

MIDCONTINENT POWER SECTOR COLLABORATIVE'S COMMENTS TO THE U.S. EPA ON THE DRAFT FEDERAL PLAN AND MODEL RULES

January 21, 2016

The Midcontinent Power Sector Collaborative (formerly Midwestern Power Sector Collaborative) is a diverse stakeholder group formed in 2012 to engage EPA and states on the regulation of carbon dioxide emissions from power plants in the Midcontinent region. Participants include state officials, investor-owned utilities, generation and transmission cooperatives, merchant generators, public power producers and environmental organizations from the Midcontinent region or with a significant presence in the region.¹ The Collaborative is facilitated and staffed by the Great Plains Institute.

On August 3, 2015, EPA finalized its Clean Power Plan (CPP) emission guidelines to states under Section 111(d) of the federal Clean Air Act. The CPP requires states to develop and submit for approval state plans that implement the CPP emission guidelines. In states that for whatever reason do not submit an approvable state plan to EPA by the regulatory deadline, EPA will impose a federal plan to implement the emission guidelines.

Simultaneously with the issuance of the final Clean Power Plan emission guidelines, EPA proposed a draft federal plan that consists of two model trading rules—one mass-based and one rate-based. The model trading rules can also be used by states in their state plans. EPA noticed the proposed federal plan and model trading rules in the Federal Register on October 23, 2015 and is providing a 90-day comment period, which ends January 21, 2016.

What follows are the Collaborative's comments on the proposed federal plan and model trading rules.

1. State versus Federal Implementation

All other things being equal, Collaborative participants prefer that states develop their own state plans rather than having EPA implement federal plans. In those instances when EPA has to implement a federal plan, Collaborative participants encourage the agency to engage and involve the states in design choices.

¹ Participants in the Collaborative are listed at the end of this comment document.

2. The Proposed Federal Plan

2.1. General Approach to the Federal Plan

- 2.1.1. Trading Ready. In states for which EPA implements a federal plan, Collaborative participants strongly support the implementation of a trading-ready federal plan.
- 2.1.2. Decision on Rate versus Mass. In the proposal, EPA indicates that it will make a decision on whether to implement a mass- or rate-based trading program when it first is called on to implement a federal plan in a state and that the same type of plan will be implemented everywhere a federal plan is implemented.
- (a) If EPA determines that only one trading-ready approach, rate or mass, will be implemented in all states that get a federal plan, then EPA should indicate when it finalizes the model rules in summer of 2016 whether it intends to implement a rate- or mass-based federal plan.
- (b) If EPA keeps open the option to implement both types of trading ready plans, it should specify the criteria by which it will make the decision of rate or mass for a given state.
- 2.1.3. Timing. EPA should finalize a federal plan as soon as practicable within the one-year timeframe proposed in the preamble to the proposed federal plan.

2.2. Mass-Based Trading as a Federal Plan

- 2.2.1. Preference for Allowance Distribution by States. Collaborative participants support reserving decisions about allowance distribution to states whenever possible. Even in cases where EPA imposes a federal plan in a state, EPA should readily allow states to substitute state allowance distribution for the federal approach, provided that the state adequately addresses leakage as is ultimately required. In the absence of a given state proposing allowance allocations, EPA should tailor its allocation approach to the individual state.
- 2.2.2. Treatment of Retired Units. In the allocation methodology adopted by EPA as part of a finalized federal plan, effort should be made to avoid creating a disincentive to retire existing coal units that would have otherwise retired.
- 2.2.3. Federal Plan Should be Trading Ready. Collaborative participants support making any federal plan trading ready so the owners and operators of affected units can trade allowances with entities in other trading ready states.

2.3. Rate-based Trading as a Federal Plan

- 2.3.1. Emission Rate Credit (ERC) Eligibility. In the rate-based model rule, EPA indicates that it will allow certain types of incremental renewable generation and incremental nuclear generation to earn ERCs. If EPA implements a federal rate-based plan in a state, it should allow a broader range of resources to qualify for the generation of ERCs, including, but not limited to, end-use energy efficiency and utility-sponsored combined heat and power (CHP) projects. In the preamble to the federal plan proposal, EPA seeks comment on how to include energy efficiency projects among the “eligible resources” given the one-year timeframe for issuing a federal plan and the differences in energy efficiency programs across states. Collaborative participants suggest that EPA could include, at a minimum, those energy efficiency resources for which EM&V protocols are developed under the CEIP. In addition, EPA could identify energy efficiency project types that tend to be similar from state to state and include those project types as eligible resources in the federal plan. Over time, EPA should then work to add additional project types in the state. EPA should not include language in any finalized federal plan that would permanently preclude the use of these types of resources in the future.
- 2.3.2. Changes to Process for Issuing ERCs. EPA should look for ways to simplify the ERC-issuance process, while maintaining rigor and transparency, to help ensure that ERCs will be available when they are needed.
- 2.3.3. Federal Plan Should be Trading Ready. Collaborative participants support making any federal plan trading ready so the owners and operators of affected units can trade ERCs with entities in other states. Participants believe that trading ready means that an affected unit under a federal plan could use ERCs from a state with an approved trading-ready rate-based state plan in categories beyond those allowed in the proposed federal plan.

3. The Model Trading Rules for Use by States

3.1. General Comments on the Model Trading Rules

- 3.1.1. Trading Ready. Collaborative participants strongly support EPA providing states with model rules that are trading ready to help enable trading across as broad a group of states as possible.
- 3.1.2. Timing. To facilitate state planning using the model trading rules, EPA should release the final, complete trading ready model rules as soon as possible after the close of the comment period. EPA should further consider issuing guidance on specific trading-related components as soon as possible.

3.1.3. Issue Separate Model Trading Rule. EPA should issue a model rule separate and apart from a federal plan so that it is clear what is presumptively approvable.

3.2. Mass-Based Trading Model Rule

3.2.1. New Sources and Options to Address Leakage. In the final rule, EPA offers states at least four discrete pathways to “neutralize the incentive” that may be created to shift from existing generation to new generation when implementing a mass-based approach: cover new units and accept a new source complement to the state’s mass-based budget; adopt EPA’s “presumptively approvable” approach to addressing leakage finalized in the model rule; adopt an alternative approach to addressing leakage; or demonstrate that no such incentive exists in the state. Collaborative participants have different points of view regarding which of the four options is preferable and/or appropriate and how best to structure them, but nevertheless provide the following comments on the treatment of leakage in the final model trading rule.

- (a) In the final model rule, EPA should identify and deem presumptively approvable additional methods to address the “leakage” from existing to new units beyond the allocation methods proposed in the draft federal plan. For example, if the use of set-asides remains a presumptively approvable leakage mitigation option, EPA should consider allowing a state to demonstrate that state policies would deliver an equivalent outcome to the set-asides to address leakage with no set-asides required.
- (b) EPA should provide greater clarity to states regarding how leakage is measured and what will be required to demonstrate that leakage is not a concern for a state.
- (c) EPA should provide guidance on any presumptively approvable leakage “fixes” as appropriate and as soon as possible after the close of comments on the proposal.
- (d) EPA should consider allowing states to be subject to a contingent mechanism to address leakage that would be triggered if leakage is determined to have occurred in the prior compliance period. Collaborative participants have a range of views regarding how to determine whether leakage has occurred, as well as what methods are appropriate for determining the absence of leakage. Methods discussed for demonstrating the absence of leakage included:
 - (i) A demonstration that either of the following two conditions are met in a state for the prior compliance period:

- (a) the aggregate output (MWh) of existing natural gas combined cycle units subject to the CPP in the state was equal to or greater than the BSER assumption (e.g. 75% capacity factor) for that prior compliance period; or
 - (b) the increase in aggregate output of existing natural gas combined cycle units subject to the CPP in the state plus the increase in renewable energy output (both relative to the BSER baseline period output) was equal to or greater than the decrease in aggregate output of existing steam units in the state, again compared to the BSER baseline period output.
- (ii) A demonstration that either of the following two conditions are met in a state for the prior compliance period:
 - (a) the aggregate output (MWh) of existing natural gas combined cycle units subject to the CPP in the state and new non-emitting generation was equal to or greater than the BSER assumption, based on the effects of building blocks 1 through 3 as well as the additional cost-effective renewable generation that served as the basis for EPA's expansion of each state's mass budget; or
 - (b) the reported emissions from all existing & new steam and natural gas combined cycle units were, in aggregate, lower than the state's existing mass-based budget plus new source complement.

3.2.2. Allowance Distribution and Set Asides. States that opt for mass-based trading should have full flexibility in distributing allowances, including treatment of retired units and any set asides states deem appropriate, provided that the states address leakage in a manner consistent with the final model rule. EPA should make this very clear in the final trading ready mass-based plan.²

² EPA generally states that states have full discretion to distribute allowances, but some provisions of the proposed model rule suggest otherwise. For example, §62.16240(a)(2) and (3) may be read to preclude allocation to EGUs after two years of non-operation and after modification or reconstruction. EPA should be clear that such provisions only apply if EPA is implementing the model rule as a federal rule and that states are free to distribute allowances as they see fit.

3.3. Rate-Based Trading Model Rule

- 3.3.1. Support for Trading Ready Subcategory Rate Approach. Collaborative participants support EPA's offering a subcategory rate trading ready model rule for those states that choose a rate-based approach.
- 3.3.2. ERC Eligibility. The Collaborative supports EPA's allowing states to develop and implement additional ERC project types that meet the general requirements for creation and verification of ERCs in the final CPP rule.
- 3.3.3. Pre-construction ERC Eligibility Determination. EPA should provide a process for obtaining a pre-construction ERC eligibility determination or clarify that a state may issue such a determination under the process provided in the proposed model rule.
- 3.3.4. ERC EM&V Requirements. EPA should make model EM&V requirements for ERC issuance available to states, especially in those categories of ERCs that are common across states likely to take a rate-based approach.
- 3.3.5. ERC Infrastructure. The Collaborative supports EPA's provision of an optional ERC tracking system, and EPA should also develop and administer an application tracking system for ERC eligible resources.
- 3.3.6. ERC Consistency from State to State. EPA should not require total consistency in ERCs from state to state, provided that all ERC eligibility and EM&V requirements are met in a way that is rigorous, straightforward and widely demonstrated. EPA should work with states choosing a trading ready rate-based approach to encourage and assist maximum consistency across states in order to improve the ERC trading market and facilitate trading.
- 3.3.7. Out-of-State ERC Applications. EPA should not prevent a state from accepting applications for ERCs for activities that took place in another rate-based state, but in approving state plans EPA should require a specified level of rigor and transparency in state ERC issuance processes so that double-counting is avoided and ERC proponents are less likely to forum shop when deciding where to apply for ERCs. EPA should define what is necessary to meet this specified level of rigor and transparency for ERCs issuance.

- 4. The Clean Energy Incentive Program (CEIP).** On October 21, 2015, EPA issued a 4-page memorandum outlining areas EPA is seeking comment on relative to implementation of the CEIP. While not all participants agree on the value of the CEIP, they make the following recommendations regarding the implementation of the program.
- 4.1. Ease of Implementation for States.** EPA should make implementation of the CEIP as easy as possible for states by providing clear rules and supplying EM&V requirements that a state can use to implement the CEIP.
 - 4.2. Proposed Action.** On January 6, 2016, EPA issued a notice that it intends to propose an action regarding components of the CEIP portion of the CPP in the spring of 2016 and provide an opportunity for public comment on the new proposal. In this action, EPA should carefully consider the timing of eligibility and definition of project commencement so as to enhance the incentive for early development of renewable energy or energy efficiency projects.
 - 4.3. Rules for CEIP eligibility.** EPA should include utility-sponsored CHP as eligible for energy efficiency projects under the CEIP, provided that there is a demonstrated reduction in emissions.
 - 4.4. Definition of Low Income.** The definition of “low-income community” should seek to encourage low-income energy efficiency projects and avoid erecting new barriers to those projects, while ensuring low-income individuals receive maximum benefits from the CEIP. To this end, participants encourage EPA to work with states to provide appropriate flexibility on the definition of low-income.
 - 4.5. Distribution, Allocation and Reallocation of CEIP Matching Pool.** Participants encourage EPA to work with states to determine the appropriate proportion between energy efficiency and renewable energy, as well as to consider allowing states to reallocate between the categories. After projects have had a full opportunity to apply to the program, but before EPA takes action to redistribute or retire unused matching credits, participants recommend that EPA consider allowing state plan states to redirect some portion of the unused matching ERCs or allowances from one category to the other.

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