

# Proposed federal plan and model trading rules -draft discussion comments-

*The comments provided below are draft only, and are intended to stimulate stakeholder discussion and input. The MPCA and Department of Commerce are open to all feedback and are particularly interested in hearing alternative views.*

## Trading programs as the federal plan and for model rules

Minnesota supports the use of a flexible trading-ready program for the federal plan. The success of the Clean Power Plan rests in part on its flexibility. States, and not EPA, remain the most appropriate regulators of environment and energy programs, and an inflexible federal plan could interfere with orderly energy planning from state to state, threatening reliability and resulting in significant ratepayer impacts. Trading and trading-ready programs can provide considerable flexibility, resulting in a more cost-effective achievement of required emissions performance standards. EPA must ensure that when finalizing the model rules and federal plan, it supports to the greatest extent possible a robust and liquid trading market.

Minnesota supports the proposed provision of two separate model trading rules (rate and mass based) to assist states seeking to develop trading and trading-ready state plans. The full benefits of trading programs will only be realized if robust programs with sufficient numbers of trading partners and “currency” are developed. The proposed model rules provide such a framework and with some modifications, can ensure least cost achievement of Clean Power Plan requirements.

### **EPA administered tracking system**

As proposed by the model rule, state trading-ready plans must use an EPA-administered tracking system. Minnesota supports this provision as an efficient method to support a broad trading program with less cost and administrative burdens on individual states.

### **Trading linkages between federal plan states and trading-ready state plan states (within the same program – rate or mass)**

Minnesota supports EPA’s proposed approach, allowing broad linkages between federal plan states and trading-ready state plan states. The success of a trading program is at least partially dependent on a sufficient number of trading partners, and allowing linkages between state and federal plan states better ensures a sufficient pool of these trading partners. Minnesota does not, however, support extending linkages under mass based programs to states issuing allowances in metric tons. A functional, efficient trading program depends upon like “currency,” and we recommend that currency be limited to short ton based allowances. Introducing allowances that may have different actual value in terms of authorized pounds of CO<sub>2</sub> emissions complicates and generally weakens the trading program.

### **Proposed unlimited banking of ERCs or allowances, but no “borrowing” (from future periods)**

Minnesota supports EPA’s proposed approach to ERC and allowance banking, wherein ERCs and allowances do not expire and can be banked and/or used for compliance in perpetuity. This approach has been successful in other federal trading programs, such as the Acid Rain Program, in that emissions reductions continued to occur as expected (and even beyond initial expectations), even as the number of allowances available increased due to the existence of banked allowances. Early emissions reductions that exceed performance required by the applicable standard or target, and therefore provide the availability of banked

allowances, tend to be followed by continued good emissions performance ensuring program success. While programs with expiring allowances or credits also work successfully, they do reduce program flexibility somewhat, and increase complexity of tracking and trading systems. Because the success of the Clean Power Plan rests in part on a liquid trading market, Minnesota recommends EPA finalize its model rules and federal plan with unlimited banking of non-expiring allowances and ERCs.

Minnesota also concurs with EPA's proposal to prohibit allowance or ERC "borrowing" from future compliance periods. Whereas the ability to bank allowances/ERCs depends on earlier performance exceeding expectations of the program targets, borrowing indicates failure to meet earlier target expectations. Early emissions reductions – at a minimum, those expected by EPA's earliest targets, are necessary to ensure progress in national efforts to address climate change. Allowance or ERC borrowing essentially allows a state or EGU to delay this critical progress, and is therefore inappropriate. Furthermore, the model rule provides for multi-year compliance periods with allowances distributed for the entire compliance period at one time, rather than year by year, which make allowance/ERC borrowing unnecessary.

### **Subcategorized rate-based trading approach**

Minnesota supports the use of the subcategorized emissions performance rates in a trading and trading-ready system. The uniform performance standards ensure equal value of credits across states that would have disparate blended state-specific target rates, better facilitating movement of credits (ERCs in the market, within and across state borders).

### *Emission rate credit (ERC) generation- disparate treatment between federal plan and model rules*

While Minnesota expects to take advantage of broader ERC-generation eligibility if it crafts a plan for a rate-based trading system, we do not generally oppose limiting eligible ERC generating resources in the federal plan. It is important to maintain compliance flexibility for states submitting their own plans. While providing some compliance flexibility to sources affected by a federal plan is important, it is not necessary to provide the full flexibility available to states seeking to design their own Clean Power Plan compliance systems. Broadening the eligibility for ERC generation for states whose plans are administered by EPA would create additional administrative burden/expense and further involve EPA in project by project energy planning decisions typically made at the state (or even local) level. We defer to EPA's judgment regarding its ability to manage a broader/more flexible program, but note that EPA does intend to manage EM&V and tracking for energy efficiency for federal plan states under the Clean Energy Incentive Program and wonder whether EPA might be able to accommodate energy efficiency as an ERC-eligible resource throughout the federal plan compliance period.

### *ERC generation – restricting ERC issuance for emissions reductions in mass-based states*

As proposed in the model rule, EPA intends to restrict ERC issuance for any emission reduction measures located in a mass-based state, except for RE, and only that RE shown to meet load in the rate-based state seeking to issue ERCs (demonstrated with power delivery contracts or power purchase agreements). Minnesota believes these limitations to be reasonable to prevent double counting of resources and ensure program integrity.

### **Mass-based allocations**

Minnesota believes EPA's proposed general federal plan allocation methodology – based upon shares of historic generation – is appropriate, for the reasons identified by EPA in its proposal: it allows for

distribution of allowances prior to the start of the program, it is transparent and reliable, and has been used for other federal trading programs.

Minnesota strongly supports the proposed approach allowing federal-plan states (as well as model rule/trading-ready states) to assume control of allocations with a limited state-plan submittal. Modifying allowance allocation does not affect program stringency, but can provide an important means to address unique, state-specific energy planning requirements EPA's proposed allocation strategy may not be able to support.

#### *Allocations to units that retire*

As proposed, EPA intends to shift allowances for units who do not operate for two full calendar years to the renewable energy set aside, but it is unclear whether this proposal is specific only to federal plan states, or whether this component is part of the "presumptively approvable" elements from the model rules for states developing plans. Minnesota suggests that this component not be included as part of a presumptively approvable plan pathway for states developing their own plans.

If, however, EPA does finalize the model rule with this component included as a presumptively approvable element for state plans, Minnesota recommends that EPA modify its proposed approach regarding allocations to units that "retire." Xcel Energy's Sherburne County Generating Station (Sherco) Unit 3 in Minnesota was offline for a full two years for repair from 2012-2013 (indeed, this outage resulted in a need for EPA to modify Minnesota's baseline for the Clean Power Plan), and under EPA's proposed approach, would have lost its "share" of allowances, though it came back online and continued operating. At a minimum, EPA's treatment of non-operating units should consider circumstances wherein a plant might be temporarily idled for necessary repair work that can take significant amounts of time to complete. Further, EPA's approach should recognize the significant compliance resource retiring units can make available to an affected utility, and ensure that the affected utility receives the benefit of this resource for more than one compliance period, lest they disincentivize possible retirement strategies by such utilities. As proposed, Minnesota fears that EPA's treatment could result in utilities keeping older, less-efficient units operating longer than necessary if only to ensure continued availability of allowances. We recommend EPA consider additional flexibility for retiring/non-operating units.

#### *Addressing leakage*

Minnesota is unsure whether EPA's new source leakage concerns are addressed by the proposed model rules set-asides, in particular, whether the one-sized fits all approach identified in EPA's set asides aligns with current and planned energy profiles in different states to actually align incentives for existing NGCC units under mass based programs to those under rate based programs.

In the case of the proposed output based set aside, only generation from existing NGCCs operating higher than 50% capacity is eligible – this is intended to incentivize generation that would not have occurred absent this set-aside; however, in many states, NGCC capacity is far lower, and business-as-usual capacity factors absent the set-aside could be far lower than 50%. Minnesota recommends EPA consider whether the output-based updating set aside should rely upon individual states' typical NGCC capacity factor (or even each unit's typical capacity factor) in terms of defining the point at which NGCC units can earn allowances from the output-based updating set aside

In the case of the renewable energy set-aside, Minnesota recommends EPA allow energy efficiency, and broader categories of renewable energy as identified by states in state plans (if desired) be eligible under the renewable energy set aside. States are in a better position to assess energy planning needs than is the

EPA, and to the extent that energy efficiency programs can, similar to renewable energy developments, reduce emissions leakage to new sources, states should be allowed to leverage such resources as presumptively approvable “leakage strategies.”

EPA must identify more presumptively approvable “leakage” strategies for model rule states, and provide description of any required technical demonstrations needed to support the use of different strategies (other than those included in the final model rule). Minnesota recommends EPA identify presumptively approvable elements of a state demonstration that new source leakage is unlikely to occur in a specific state based on energy planning processes, statutory requirements, technical demonstrations, etc... In particular, EPA should address whether a robust Integrated Resource Planning process where a state utility commission must consider lowest cost resources – which would not tend to favor new NGCC resources – could be considered sufficient to address leakage. Such a demonstration would be intended to avoid the use of EPA-prescribed allowance set asides. The final model rule should provide states with a menu of presumptively approvable allowance set aside options and/or other leakage strategies from which to choose that may better suit each state’s particular energy profile.

EPA might also identify in the model rule a prescribed end to the “leakage period” where model rule leakage strategies (set-asides) may be allowed to expire. It is inappropriate to continue incentivizing existing unit generation in perpetuity – this effectively subsidizes the continued operation of plants that may be obsolete.

## Clean Energy Incentive Program (CEIP)

### **EPA reserves of matching allowances**

EPA proposes to create an account of “matching” allowances for each state participating in the CEIP that reflects each state’s pro rata share of a federal pool of additional allowances. It then proposes to reserve some portion of each state-specific matching allowance pool for energy efficiency programs in low-income communities and some for eligible wind and solar projects, and proposes that unused allowances in either *reserve* be redistributed among participating states. Minnesota recommends that EPA allow state plan states to re-direct unused matching allowances from one reserve to another before releasing those allowances for redistribution to other states. It is unlikely that energy programs in different states would align precisely with the planning considerations EPA will use to develop its reserves for renewable energy and energy efficiency in low-income communities. States who worked to incentivize early CO<sub>2</sub> reductions would risk losing a significant portion of their incentive simply because EPA’s assumptions may or may not reflect precisely the energy planning occurring in that state. While it is understandable that EPA’s approach seeks to achieve a reasonable balance between the CEIP-eligible activities, and especially seeks to ensure that low-income communities are able to realize benefits from energy planning decisions that have historically been unavailable to them, Minnesota worries that a strict formula for each reserve size is inappropriate for a state-by-state process. If EPA is unwilling to provide states with full flexibility on the treatment of unused allowances in each reserve, it should provide some type of process whereby states could demonstrate the appropriateness of re-directing some portion of unused allowances into the other reserve.

### **CEIP Eligibility Dates**

Minnesota understands that certain elements of the CEIP are prescribed in the final Clean Power Plan rule language published on October 23, 2015 (80 FR 64661) and are not currently open for comment. Nevertheless, Minnesota is concerned that the eligibility dates for CEIP projects identified in the final rule

will serve to delay the early action the CEIP seeks to incentivize. The EPA determines eligibility in part based upon whether a project is able to “commence construction in the case of RE, or commence operation in the case of demand-side EE, following the submission of a final state plan to the EPA, or after September 6, 2018 for a state that chooses not to submit a final state plan by that date...” Minnesota recommends that EPA modify its rule language to expand the eligibility trigger date to *initial* plan submittal (i.e., the September 2016 submittals wherein most states are expected to seek a plan submittal extension). This approach would expand the incentive for early renewable energy and energy efficiency projects, which will provide earlier CO2 emissions reductions. Further, the current deadlines provide minimal time for eligible RE projects to complete construction in order to generate allowances/ERCs and associated matches in the 2020-2021 time frame. The rule language, as finalized, could create an incentive to pause clean energy projects for the immediate future to ensure CEIP eligibility, and then asks that potentially eligible projects be completed rapidly in order to actually generate credits. Pushing the eligibility date earlier resolves both concerns.

## Administrative elements

### Conditional approval of state plans

The EPA is proposing to amend the framework regulations and amend the process for acting on Clean Air Act Section 111(d) state plans under 40 CFR part 60, subpart B, changes that would be applicable to any future section 111(d) rules going forward – not simply the Clean Power Plan emissions guidelines. Minnesota supports these changes (partial approvals/disapprovals, conditional approvals, calls for plan revisions, error corrections, completeness criteria and updates to deadlines for EPA action) and recommends that EPA align the process with the Section 110(k) State Implementation Plan process as closely as possible.

Minnesota specifically recommends that EPA clarify the conditional approval process to ensure that it may approve a state plan based on a “commitment of the State to adopt specific enforceable measures by a date certain, but not later than 1 year after the date of approval of the plan...” and identify the one-year time period between plan approval and submittal of enforceable measures explicitly. Currently, the Clean Energy Incentive Program eligibility date for renewable energy projects/energy efficiency programs is based upon the submittal date of the state plan. In order to ensure that CEIP set asides and matching allowances are fully subscribed, states will likely seek to submit plans as early as possible. Unfortunately, for many states, the rulemaking process needed to incorporate enforceable regulations required by the Clean Power Plan is considerably longer and administratively onerous than is the process to develop a state plan and could result in delays to early plan submittal. Allowing states the opportunity to submit a plan prior to completion of the rulemaking process can not only ensure states have full access to the benefits of the CEIP program, but it can allow for more orderly energy planning in that states can share compliance plans prior to formal completion of administrative rulemaking procedures. This opportunity for earlier plan submittal will allow states submitting later plans to review and consider earlier plans, and will provide Independent System Operators/Regional Transmission Organizations with information necessary to support reliability planning earlier than would a process that requires completion of all rulemaking activities prior to plan submittal.

By specifying that EPA may conditionally approve a state plan, as long as the state plan committed to adopt specific enforceable measures no later than one year after the date of plan approval, EPA could support the flexibility necessary to support sensible energy planning and broaden states’ opportunities for CEIP-eligible programs.