April 9, 2015

National Climate Coalition

EPA 111(d) FIP Issues

KEY ELEMENTS OF THE NCC'S PREVIOUS 111(D) COMMENTS

A Source-Based Program with System Flexibility in the First Instance

In its previous design recommendations,[1] the National Climate Coalition ("NCC") supported a source-based "best system of emission reduction" (BSER) combined with voluntary state programs for incorporating system-wide activities that avoid or reduce additional emissions. EPA's system-wide approach in the Clean Power Plan is legally risky because the Clean Air Act does not authorize EPA to require a source to reduce emissions by means outside of its control. An immediate system-wide approach is also risky from an energy policy perspective because the necessary regulatory and market mechanisms are not yet in place to enable states to achieve system-wide (i.e., outside-the-fenceline) reductions without serious economic, reliability and other implications.

A More Robust Energy System Program When the Necessary Regulatory Infrastructure is in Place

The NCC design recommendations contemplate that EPA, working collaboratively with the states, could build the necessary regulatory and market tools to achieve greater, outside-the-fenceline reductions, but this will take time and will require significant regional coordination, advance planning and further EPA determinations regarding the feasibility, scale and cost of such reductions, among other considerations.

Interim Milestones Set by States

As noted in the NCC December 1, 2014 comments and as section 110 of the Clean Air Act provides for state plans (e.g., SIPs), EPA should defer to the states to set their own interim progress milestones for achieving the 2030 carbon intensity performance targets taking into account appropriate state and regional considerations.

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1 *See* National Climate Coalition Program Design Recommendations, February 4, 2014 and previous submittals.

FIP OPTIONS

EPA recently announced its intention to promulgate a federal implementation plan (FIP) in the event that states are unable or unwilling to submit a complying plan on time. A FIP could take one of two approaches. It could retain the obligation on the state, as the CPP proposes, or it could place the responsibility entirely on the source. Each of these approaches is considered below.

I. THE NCC PREFERS A STATE PORTFOLIO APPROACH WITH A FIP BACKSTOP THAT IS NARROWLY TAILORED TO THE SPECIFIC SHORTCOMING

Assuming that EPA finalizes a system-based BSER (i.e., establishing emission reductions based on what the entire energy system, not just sources, can achieve), then the NCC believes that a FIP that preserves a state's portfolio options would be preferable to a source-based approach.

- Under this approach, as in EPA's proposed CPP, the FIP would identify each state's final (i.e., 2030) carbon intensity performance goal. The FIP would include one or more model rules providing state flexibility to meet that target using any of a number of energy system strategies, including measures described in Building Blocks (BB) 2-4.

- To satisfy federal enforceability obligations and as a simple FIP backstop to state portfolio commitments that would be narrowly tailored to the specific shortcoming, the plan could include a targeted carbon fee as a back stop if the state did not meet the reduction target. The fee could be imposed at the state or service territory level for any underperformance and would remain in place until the state or service territory met the required carbon intensity performance level. Revenues would be collected by the state and applied to state efforts to reduce carbon intensity or returned to ratepayers or investors, as appropriate.

II. NCC RECOMMENDATIONS IF THE FIP PLACES RESPONSIBILITY ON THE SOURCE

If the FIP places the emission reduction responsibility on the individual source (i.e., EGU) instead of the state,[2] then certain considerations must be taken into account. Given that

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[2] We understand that the contemplated FIP approach would essentially embed within an individual EGU's operating limit the full emission reduction responsibility (i.e., BBs 1-4) of the state in which the EGU operates, expressed as carbon intensity, much as EPA would if it used the "alternative BSER" approach discussed in the CPP proposal. Significant questions exist regarding the methodology by which the state's emission reduction burden would be allocated among EGUs. To the maximum extent possible,

individual EGUs have no control over outside-the-fenceline, energy-system emission reduction opportunities, EPA must develop a robust interstate emission reduction credit (ERC) program[3] to connect the EGUs with the broader energy system and provide them with an assured compliance option at reasonable cost. ERCs would in theory be generated by a state's over-performance through surplus reductions from BBs 2-4 and other outside-the-fenceline, energy-system reductions not otherwise accessible to individual sources.

There are several critical characteristics that an interstate ERC program must have to succeed:

- **Established by EPA** - The interstate ERC program must be established by EPA as states may not be able nor willing to develop the program and sources will need unrestricted access to ERCs for compliance.

- **Automatic Registration in a National Data Base** - EPA should determine the net available surplus[4] emission reductions resulting from each state's most recent annual (or other period of) performance in each of the state's service territories. EPA would register these reductions in a national ERC data base reflecting the available multistate pool of available ERCs.

- **Immediate ERC Availability** - Once EPA registers the generation of surplus ERCs, those credits would be available to EGUs through an auction or by other means.

- **ERC Revenues Returned to the States and Investors** – funds generated through EGU ERC purchases would be returned to the state[5] whose carbon intensity performance generated the credits, subject to the Dispute Resolution process addressed below. EPA will need to work with the states to develop the ground rules necessary to assure that

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EPA should ensure that similarly-situated EGUs operating in common markets are assigned similar carbon intensity or emission reduction responsibility.

3 The NCC conceptually supports the alternative approach of using a national or multistate allowance-based approach instead of a rate-based ERC approach, under appropriate conditions, but understands that such an approach may not currently be under consideration.

4 For states subject to the FIP, any emission reductions relative to the state's 2012 (or other appropriate) baseline would be considered surplus. For states with approved 111(d) plans, to avoid double counting only reductions beyond the state's minimum enforceable 111(d) commitment for the applicable year would be considered surplus for purposes of the national ERC program.

5 Given the limitations on EPA's fundraising authority, presumably EPA would establish a trust account for collection, tracking and distribution of funds. States would receive funds in direct proportion to their relative ERC generation (i.e., the share of state ERCs contributed to the national credit pool).

funds ultimately are returned to the ratepayers, investors or taxpayers who financed the measures that directly or indirectly generated the ERCs.

- **No ERC Withholding** - Because EPA's BSER determination assumes widespread availability of all emission reductions, states should not be allowed to withhold their surplus reductions from the interstate ERC market.

- **Sequencing** - Compliance obligations would be timed so that the ERC credit pool is in place and adequately supplied (see below) before compliance obligations commence. Interim standards that allow a gradual glide-path would increase opportunities for states to generate ERC credit through over-performance in the early years,[6] helping to build the credit pool.

- **Minimum ERC Balance and ACP** - The program must provide for a minimum national ERC balance to ensure an adequate supply of ERCs to meet anticipated EGU demand at reasonable cost. Given significant uncertainties regarding the potential supply of ERCs, the program must be backstopped by an alternative compliance payment (ACP) option or other reasonably-priced safety valve if it is to avoid impermissible burdens on individual EGUs or regulated states.

    - **ACP** - given that it will take some time to assure an adequate supply of ERCs in the interstate credit registry/pool, EPA should establish a ceiling-price alternative compliance payment option (e.g., safety valve) as we have previously recommended. States would apply collected funds for investment in energy system GHG reductions.

- **Qualified ERC Purchasers Only** - To ensure adequate ERC supply, only regulated entities (either EGUs or utilities/LSEs, or states if the burden is placed at a state level) would be able to purchase ERCs.

- **Parallel to Independent State Programs** - Creation of an interstate ERC market would not interfere with separate state or regional GHG trading programs, which would operate independent of the FIP program (i.e., as parallel but independent programs). ERCs generated by states not subject to the FIP as surplus to the state's applicable 111(d) carbon intensity commitments would still be registered in the national ERC credit pool and made available to EGUs or LSEs (or states) as needed for compliance.

- **Dispute Resolution and Appeal Process** - EPA should issue guidelines clarifying ERC ownership among potentially competing public and private investors and states. EPA

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6 For states subject to a FIP, ERCs would be generated by reference to the state's 2012 (or other appropriate period) carbon intensity baseline. For states with approved 111(d) plans, ERCs would be generated by reference to that state's commitment for the given year.

also should establish an appeal procedure to resolve any disputes related to ERC generation determinations. Unleashing capital will require clear ERC ownership rules and a fair and efficient dispute adjudication process.

Potential Advantages of this Approach:

- **Minimizes Intrusion into Energy Planning** – This approach creates an ongoing incentive for state and regional action but does not interfere with state and regional energy planning. Other than data sharing, the FIP would not impose independent federal planning burdens other than those related to automatic ERC generation and fund distribution.

- **Rewards Early Action** - States that beat their carbon intensity baselines or (for approved states, their targets) will automatically generate ERCs and receive funds from ERC purchases, potentially rewarding ratepayers, investors and taxpayers in such states. Accordingly, such a design would provide an incentive for other states to move quickly to lower energy system carbon intensity, generate their own ERCs and capture ERC payments.

- **Encourages Interstate Coordination** – The approach offers a way for states to harmonize their actions.

- **Minimizes Resource Burdens on Individual States** – FIP States could focus their resources on their own energy planning while using the FIP approach to meet federal requirements.

- **Cost Minimization** – by developing a national ERC pool, the approach would avoid the potential for compliance costs to be determined by regional or local factors (e.g., gas supply, renewable investment, weather or other constraints). The national scale of the ERC pool together with the ceiling-price ACP mechanism would provide desirable cost uniformity, stability and mitigation benefits.

- **Ensures Adequate Compliance Options for Regulated Sources** – the interstate ERC pool and ACP would ensure that EGUs have sufficient compliance options to meet their FIP obligations.

- **Establishes Price Signal for Long-Term Capital Deployment** – ERC transactions will provide a price signal that will help private capital and sources make long-term capital deployment decisions. In some cases, additional revenue streams from ERC creation and sale will make certain development opportunities financially possible.

Because this draft discussion document is an integrated package of recommendations that reconciles often conflicting individual company or association perspectives, no particular position should be attributed to any individual National Climate Coalition member. The Coalition offers these comments recognizing that EPA will receive a variety of comments from other stakeholders. We look forward to continued dialogue with all stakeholders and commit to give serious consideration to and to comment upon constructive ideas offered by others. Coalition positions may evolve over time in response to such ideas or following further ongoing analysis.

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