO2 emissions to reflect the approximate percentage of forestlands under certification in the state of New York, which percentage shall be adjusted each year as determined by the New York Department of Environmental Conservation;

(iii) construction and demolition waste shall not be considered unadulterated wood and shall not be eligible biomass.

(See also Model Rule XX-8.7)

### ***Old Growth***

Under the Draft Rule, old growth is not considered an eligible biomass fuel. ENE concurs that harvesting late-successional forests for biomass should not be eligible for CO<sub>2</sub> deductions, since it could take many decades for the forest to recapture the lost carbon, and these types of forests are rare. However, the Department needs to provide more detail on what old growth means, since there is no commonly accepted definition for the region and no current way to track this.

## **7. Subpart 242-10: CO2 Emission Offset Projects**

ENE suggests that DEC consider separating their RGGI regulations and make the offset section a stand-alone regulation similar to CT's proposed regulations. In Connecticut's draft regulations, the Connecticut Department of Environmental Protection (CT DEP) separated their draft regulations into two components, one for general RGGI rules and one relating to offsets. This way if the category of eligible offsets is expanded, CT DEP will not have to reopen all of their RGGI regulations, only the section that pertains to offsets.

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## **NYSERDA PROPOSED REGULATION 21 NYCRR PART 507 CO2 ALLOWANCE AUCTION PROGRAM**

### **8. 507.3: Multi-state Auctions**

We encourage NY to participate in a regional auction. There are likely many reasons to do so, including reduced transaction costs, a higher level of consistency among states, transparency, market stability, and the ability of a market monitor to focus on one major trading platform or event.

#### **9. 507.4: The Energy Efficiency and Clean Energy Technology Account**

As stated above regarding DEC's Subpart 242-5.3(a) Energy Efficiency and Clean Energy Technology Account, we are supportive of NYSERDA administering the energy efficiency and clean energy technology account. As we have mentioned in previous comments, we believe that the value of RGGI allowances should only be spent on activities or programs that meet the following criteria:

- 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.


We believe the state should make an explicit policy statement, such as the one above, in the regulations that will guide all future investments of RGGI allowance value.

The criteria noted above would mean that programs and investments would be limited to the electric sector and those activities that most reduce consumer costs or maximize cost-effective investments would be targeted. In the near term, we believe the primary investment should be in additional electric sector energy efficiency programs. However, over time, other non-emitting electric sector technology investments could be considered such as renewables or carbon capture and sequestration.

Energy efficiency investments provide four major benefits to the state's electricity ratepayers:

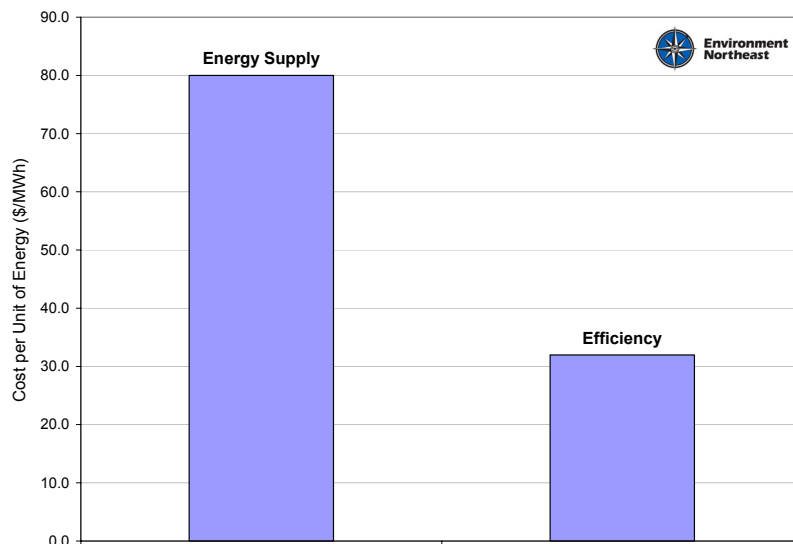
- Consumer's electric bills are reduced through reductions in their energy consumption;
- Investments in efficiency substitute for payments for fossil fuels and keep energy dollars in-state leading to economic and job growth;
- Through reduced energy demand, the RGGI cap is easier to achieve and the program as a whole is cheaper leading to lower wholesale electric prices for everyone; and
- Reduced demand avoids the need to build expensive new transmission and distribution infrastructure as well as new power plants.

Electric energy efficiency programs in RGGI states are active and strong which are run by the electric distribution companies. These programs save consumers three to four dollars for every dollar invested and studies of the achievable potential for energy efficiency indicate that there is a vast resource that is still untapped. Doubling or even tripling efficiency investments would be required to come close to achieving all that is cost-effective. The table and figure below illustrate the benefits of existing programs and the cost of efficiency investments that save a unit of energy versus electric supply purchases that deliver an additional unit of energy to the grid. For example, the current Massachusetts energy efficiency programs administered by the utilities deliver the following benefits (we understand that the programs administered by NYSERDA deliver similar results):

<b>Total &amp; Projected Massachusetts Electric Efficiency Program Costs &amp; Benefits</b>			
Based on 2005 Programs for All Companies			
<b>One Year Costs and Benefits (2005)</b>			
Utility Cost	\$124	Million	
Total Resource Costs	\$164	Million	
Total Resource Benefits	\$506	Million	
Net Total Resource Benefit	\$343	Million	
Electric System Only Benefits	\$410	Million	
Total Resource Benefit Cost Ratio	3.1	(Benefit/Cost)	
Electric System Benefit Cost Ratio	3.3	(Benefit/Cost)	
Peak (Summer) Demand Reduction	58.5	MW	
Annual Energy Savings	458,325	MWh	
Lifetime Energy Savings	5,123,738	MWh	
Total Resource Summer Demand Cost	2,800,376	\$/MW	
Total Resource Energy Cost	32.0	\$/Lifetime-MWh	
Approx. Avoided Energy Cost (ISO-NE 2005 Avg. LMP)	80.0	\$/MWh	
Equivalent Lifetime Emissions Avoided			
SO <sub>2</sub>	5,201	Tons	
NO <sub>x</sub>	1,383	Tons	
CO <sub>2</sub>	2,823,180	Tons	
<b>Projected Costs and Benefits over Ten Years</b>			
Utility Cost	\$1,242	Million	
Total Resource Costs	\$1,637	Million	
Total Resource Benefits	\$5,064	Million	
Net Total Resource Benefit	\$3,426	Million	
Electric System Only Benefits	\$4,096	Million	
Peak (Summer) Demand Reduction	585	MW	
Annual Energy Savings	4,583,250	MWh	
Lifetime Energy Savings	51,237,380	MWh	
Equivalent Lifetime Emissions Avoided			
SO <sub>2</sub>	52,006	Tons	
NO <sub>x</sub>	13,834	Tons	
CO <sub>2</sub>	28,231,796	Tons	
Sources:	All program costs and benefits are compiled from MA DOER spreadsheets based on <i>2005 Energy Efficiency Annual Reports</i> filed by each company with MA DOER and DTE		
	Emissions based on: ISO New England, May 2006, <i>2004 New England Marginal Emission Rate Analysis</i> , from annual average (all hours) and lifetime energy savings		

The figure below compares the cost to save consumers a unit of energy versus to cost to supply an additional unit of energy, we are not investing enough in the cheapest resource.

### Electric Generation vs. Energy Efficiency Costs

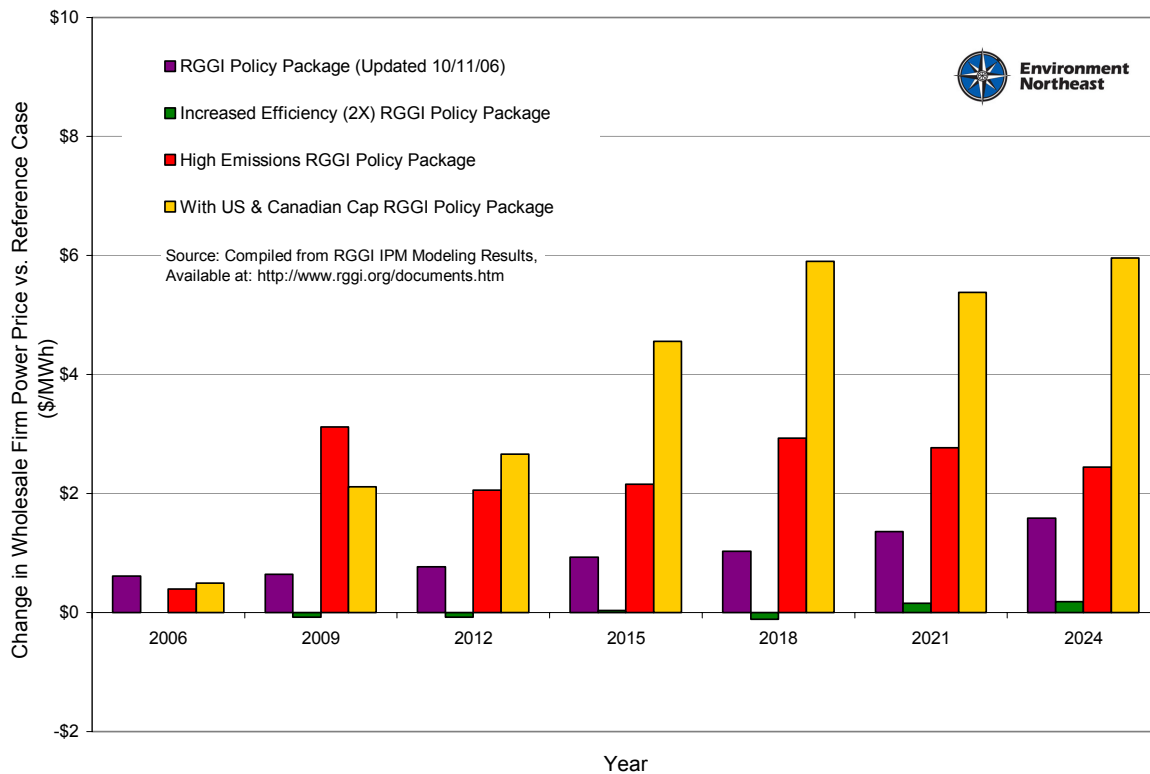


These efficiency programs put real dollars back in ratepayer’s pockets that they can then spend on other parts of the state’s economy. The state spends billions of dollars every year on fossil fuels from other parts of the country and the world. Avoided electric consumption translates into avoided payments for natural gas and oil (plants using these fuels are primarily on the margin), reducing the state’s trade imbalance. In contrast efficiency programs fund energy service companies with local employees to install new more efficient equipment that is more likely to have been manufactured in the state or region. Investments in energy efficiency boost the state’s economy and lead to job growth both in the energy service sector and in the economy as a whole due to transfers of payments from the electric sector to other parts of the economy.

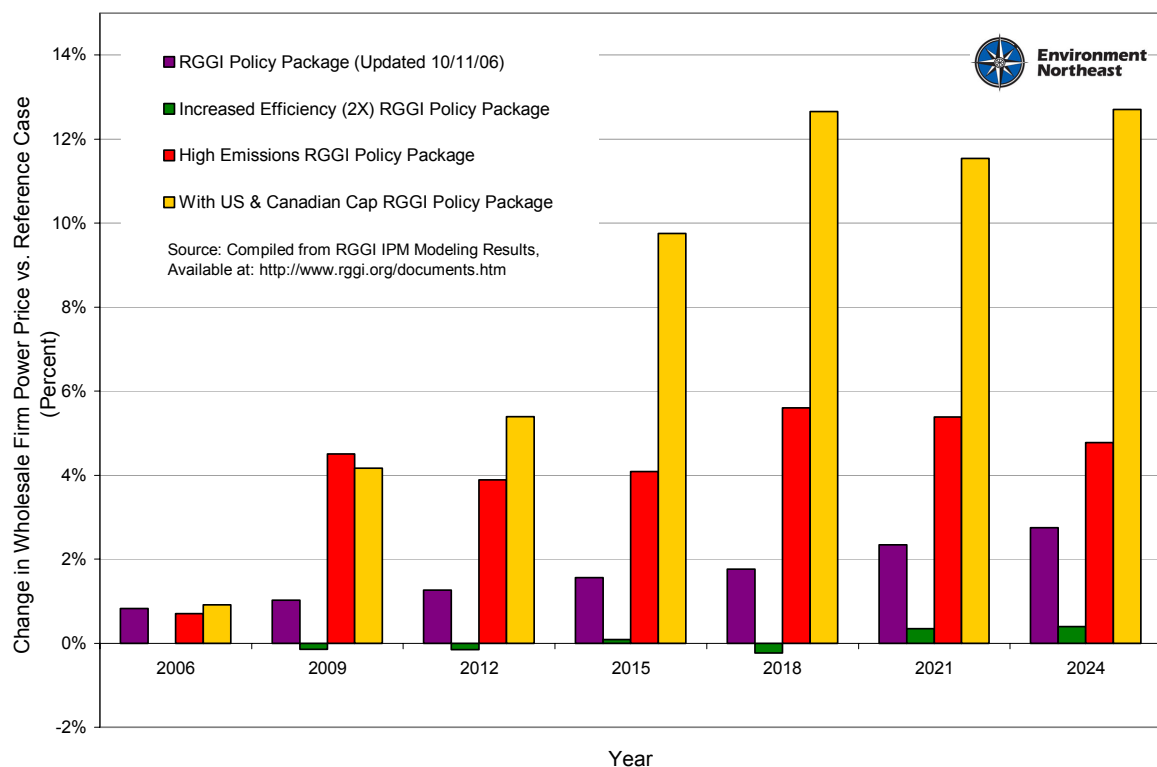
Energy efficiency programs have significant system-wide benefits. In particular, reduced demand depresses the wholesale electric energy price, and because peak is lower, the capacity price is also reduced. These benefits are significant today, but under RGGI, the system benefits are even larger.

If electric consumption is growing and the RGGI program requires a decline in emissions, the goals are harder to achieve and more expensive than if electric consumption is held steady or even declines through investments in efficiency. The RGGI modeling results bear this out. The following figure illustrates the change in wholesale electric prices between the equivalent RGGI reference case and the policy case.

**Forecasts of Changes in Wholesale Electric Power Price Increases Due to RGGI**



## Forecasts of Changes in Wholesale Electric Power Percent Increases Due to RGGI



As the figures above indicate, the wholesale electric price is actually reduced in some years if RGGI is implemented along with a doubling of efficiency investments. Efficiency investments along with RGGI will deliver these savings to all consumers in the RGGI region.

Note that wholesale power prices are over half of delivered retail prices with wholesale prices in the range of \$60 to 100 per MWh and transmission and distribution costing about \$30 to 50 per MWh.

### 10. 507.6 (c) Frequency

ENE supports quarterly auctions and that NYSERDA will make CO2 allowances available for future control periods. It is our understanding that a futures market would provide some price certainty and help reduce long-term risk.

### 11. 507.6 (e) Reserve Price

ENE is supportive of NYSERDA including a reserve price in the regulations. A reserve price is a very common element of auction design and we support inclusion of this mechanism in the auction, as discussed in the section above. The reserve price accomplishes three essential goals: 1) it ensures that the states do not give away a commodity below its value to society (the program goal is to deliver a reduction in emissions which requires the allowances to have a price), 2) it guards against collusive behavior, and 3) it gives developers of new technologies a higher level of certainty as to the value of carbon, reducing their development risks.

The reserve price should be set at a level that reflects the low-end of society's willingness to pay for carbon emissions reductions, which we believe should be at least \$3/ton CO<sub>2</sub> and as the market develops the reserve price should transition to being about 80% of the current spot market price or the \$3/ton limit, whichever is higher.

Allowances not sold through the reserve price mechanism should be removed from the market and permanently retired or withheld from the market in a contingency account and released only if the price in the previous quarterly auction exceeds \$20/ton CO<sub>2</sub>. All price based mechanisms should be indexed to inflation plus have an additional percentage increase to reflect our willingness to pay more for carbon mitigation over time.

## **12. 507.7 Auction Formats**

We are aware that NY's Auction regulations were released before the final auction report of Holt, Shobe, Burtraw, Palmer and Goeree *Auction Design for Selling CO<sub>2</sub> Emissions Allowances under the Regional Greenhouse Gas Initiative* was finalized and we hope that the state incorporates the recommendations of the auction report into the NYSEERDA regulations. Based on the auction design team's analysis, we support the general auction design they suggested: sealed-bid, uniform price auction.

## **13. 507.8: Participant Eligibility**

The allowance auction should always be open to all. Open markets will increase liquidity and allow for the development of strong secondary markets and other financial tools that allow for hedging and increased market stability. Since RGGI is a regional cap and trade program, the auction should always be open to CO<sub>2</sub> budget units who are regulated under the RGGI process. Therefore, at a minimum, category (2) "owners of CO<sub>2</sub> budget units located outside of New York but within those states that have final CO<sub>2</sub> Budget Trading (sic) rules in place at the time of auction and are RGGI Participating States" should be eligible to participate in all auctions along with category (1) "owners of CO<sub>2</sub> budget units located in New York"

ENE is also supportive of the auction design team's recommendation that there be rules related to possible limits on the % of allowances any entity could own and to the need for market monitoring. To ensure that the carbon market is not being manipulated, a market monitor should be established who reviews and analyzes the RGGI allowance market on a regular basis to ensure that no entity is exercising market power. This would be similar to the market monitoring done for other markets such as the ISO markets, although the analysis and level of effort would likely be less onerous or the market could be assessed by a regional contractor working for the Regional Organization who would report any irregularities to the appropriate state agency for review and action

We appreciate the opportunity to comment on the development of RGGI in New York. This program is a critical part of the state and region's plan to reduce greenhouse gas emissions.

Please let us know if you have any questions based on our comments. We look forward to working with the states to implement the RGGI rule in all the Northeastern states.

Sincerely,



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