



**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
DEPARTMENT OF ENVIRONMENTAL MANAGEMENT  
OFFICE OF AIR RESOURCES**

In Re: Proposed Air Pollution Control Regulation No. 46 “CO<sub>2</sub> Budget Trading Program” and Proposed Air Pollution Control Regulation No. 47 “CO<sub>2</sub> Budget Trading Program Allowance Distribution”

**Response to Comments and Decision**

**Introduction**

The Rhode Island Department of Environmental Management’s (“DEM”) Office of Air Resources posted a notice on the Rhode Island Office of the Secretary of State website on 2 May 2008 announcing a public hearing and offering the public an opportunity to comment on its proposal to adopt Air Pollution Control Regulation No. 46, entitled “CO<sub>2</sub> Budget Trading Program” and Air Pollution Control Regulation No. 47, entitled “CO<sub>2</sub> Budget Trading Program Allowance Distribution”

The public hearing was held on Thursday, June 5, 2008. The comment period closed at 4:00pm on June 5, 2008, thirty one (31) days after the date of initial public notice. A transcript of the public hearing was prepared.

Proposed Air Pollution Control (“APC”) Regulation No. 46 will regulate CO<sub>2</sub> emissions from fossil-fuel-fired electric power plants with a nameplate capacity of twenty five (25) megawatts or greater. CO<sub>2</sub> allowances (one (1) allowance allows the holder to emit one (1) ton of CO<sub>2</sub>) will be auctioned or sold by the Department or its agent. To demonstrate compliance with the CO<sub>2</sub> Budget Trading Program, power plants must provide one (1) CO<sub>2</sub> allowance for each ton of CO<sub>2</sub> emitted during each compliance period. Proposed Air Pollution Control (“APC”) Regulation No. 47 specifies the mechanism for auctioning and selling the allowances.

Five individuals provided comments on the record at the public hearing. They were Eugenia Marks (Audubon Society of Rhode Island), Matt Auten (Environment Rhode Island), Denise Parrillo (Clean Water Action) and Cynthia Giles (Conservation Law Foundation)

Written comments were received from David Farnsworth (State of Vermont, Public Service Board), Lynn Smallridge (FPL Energy), Christopher Sherman (NEPGA), Pamela Faggert (Dominion Resources Services, Inc.), Matt Auten (Environment Rhode Island), Denise Parrillo (Clean Water Action), Cynthia Giles (Conservation Law Foundation) and (Northeast Regional Greenhouse Gas Coalition)

## Response to Comments

This section will present DEM's response to the comments received at the public hearing and during the public comment period. Each comment is followed by DEM's response.

The following comments were received on 5 June 2008 via email from David Farnsworth of the Public Service Board of the State of Vermont to Barbara Cesaro, of DEM.

**Comment:** In APC Regulation No. 46, section 46.4.3(c)(2)d. the last sentence states that: *In no event shall the size of the voluntary renewable set-aside exceed 1% of the number of allowances in the annual base budget.* It is more appropriate to have that condition in 46.4.3(c)(2)c.

**Response:** Based on another comment, the DEM revised the language for the section on the voluntary renewable set-aside account, so this comment is no longer applicable. See the response to comments from Lynn Smallridge below.

**Comment:** In APC Regulation No. 46, section 46.8.4 there should be a condition that records the CO<sub>2</sub> allowances allocated to the voluntary renewable energy set-aside account from section 46.46.3(c).

**Response:** DEM agrees with this recommendation. The final regulation will be revised by adding the following conditions to section 46.8.4:

*(c) By January 1, 2009, the Department or its agent will record in the Voluntary Renewable Energy Market Set-aside Account CO<sub>2</sub> allowances for allocation years of 2009, 2010, 2011, and 2012.*

*(d) By January 1, 2010, the Department or its agent will record in the Voluntary Renewable Energy Market Set-aside Account the CO<sub>2</sub> allowances for the allocation year three years in the future.*

**Comment:** In APC Regulation No. 46, section 46.8.4 there should be a condition that records future year allocations to the Rhode Island Auction/Sale Account.

**Response:** DEM agrees with this recommendation. The final regulation will be revised by adding the following condition to section 46.8.4:

*(b) By January 1, 2010 and each January thereafter, the Department or its agent will record in the Rhode Island Auction/Sale Account the CO<sub>2</sub> allowances for the allocation year three years in the future.*

**Comment:** In APC Regulation No. 47, the definition of "Agent" should also include the USEPA as stated in APC Regulation No. 46.

Response: DEM agrees with this recommendation. In the final regulation the definition of Agent will be revised as follows:

“Agent” means an independent contractor, United States Environmental Agency (USEPA), consumer trustee, or other entity including a regional entity.

**Comment:** DEM should make it clear in APC Regulation No. 47, subsection 47.9(h) that the notification should include a statement that there is no *material* change to the information provided in the application or a revised application if *material* changes have occurred. A material change implies a substantive change.

Response: DEM agrees with this recommendation. The condition in the final regulation will be revised as follows:

*47.9(gh) Prior to each CO<sub>2</sub> allowance auction or sale a prospective bidder or buyer that has qualified under this subsection must notify the Department of its intent to participate in the upcoming auction or sale. This notification shall include either a statement that there has been no material change to the information provided in the application, or a revised application if material changes have occurred. A material change is a substantial change of decisional significance.*

**Comment:** DEM should revise APC Regulation No. 47, section 47.12 to make it clear that only the *winning* bids and sales will be published on the central auction website or the Departments website. If all bids and sales were publicly available after an auction/sale is over, a party may be able to determine a participant’s bidding strategy, potentially putting the participant at a disadvantage in a subsequent auction.

Response: DEM agrees with this recommendation. Section 47.12 in the final regulation will be revised as follows:

*47.12 Publication of Results*

*~~The Department or its agent may publish the winning bids and/or allowance sales along with the corresponding dollar amounts of the bids and/or purchase price on the central auction website or Department's website, whichever is appropriate.~~ will publish on the central auction website or the Department’s website, whichever is appropriate, the auction clearing price and the number of allowances sold in the auction.*

**Comment:** DEM should remove subsection 47.9(d) of APC Regulation No. 47. Only parties wishing to participate in an auction or sale should be required to maintain a compliance account or general account. There is no requirement in the CO<sub>2</sub> Budget Trading model rule that a party wishing to hold allowances must maintain a compliance or general account.

Response: DEM agrees with this recommendation. This condition will be removed from the final regulation.

**Comment:** DEM should remove subsection 47.9(g) of APC Regulation No. 47. Since bidders need to notify the Department or its agent of any material change prior to each auction, there is no need for participants to file an application annually.

Response: DEM agrees with the recommendation. The condition in the final regulation will be revised as follows:

*47.9(fg) Prospective bidders and buyers that qualify for participation under this subsection will be qualified for all subsequent CO<sub>2</sub> allowance auctions and sales, and will be eligible to bid in such auctions or buy in a sale provided that such party has complied with the financial security requirements of this subsection. Application information must be verified with the Department annually.*

**Comment:** In subsection 47.10(b) of APC Regulation No. 47, DEM proposes that: “*If the quantity of allowances available for purchase in a particular sale is less than the quantity of allowances sale participants want to buy, then the quantity of allowances made available to each prospective buyer shall be determined as follows: the number of allowances available times number of allowances requested by the buyer divided by the number of allowances requested by all buyers.* DEM should consider other tie breaking options.

Response: DEM agrees with this recommendation. The condition in the final regulation will be revised as follows:

*47.10(b) Sale Criteria*

*If the quantity of allowances available for purchase in a particular sale is less than the quantity of allowances sale participants want to buy, then the quantity of allowances made available to each prospective buyer shall be determined by a random process. as follows: ~~the number of allowances available times number of allowances requested by the buyer divided by the number of allowances requested by all buyers.~~*

**Comment:** Subsection 47.6(d) states that: “*No buyer or combination of buyers may buy more than 25% of the allowances available for sale in any given sale*”. This condition implies that DEM won’t sell more than 25% of its allowances at each sale. The condition should be revised to say: *No buyer or combination of buyers that have related beneficial interests may buy more than 25% of the allowances available in any given auction.*

Response: DEM agrees that the language is unclear. The condition in the final regulation will be revised as follows:

*47.6(de) No buyer or combination of buyers that have related beneficial interest may buy more than 25% of the allowances available for sale in any given sale.*

The following comments were received on 5 June 2008 via email from Christopher P. Sherman, General Counsel of New England Power Generators Association, Inc. (NEPGA) to Stephen Majkut, of DEM.

**Comment:** NEPGA encourages Rhode Island to fully coordinate every aspect of the state auction with the other CO<sub>2</sub> reduction auctions. Of particular importance is maintaining consistent criteria for each program and the ability to trade allowances within the parameters of those programs. The regional and global efforts being undertaken by numerous jurisdictions will inevitably affect the price and availability of allowances for the individual program participants, and have an undetermined corresponding affect on electric reliability in those areas.

Ideally, NEPGA believes that the most effective way to address carbon emission reductions is to develop a national, economy-wide program. A single state or even regional program, by virtue of the small percentage of global emissions from the limited geographic size, cannot make significant impacts to the overall goal of reducing the amount of global greenhouse gases. In contrast, a federal auction will provide greater market liquidity, price transparency and prevent emissions leakage from within the region.<sup>1</sup>

**Response:** DEM understands your concerns and will coordinate with other state auctions to the extent practicable. No changes will be made to the proposed regulations as a result of this comment.

**Comment:** Accordingly, NEPGA urges Rhode Island to enact a sunset provision in the Regulations that allow for their elimination and replacement with another program should such a federal program be implemented in the future. Such a provision would be consistent with the RGGI Memorandum of Understanding (MOU) which states as follows:

“when a federal program is proposed, the Signatory States will advocate for a federal program that rewards states that are first movers. If such a federal program is adopted, and it is determined to be comparable to this Program, the Signatory States will transition into the federal program.”

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<sup>1</sup> “Emissions leakage” is the concept that there could be a shift of electricity generation from capped sources subject to RGGI to higher-emitting sources not subject to RGGI. *See*, Potential Emissions Leakage and the Regional Greenhouse Gas Initiative (RGGI): Evaluating Market Dynamics, Monitoring Options, and Possible Mitigation Mechanisms (March 14, 2007). *See also*, “CO<sub>2</sub> emission leakage refers to any increase in CO<sub>2</sub> emissions outside of the RGGI cap region which offsets the CO<sub>2</sub> reductions in the RGGI region with the cap imposed. (emphasis added) Evaluation of Impact of Regional Greenhouse Gas Initiative CO<sub>2</sub> Cap on the New England Power System, Platts, et. al. at 20.

Contrarily, Regulation No. 46, § 3.6 states, *inter alia*, as follows:

No provision of the CO<sub>2</sub> Budget Trading Program... shall be construed as exempting or excluding the owners and operators... from compliance with any other provision of **any** Air Pollution Control Regulation, the Rhode Island State Implementation Plan, a federally enforceable permit, or the Clean Air Act. (*emphasis added*)

**Response:** If a federal program is implemented, DEM will honor the commitment in the RGGI Memorandum of Understanding regarding implementation of a federal program. DEM will not add a sunset provision to the final regulation.

**Comment:** Accordingly, NEPGA is concerned that inadequate consideration has been given to the coordination of RGGI and other existing or proposed CO<sub>2</sub> reduction initiatives. Of particular concern are the potential inconsistencies of criteria for qualifying projects under each program and the ability to trade offsets within the parameters of those programs. The global efforts being undertaken by numerous jurisdictions will inevitably affect the price and availability of offsets for the individual program participants, and have an undetermined corresponding affect on electric reliability in those areas. These unknown affects seriously question the prudence of implementing regional programs that engage anything less than all emitting sectors on a national or international basis.

**Response:** Rhode Island committed to the RGGI MOU knowing that RGGI would only cover power plants. Rhode Island agrees with all the representations in the MOU regarding the need for going forward with a program to limit CO<sub>2</sub> emissions at power plants only at this time.

**Comment:** There is overwhelming and understandable interest from non-market participants in receiving the revenue generated from the one-hundred percent auction. However, without even the generalities of a skeletal framework, no single proposal has been put forth with quantitative assurances for the actual reduction of CO<sub>2</sub> emissions among the competitors for these lucrative proceeds. While promising to be large, numerous questions still remain regarding the availability of revenues to actually achieve the goals of the program.<sup>2</sup> Given the absence of compliance options offered by the proposed program, and the unavailability of back-end emission control technologies, many generating units that are essential for electric reliability could unavoidably be forced to curtail operations or shut down completely. In order to maintain electrical reliability and cost effective electrical supply, Rhode Island should use emission credit proceeds to increase efficiencies at power plants so that actual greenhouse gases are reduced.

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<sup>2</sup> The purpose of the RGGI program is “to stabilize and then reduce anthropogenic emissions of CO<sub>2</sub>, greenhouse gas, from CO<sub>2</sub> budget sources **in an economically efficient manner.**” RGGI Model Rule, §XX-1.1 (*emphasis added*) *See also*, “the Rhode Island component of the CO<sub>2</sub> Budget Trading Program, ... is designed to stabilize and then reduce anthropogenic emissions of CO<sub>2</sub>, a greenhouse gas, from the CO<sub>2</sub> budget sources **in an economically efficient manner.**” Regulation No. 46, §15.1

**Response:** DEM is bound by the requirements of RIGL §23-82-6, which specifies the use of the auction or sale proceeds. The proceeds from the auction or sale of the allowances shall be used for the benefit of energy consumers through investment in the most cost-effective available projects that can reduce long-term consumer energy demands and costs.

**Comment:** Due to the uncertainties of the energy markets, as well as the absence of a functioning RGGI allowance market, generators are currently developing compliance strategies and are unable to properly gauge the likelihood of their success upon implementation. This problem transcends the normal market hedging issues that are experienced by generators pertaining to fuel procurement and the existing markets for environmental allowances, as those trading mechanisms are more developed in both the primary and secondary markets.

The dynamics of New England's competitive electricity market have provided tremendous benefits to the overall region. Of considerable importance to the New England economy is the fact that wholesale electricity prices in New England, adjusted for fuel costs and inflation, have declined by 16.5 percent during the four-year period from 2001- 2004.<sup>3</sup> However, Rhode Island's retail rates, like those of the other states in New England, are well above national averages and the DEM should remain vigilant about the effects of the Regulations on the markets. ISO-NE summarized the potential effects on the New England electricity market as follows:

The RGGI cap-and-trade program would create CO<sub>2</sub> emission allowances needed by generators, which would have a market value. This value would be reflected in the generator bid prices, similar to how SO<sub>2</sub> and NO<sub>x</sub> allowances are reflected today. This additional generator cost could shift the dispatch of the generators and their CO<sub>2</sub> emissions, and potentially affect electric system operation and reliability in New England.<sup>4</sup> (*emphasis added*)

The liquidity of the allowance market will remain undetermined until the auctions have gone through numerous iterations. Despite the 3-year compliance period, it is conceivable for a generator to be unable to procure sufficient allowances depending upon the dispatch rate of the unit to meet market demands. DEM should consider allowing generators that are not able to comply with the Regulations as a result of market circumstances or inability to obtain allowances should be allowed to comply by alternative market payments consistent with compliance cost of

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<sup>3</sup> ISO New England website, [www.iso-ne.com](http://www.iso-ne.com). We have adjusted for inflation ISO New England's fuel adjusted nominal value of 11 percent to yield a real decrease of 16.5 percent.

<sup>4</sup> *See generally*, Evaluation of Impact of Regional Greenhouse Gas Initiative CO<sub>2</sub> Cap on the New England Power System, Platts, et. al.

allowances. In this manner the Regulations will be liberally construed so as to permit the DEM “to effectuate the purposes of state law, goals and policies.”<sup>5</sup>

**Response:** The current program as proposed does not include alternative market payments. Certainty about compliance obligations is a necessary component of the market-based system that will be created by the CO<sub>2</sub> Budget Trading Program. Conversely, uncertainty that would be caused by an opt-out provision would reduce the incentive to plan for future emissions reductions and potentially result in less emission reductions. Furthermore, the regulations include a number of provisions designed to limit price impacts, including an expansion of the use of CO<sub>2</sub> offset allowances in the event that certain price triggers are exceeded. The ability to use more CO<sub>2</sub> offset allowances for compliance should increase the supply of CO<sub>2</sub> allowances available for the CO<sub>2</sub> Budget Trading Program (offset allowances are issued in addition to those allowances the state CO<sub>2</sub> budget), lowering allowance prices, and the cost of compliance. Therefore, DEM will finalize the proposed regulation without any additional components that would allow for alternative market payments.

**Comment:** Finally, given the infancy of the mandatory carbon control process, NEPGA encourages the DEM to conduct auctions as far in advance to 2009 as possible. In furtherance thereof, NEPGA is supportive of the DEM’s proposal to distribute their 2009, 2010, 2011 and 2012 allowances on or before January 1, 2009, to the Rhode Island Auction/Sale account.

**Response:** DEM intends to participate in the first regional auction planned for September 10, 2008. All allowances made available for auction by states, for a respective compliance period, will be offered for sale prior to the end of that compliance period. Future allowance vintages will be made available for sale in a quantity up to fifty percent (50%) of their respective annual allocation, and such offerings may be for allowances extending up to four (4) allocation years into the future.

The following comments were received on 5 June 2008 via email from Lynn Smallridge, Environmental Specialist of FPL Energy to Stephen Majkut, of DEM.

**Comment:** Consistent with comments made by FPLE in Rhode Island and other RGGI state proceedings, FPLE strongly supports the development of a national, upstream, economy-wide program as the preferred method of addressing the global issue of climate change and reducing CO<sub>2</sub> emissions. We continue to urge Rhode Island, and all RGGI states, toward that construct. In the absence of this approach, a well-designed cap-and-trade program implemented on a uniform, regional basis can achieve the goals of stabilizing and, ultimately, reducing CO<sub>2</sub> emissions while minimizing the disproportionate impacts inherent in a single-state design. We

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<sup>5</sup> See, Regulation No. 46 § 15.3

strongly encourage Rhode Island, through the Department, to collaborate closely with the other RGGI states in developing and implementing a market-based program supported by auction rules that are regionally consistent so that CO<sub>2</sub> reductions can be achieved while maintaining the reliability of the region's electric system. Consistency of the program and auction rules by RGGI member states is critical to achieving the goals that RGGI was formed to reach. Deviations by any member state in the use of set-aside accounts or auction mechanisms will create market disruptions resulting in inefficiencies and price volatility. Additionally, price volatility within the RGGI market will only lead to higher energy prices than what they otherwise would have been if a uniform program was implemented.

**Response:** DEM continues to work closely with the other participating states in the implementation of its CO<sub>2</sub> Budget Trading Program. In accordance with the MOU, signatory states have committed to propose programs substantially as reflected in the model rule. In conducting regional auctions, participating states have come to agreement on the design elements as stated in the March 17, 2008 document entitled: "Design Elements for Regional Allowance Auctions under the Regional Greenhouse Gas Initiative". Participating states maintain the flexibility to have set-aside accounts.

**Comment:** We would note that on March 17, 2008 the RGGI states issued "Design Elements for Regional Allowance Auctions under the Regional Greenhouse Gas Initiative." Within these design elements, it was indicated that "(t)he participating states have agreed to participate in uniform regional auctions for the allowances that each state will be offering for sale. The initial auction is currently planned for September 10, 2008 with a second auction scheduled for December 17, 2008." We would note that at least several of the RGGI states have indicated that they may be unable to participate in the initial (September 10, 2008) regional auction, as their regulatory and/or legislative processes may not yet be completed. The inability of the states to move together in implementing RGGI and conducting regional auctions can contribute to the efficiency and volatility concerns noted above. Those entities regulated under RGGI, including FPLE, have noted throughout the legislative and regulatory processes that transparency and regulatory certainty were critical in ensuring efficient, fair application of this new policy and process within a minimum of impact to ratepayers. While Rhode Island has not suggested that it would fail to meet the September 10, 2008 date for participation in the regional auction process, the fact that at least several RGGI states are considering delaying their participation is troubling at best. As regulated entities, we cannot and should not defer our responsibility under RGGI; nor should individual states. While the RGGI Memorandum of Understanding provides that regulations implementing the CO<sub>2</sub> Budget Trading Program be adopted by RGGI members by December 31, 2008, we urge all RGGI states to commence the regional auction process on September 10, 2008, as announced by the RGGI states on March 17, 2008.

**Response:** DEM is committed to implementing the RI CO<sub>2</sub> Budget Trading Program on schedule and thereby regulating CO<sub>2</sub> emissions from CO<sub>2</sub> budget sources beginning January 1, 2009. DEM agrees that it would be beneficial if all participating states could participate in the first regional auction; however, states will make that decision according to their own state concerns and state law.

**Comment:** The last of our general comments is related to the “sunsetting” of state greenhouse gas reduction regulations once a federal program is implemented. The Memorandum of Understanding states: “when a federal program is proposed, the Signatory States will advocate for a federal program that rewards states that are first movers. If such a federal program is adopted, and it is determined to be comparable to this Program, the Signatory States will transition into the federal program.” We strongly encourage that language be added to the regulations to facilitate this transition. Failing to sunset a state program when a federal program which regulates the same emissions is adopted will result in even higher compliance costs for state consumers with no additional environmental benefit.

**Response:** DEM is proceeding with plans to implement the Rhode Island CO<sub>2</sub> Budget Trading Program without a sunset provision. If a federal program is implemented, Rhode Island will honor the commitment in the RGGI MOU regarding implementation of a federal program.

**Comment:** Our comments on the proposed regulation relate primarily to the Voluntary Renewable Energy (VRE) Set-aside (Regulation 46.4.3 (c)). FPLE commends Rhode Island for including this provision. We believe policies which encourage the reduction of carbon-intensive generation, furthering the purposes for which RGGI was originally intended, are worthwhile and appropriate.

While we appreciate the state’s following the example of VRE set-aside language described in the RGGI Model Rule, there is a much less administratively burdensome method to managing the allocation. The Model Rule suggests that any person may submit data to the regulatory agency to document purchases of renewable energy or renewable energy attribute credit purchases by retail customers in the state during the most recent three-year period for which data is available. This documentation is due no later than July 30 before the start of a control period. The purpose of this documentation is to determine how many allowances should be set aside for the control period. For a number of reasons we believe this data collection process is unnecessary. FPLE suggests simply setting aside from each year’s budget an amount of allowances equal to the maximum amount the state would allow for VRE purchases. At the end of each calendar year, the state could then collect data from the actual purchases, retire allowances equal to the amount of renewable energy or renewable energy attribute credits multiplied by the average CO<sub>2</sub> rate in the area/region from which the renewable energy was produced, and then return any excess allowances in the set aside account into the next auction of allowances. This annual true-up would eliminate the up-to-three-year lag between the actual purchase and the retirement of the

allowance. In the case where the voluntary purchases exceed the amount in the annual set-aside account, we would strongly urge additional allowances be retired under the cap to ensure the credibility of the voluntary purchases.

Regarding the size of the VRE Set-aside, we appreciate the state's willingness to set aside one percent (1%) of the annual base budget for this purpose. However, we believe there should not be a cap placed on this beneficial program. As retail customers become more aware of ways to reduce their carbon impact, we believe limiting this method of doing so provides no environmental benefit; in fact, it is in direct conflict with the stated purposes of RGGI. Rhode Island state regulation allows a "de minimis" amount of allowances be set aside for VREs. We believe the 1% proposed is a very modest beginning that should be revisited once the program is underway, particularly since the "1% of the annual base budget" will actually shrink in total allowances as the annual budget begins to reduce. We strongly suggest that the Department reserve the right to adjust the set aside amount as necessary to protect the credibility of the VRE program.

Should the Department not wish to amend the VRE section as suggested, we have specific concerns with some of the language as currently written. First, section 46.4.3(c) (2) a. reads "*Any person may submit data to the Department documenting purchases of voluntary renewable energy to meet the requirements of this subsection by no later than July 30 prior to the beginning of a control period...*". FPLE is concerned that there will not be sufficient time and notice for entities wishing to provide this documentation before the July 30, 2008 deadline in anticipation of the first control period. It is unclear exactly when final Rhode Island regulations will be promulgated and, once completed, if there will be sufficient time to enact appropriate administrative forms and procedures for this data collection. If the deadline is missed, it appears there would be no set aside for the entire initial control period. We strongly encourage the Department to consider these concerns.

Response: RIGL §23-82-5(a) states that "*A de minimus portion of allowances may be set aside to support a voluntary renewable energy provisions of the regional greenhouse gas initiative model rule*". The one percent (1%) is the DEM's definition of the term "de minimus" and is not in conflict with the law. DEM agrees that the language in the voluntary renewable set-aside subsection can be revised to be less burdensome. The subsection will be revised in the final regulation as follows:

(c) Voluntary renewable energy market set-aside allocation. ~~For each control period, the Department shall allocate to the voluntary renewable energy market set-aside account a certain number of tons, calculated as set forth in this subsection, from the Rhode Island CO2 Budget Trading Program base budget set forth in subsection 46.4.1, as applicable. The Department shall administer the voluntary renewable energy set-aside in~~

accordance with this subsection.

(1) ~~The Department will open and manage a general account for the voluntary renewable energy market set aside for each control period.~~

(2) ~~The number of tons that will be allocated to the voluntary renewable energy market set aside account in a specific control period will be determined as set out in this subsection.~~

a. ~~Any person may submit data to the Department documenting purchases of voluntary renewable energy that meet the requirements of this subsection by no later than the July 30 prior to the beginning of a control period. Such data must be from reputable sources, which may include retail electricity providers, organizations that certify renewable energy products, and other parties as determined by the Department. To be considered, data must be verifiable and document the following for voluntary renewable energy purchases.~~

(i) ~~Documentation of voluntary renewable energy or renewable energy attribute credit purchases by retail customers, by customer class, in the State during the most recent three-year period for which data are available.~~

(ii) ~~Documentation that the renewable energy or renewable energy attributes related to voluntary renewable energy or renewable energy attribute credit sales was procured by the retail provider.~~

(iii) ~~Time period when the retail purchase(s) was made.~~

(iv) ~~State where the electricity was generated or the renewable energy attribute credit was created, including documentation of facility name, unique generator identification number, and fuel type.~~

(v) ~~Time period when the electricity was generated or the renewable energy attribute credit was created.~~

b. ~~Subject to the timely receipt of adequate data pursuant to 46.4.3(e)(2)a. of this subsection, and based on such data, the Department shall project the voluntary renewable energy purchases in the State during a control period that~~

represents renewable energy generation in one or more participating states. The megawatt hours (MWh) of projected voluntary renewable energy purchases in a control period shall be multiplied by the marginal CO<sub>2</sub> emissions rate (lbs. CO<sub>2</sub>/MWh) in the control area where the generation occurred, as determined by the Department. If data to determine the marginal emissions rate is unavailable, the average emissions rate shall be used, as determined by the Department.

- e. — The CO<sub>2</sub> tons to be allocated to the voluntary renewable energy set aside account shall be calculated as follows:

$$\text{CO}_2 \text{ tons} = \text{MP} \times \text{EF}$$

where:

CO<sub>2</sub> tons, rounded down to the nearest whole ton, is the number of allowances to be placed in the reserve account.

MP is the projected MWh of voluntary renewable energy purchases in the State during the future control period that meets the requirements of this subsection.

EF is the CO<sub>2</sub> emissions factor for the control area where the electricity represented by the sale was generated.

- d. — If following the end of a control period, the number of CO<sub>2</sub> allowances allocated to the voluntary renewable energy set aside account is less than the number of CO<sub>2</sub> tons represented by the actual MWh of voluntary renewable energy purchases during the control period, the Department will add the difference between CO<sub>2</sub> tons represented by actual purchases, as calculated in accordance with 46.4.3(e)(2)c. of this subsection, and CO<sub>2</sub> allowances held in the set aside account to the projection for the following control period, pursuant to 46.4.3(e)(2) of this subsection. If following the end of a control period, the number of CO<sub>2</sub> allowances allocated to the voluntary renewable energy set aside account is greater than the number of CO<sub>2</sub> tons represented by the actual MWh of voluntary renewable energy purchases during the control period, the Department will subtract the difference between CO<sub>2</sub> tons represented by actual purchases, as calculated in accordance with 46.4.3(e)(2)c. of this subsection, and CO<sub>2</sub> allowances held in the set aside account from the projection for the following control period, pursuant to 46.4.3(e)(2) of this

~~subsection. In no event shall the size of the voluntary renewable set aside exceed 1% of the number of allowances in the annual base budget.~~

~~(3) As of the December 31 that is after the end of a control period for which an allocation has been made to the voluntary renewable energy set aside account, the Department shall determine the actual MWh of voluntary renewable energy purchases that occurred during the control period. The Department shall retire CO<sub>2</sub> allowances in the voluntary renewable energy set aside account in an amount up to the number of tons of CO<sub>2</sub> represented by actual voluntary renewable energy purchases, based on actual MWh purchases and the emissions factor determined pursuant to 45.4.3(e)(2) of this subsection.~~

(1) The Department shall open and manage a general account for the voluntary renewable energy market set-aside for each allocation year.

(2) The Department shall allocate 1% of the number of allowances of the annual base budget to the voluntary renewable energy market set-aside account.

(3) The Department shall permanently retire CO<sub>2</sub> allowances from the voluntary renewable energy market set-aside account for a given allocation year. The number of allowances to be retired shall be made based on the following:

a. Any person may submit data to the Department or the Department may gather data documenting purchases of voluntary renewable energy that meet the requirements of this subsection by no later than the March 1 immediately following the allocation year for which it is being made and must include information to assure that the voluntary renewable energy purchase demonstrates creditable CO<sub>2</sub> emissions reductions. Such data must be from reputable sources, which may include retail electricity providers, organizations that certify renewable energy products, and other parties as determined by the Department. To be considered, data must be verifiable and document the following for voluntary renewable energy purchases:

(i) Documentation of voluntary renewable energy or renewable energy attribute credit purchases by retail customers, by customer class, in the State during the allocation year immediately preceding

the application date.

- (ii) Documentation that the renewable energy or renewable energy attributes related to voluntary renewable energy or renewable energy attribute credit sales was procured by the retail provider.
- (iii) Time period when the retail purchase(s) was made.
- (iv) State where the electricity was generated or the renewable energy attribute credit was created, including documentation of facility name, unique generator identification number, and fuel type.
- (v) Time period when the electricity was generated or the renewable energy attribute credit was created.

b. By October 31<sup>st</sup> following the March 1<sup>st</sup> application deadline established in subsection 46.4.3(c), the Department will determine the actual MWh of voluntary renewable energy market purchases that occurred during the allocation year. The Department will retire CO<sub>2</sub> allowances from the voluntary renewable set-aside account in the amount up to the number of CO<sub>2</sub> tons represented by actual voluntary renewable energy market purchases, based on actual MWh purchases demonstrated by each applicant as follows:

$$\text{CO}_2 \text{ tons} = \text{MP} \times \text{EF}$$

where:

CO<sub>2</sub> tons, rounded down to the nearest whole ton, is the number of allowances to be retired from the set-aside account.

MP is the MWh of voluntary renewable energy purchases in the State during the allocation year.

EF is the CO<sub>2</sub> emissions factor for the control area where the electricity represented by the sale was generated.

In no event shall the department retire more than 1% of the base budget for the allocation year.

- (4) After retiring the CO<sub>2</sub> allowances from the voluntary renewable energy market set-aside account, the Department will transfer any remaining CO<sub>2</sub> allowances from the set-aside account to the Rhode Island

Auction/Sale Account.

**Comment:** A typographical error has occurred in section 46.4.3(c)(3). The final line reads, “...factor determined pursuant to 45.4.3(c)(2) of this subsection.” We believe the intended citation is 46.4.3(c)(2).

**Response:** DEM agrees that there was a typographical error; however, since the subsection has been rewritten in response to your earlier comment, this comment is no longer applicable.

**Comment:** An incorrect word choice was used in section 46.11.1 (c)(4) which reads, “Whether the facts that form the basis for certification under section 46.9 and 46.10 of each monitor at each unit at the source, or for using an *excepted* monitoring method or alternative monitoring method approved under sections 46.9 and 46.0, if any, have changed; and”. We believe the word “excepted” should be “accepted”.

**Response:** DEM agrees and will revise the language in 46.11.1(c)(4) in the final regulation as follows:

*46.11.1(c)(4) Whether the facts that form the basis for certification under section 46.9 and 46.10 of each monitor at each unit at the source, or for using an ~~excepted~~ accepted monitoring method or alternative monitoring method approved under sections 46.9 and 46.10, if any, have changed; and*

**Comment:** We recognize the rationale in 47.2 (a) and (b) behind the flexibility and optionality of implementing RGGI on a state-specific or regional basis as described above. And while that flexibility and optionality may make sense from a legislative and regulatory perspective, the practical implications of implementing RGGI on anything less than a regional basis are largely negative. A state-specific auction within a market as relatively limited in size as is Rhode Island will result in an auction or sale process lacking in liquidity and subject to significant volatility in pricing. From an auction design perspective, this is exactly the opposite of what the RGGI designers intended in crafting a regional auction program. Additionally, a state-specific program could lead to different valuations for allowances in each of the RGGI states, resulting in both confusion and, as noted earlier, price volatility. Broader, transparent and more liquid markets – characteristics of a regional auction process -- are critical to enabling RGGI and the specific RGGI states to meet the goals of reducing greenhouse gases and producing revenues for the beneficial purposes envisioned by Rhode Island and the RGGI member states.

In 47.2 (c): We note that the “*Department may make CO<sub>2</sub> allowances for future control periods available for auction or sale.*” While this language, again, provides optionality and flexibility to the Department in suggesting that both an auction or direct sale of allowances (or both) could be utilized, we strongly urge

the avoidance of any direct sale of allowances that might detract from, or lead to inefficiencies in, a regional auction process.

**Response:** DEM appreciates your concerns; however, RIGL §23-82 gives DEM the authority to sell or auction allowances and the option to use a regional entity. DEM does not believe its regulations should limit the flexibility provided in the statutory authority. No change in the proposed regulations will be made as a result of this comment.

**Comment:** Subsection 47.5(b): *Auctions will be held at least annually and may be held as often as necessary to effectuate the purposes of the CO<sub>2</sub> Budget Trading Program.* Consistent with the Auction Design Elements issued by the RGGI states in March 2008, we strongly recommend that auctions be held at least quarterly or, perhaps, even more often to better coordinate with the regional energy markets implemented by ISO New England.

**Response:** Subsection 47.5(b) requires that auctions be held at least annually and gives the DEM flexibility to hold auctions more often. The DEM plans to auction or sell allowances on a regular basis. However DEM does not believe it prudent to limit flexibility by specifying a schedule for auctions. No change in the proposed regulations will be made as a result of this comment.

**Comment:** Subsection 47.5(c): *Prior to the auction the department or its agent may set a binding reserve price to be accepted for CO<sub>2</sub> allowances in any auction. Such reserve price may or may not be disclosed to the public or prospective bidders.* Consistent with the Auction Design Elements, we strongly recommend disclosure of the binding reserve price to ensure transparency and efficiency in the auction process.

**Response:** The DEM agrees and will disclose a reserve price to the public or prospective bidders. In addition, based on another comment, the Department will set a binding reserve price. Subsection 47.5(c) will be revised in the final regulation as follows:

*47.5(c) Prior to the auction the Department or its agent shall ~~may~~ set a binding reserve price to be accepted for CO<sub>2</sub> allowances in any auction. Such reserve price shall ~~may or may not~~ be disclosed to the public or prospective bidders.*

**Comment:** Subsection 47.5(d): *All unsold allowances of an allocation year will be made available in the succeeding auction of that allowance's allocation year, or control period if its allocation year has ended, in which a reserve price greater than the MRP is in effect. At the end of each control period, the Department may retire any unsold allowances from the concluding control period or offer them in a subsequent auction(s) during the next control period(s) in which a reserve price greater than the MRP is in effect.* FPLE strongly opposes the retirement of unsold allowances. Doing so would have the effect of reducing the cap which was agreed upon among the states in the Memorandum of Understanding. Any consideration

of adjusting the cap should appropriately be made during the review of the program that will be conducted in 2012. Arbitrary adjustments based on temporary market or auction conditions is disruptive and should not be undertaken.

**Response:** In 2012, as part of the first program review envisioned in the December 2005 RGGI MOU, the DEM will decide, along with other the participating states, whether to retire any unsold allowances from the first compliance period, or to offer these allowances for sale in subsequent auctions during the second compliance period. As that decision making process, if needed at all, is over three years away, DEM will make no commitment about retirement at this time.

**Comment:** 47.6(d): *No buyer or combination of buyers may buy more than 25% of the allowances available for sale in any given sale.* We reiterate FPLE's opposition to the sale of allowances, strongly preferring an auction-based process as the most efficient mechanism for determining the correct valuation of allowances. However, should the Department retain the option to sell allowances, we recommend inserting the words "that have related beneficial interests" after the word "buyers" to clarify that the full 100% of available allowances can be sold and that the restriction refers to entities with related beneficial interests.

**Response:** DEM agrees that the language in 47.6(d) should be revised. Section 47.6(d) will be revised in the final regulation as follows:

*47.6(e~~d~~) No buyer or combination of buyers that have related beneficial interest may buy more than 25% of the allowances available for sale in any given sale.*

**Comment:** As stated earlier, FPLE opposes any direct sale of allowances to participants as being anathema to the efficient, transparent functioning of the regional auction process and its associated benefits. With the exception of beneficial set-asides for purposes such as Voluntary Renewable Energy, all allowances should be sold via the auction process.

While the procedures noted in 47.10 are substantively and procedurally sound, they assume the potential incorporation of an allowance sale, which FPLE strongly opposes in favor of an auction format for the reasons stated previously in these comments.

**Response:** As previously stated, DEM does not believe its regulations should limit the flexibility provided in the statutory authority.

**Comment:** FPLE has grave concerns about releasing bid and bidder information (47.11). While releasing the final clearing price is extremely important from a market transparency perspective, there is no beneficial purpose for the market to receive winning bid and bidder information. On the contrary, this information is commercially sensitive and proprietary, and its use by other parties can ultimately

result in manipulation of both the auction and secondary markets. We urge only the release of the final clearing price and quantity of allowances purchased at that price.

Response: DEM agrees. Section 47.12 will be revised in the final regulation as follows:

*47.12 Publication of Results*

*~~The Department or its agent may publish the winning bids and/or allowance sales along with the corresponding dollar amounts of the bids and/or purchase price on the central auction website or Department's website, whichever is appropriate.~~ will publish on the central auction website or the Department's website, whichever is appropriate, the auction clearing price and the number of allowances sold in the auction.*

The following comments were received on June 5, 2008 from Pamela Faggert of Dominion Resources Services, Inc. to Stephen Majkut, of DEM.

**Comment:** Dominion supports a *national, economy-wide* cap and trade program to enhance the overall effectiveness and fairness of climate change regulations. We urge Rhode Island to add language to its regulations which provides for Rhode Island to transition from RGGI to a Federal climate change program. The RGGI Memorandum of Understanding(MOU) supports such a transition. It states: “when a federal program is proposed, the Signatory States will advocate for a federal program that rewards states that are first movers. If such a federal program is adopted, and it is determined to be comparable to this Program, the Signatory States will transition into the federal program.”

Response: If a federal program is implemented, Rhode Island will honor the commitment in the RGGI Memorandum of Understanding regarding implementation of a federal program. DEM is proceeding with plans to implement the Rhode Island CO<sub>2</sub> Budget Trading Program without a sunset provision.

**Comment:** Rhode Island should adopt a stronger cost certainty mechanism, such as a CO<sub>2</sub> alternative compliance payment (ACP) mechanism, similar to that found under the Rhode Island Renewable Portfolio Standard (RPS). A large majority of the states that have adopted RPSs have an ACP mechanism that retail entities can employ to ensure compliance and cap the financial impact to their consumers.

The *cost* of RGGI allowances could easily exceed the RGGI predicted allowance price estimates of \$1.60-\$5.40. RGGI, Inc. has announced that the first reserve price will be set at \$1.86. The reserve prices in subsequent auctions will be set by *the higher of* \$1.86 per allowance, as adjusted annually from 2009 onward based on the Consumer Price Index, or 80-percent of the current market price of the particular RGGI allowance vintage being auctioned. Given the high potential for allowance price volatility, particularly in the early auctions of any cap-and-trade

program, it is quite possible that that the *reserve price itself could end up being several times higher than the current RGGI predicted allowance price estimates.*

A high-priced carbon adder on wholesale electric prices could significantly impact retail prices, even in a deregulated market. It is important that Rhode Island consider price cap mechanisms in order to protect the health, safety and economic welfare of the public.

**Response:** Similar to that stated above, the current program as proposed, does not include alternative compliance payments. Certainty about compliance obligations is a necessary component of the market-based system that will be created by the CO<sub>2</sub> Budget Trading Program. Conversely, uncertainty that would be caused by an opt-out provision would reduce incentive to plan for future emissions reductions and potentially result in less emission reductions. Furthermore, the regulations include a number of provisions designed to limit price impacts, including an expansion of the use of CO<sub>2</sub> offset allowances in the event that certain price triggers are exceeded. The ability to use more CO<sub>2</sub> offset allowances for compliance should increase the supply of CO<sub>2</sub> allowances available for the CO<sub>2</sub> Budget Trading Program (offset allowances are issued in addition to those allowances the state CO<sub>2</sub> budget), lowering allowance prices, and the cost of compliance. Therefore, DEM will finalize the proposed regulation without any additional components that would allow for alternative compliance payments.

**Comment:** Under the current auction proposal, we continue to have serious concerns about the potential adverse impacts to electric system reliability, consumers and the state's economy.

An alternative auction policy issue that the Department should consider is to provide Rhode Island generators the "right of first refusal" in an auction for Rhode Island's share of allowances. In this way, Rhode Island generators can be assured that they would be able to procure at least a portion of their compliance obligations. This is especially critical in view of the actual volume of allowances proposed for direct sale from the Department.

**Response:** RIGL §23-82-5(b) states that "any sale of allowances must be public, competitive and open to all who wish to participate". DEM has no authority to offer Rhode Island generators, or any other group, any exclusivity in the sale of allowances.

**Comment:** The Department is proposing that all unsold allowances of an allocation year be made available in the succeeding auction of that allowance's allocation year, or control period "if its allocation year has ended, in which a reserve price greater than the Minimum Reserve Price (MRP) in effect." Additionally, the Department is proposing that at "the end of each control period, the Department may retire any unsold allowances from the concluding control period or offer them in a subsequent auction(s) during the next control period(s) in which a reserve price greater than the MRP is in effect." Dominion advocates that all unsold allowances be returned to the next auction or sale pool. We strongly oppose policies which restrict allowance volumes. Policies such as these likely will

contribute to greater allowance market risk, which in turn will lead to higher allowance prices, market volatility, hoarding and potential reliability issues. Therefore, Dominion requests the following language changes to 47.5(d):

(d) All unsold allowances of an allocation year will be made available in the succeeding auction of that allowance's allocation year, or control period if its allocation year has ended.

**Response:** As stated above, in 2012, as part of the first program review envisioned in the December 2005 RGGI MOU, the DEM plans to decide, along with other the participating states whether to retire any unsold allowances from the first compliance period, or to offer these allowances for sale in subsequent auctions during the second compliance period. As that decision making process, if needed at all, is over three years away, DEM will make no commitment about retirement of allowances at this time.

**Comment:** Rhode Island passed legislation 2007-H 5577 Substitute A on July 2, 2007 that states auction and sale of allowances will be open to all market participants.

#### 23-82-5.Sale of Allowances

“(b) The department’s regulations shall specify the mechanism for sale of allowances, including the state to make use of any voluntary regional organizations, structures or mechanisms available to states implementing a program of this type, provided that any sale of allowance must be public, competitive and **open to all who wish to participate.**”

The document states that participants will have to meet certain criteria for the initial auction and that the flexibility will be retained to limit participation in subsequent auctions. Therefore, if and when RGGI decides to limit the auction to a specific group, this may preclude Rhode Island from participating in the regional auction.

*Design Elements for Regional Allowance Auctions under the Regional Greenhouse Gas Initiative* released on March 17, 2008

#### “Participation:

All market participants will be eligible to participate in the initial auction, provided they meet applicable qualification requirements, which will include provision of financial security. Flexibility will be retained to limit participant eligibility in subsequent auctions. Auction rules will establish a total limit for the number of allowances that entities (e.g., an organization and its affiliates and/or agents) may purchase in a single auction, equivalent to 25-percent of the allowances offered for sale in any single auction.”

Therefore, Dominion requests that the Department work with the legislature to amend the statutory language to provide the Department with

discretion to require financial surety for auction participants and the flexibility to limit participation in auctions to generators, particularly if price spikes and reliability issues occur.

**Response:** DEM is proceeding with its plans to implement the Rhode Island CO<sub>2</sub> Budget Trading Program and CO<sub>2</sub> Budget Allowance Distribution regulations as authorized and required by the RIGL §23-82. The flexibility relative to the auction and sale included in the statute allows DEM to conduct a sale or auction of allowances if Rhode Island cannot participate in a closed regional auction. The DEM agrees that it is reasonable to require financial surety, and the regulation contains that requirement. DEM cannot commit at this time to support or oppose legislation to change the RGGI authorizing statute.

**Comment:** Utilizing a reserve price in the auctions disrupts the effectiveness of the market by setting an artificial bottom price. To the extent that the reserve price does not allow the price to fall to a level normally achieved in a market-based system, it will drive up costs to generators which, in turn, will be reflected in consumer prices. We request the re-evaluation of using a reserve price and urge that one not be used.

To the extent a reserve price is utilized, one that is escalated at 80% of market price in the second and subsequent auctions is problematic for several reasons. First, as demonstrated from previous cap and trade programs, initial buying to build compliance inventories provides excess demand and inflates prices. This effect is seen already in early pre-RGGI trading (announced trades are in the \$7+/ton range).

Secondly, environmental markets have a unique property in that they have no viable substitutes for compliance buyers to purchase, leaving the market susceptible to upward pressure and/or manipulation. In Treasury bond or stock markets, if the price of a specific bond or stock becomes too expensive, there are thousands of assets that are close substitutes. Buyers will purchase the cheaper substitutes relieving buying pressure on the overpriced asset. Under RGGI, the only option to compliance buyers are offsets that are limited in to 3.3% of total compliance and require significant time and resources before they would qualify and enter the market to satisfy demand.

Third, the interplay between a reserve price set at 80% of market and how unsold allowance are managed could result in scenarios that significantly extend what would have otherwise been a temporary price spike caused by market factors or manipulation. A short-term price spike could cause an abnormally high auction reserve price. Compliance buyers would either pay the high reserve price (causing increased power prices to pool) or the auction would be under-subscribed, reducing the volume of allowances in the market, thereby keeping prices high for the next auction.

As stated in the RGGI Final Auction Report:

*“A reserve price is an auction price below which the seller chooses to retain ownership of the item rather than sell it. The most obvious use of a reserve price is to prevent the item from being sold at a price below the seller’s opportunity cost.”<sup>6</sup>”*

If reserve prices are part of the auction design, they should not introduce uncertainty into the process. Reserve prices should be: stable to allow for planning, not interfere in the workings of the market and set at a level below which the program would be deemed unsuccessful.

**Response:** Rhode Island's decision to propose the use of a reserve price was based on extensive analysis by the auction design research team with stakeholder input. DEM concluded that the reserve price protects against the possibility of collusion and provides a price signal that supports a minimum rate of investment in technologies and strategies that reduce CO<sub>2</sub> emissions. DEM agrees with the comment that reserve prices should be stable to allow for planning, not interfere in the workings of the market and be set at a level below which the program would be deemed unsuccessful.

**Comment:** The state intends to conduct a direct ‘sale’ of allowances, as provided for in Rhode Island law. The details of the sales program should be specified in the proposed Rhode Island RGGI regulations. Specifically, the program design questions such as those that follow should be answered: who will be allowed to purchase; what will happen if there are more buyers than available allowances; how will the price be determined; and how will the direct sale, at a price determined by the state, affect the 12-month average market price that is used in determining when a Trigger Event has occurred?

**Response:** If DEM conducts a sale of allowances it will be open to all who wish to participate, a random process tie breaker will be used if there are more buyers than available allowances (as indicated above) and there will be a reserve price determined by the state so as not to conflict with the regional auction. Any other specifics will be included in the notice of the sale. There is no reason why the allowance sale prices in Rhode Island should be excluded from all allowances in calculating the twelve (12)-month average market price used to determine trigger events.

**Comment:** Auctions need to be held as early as possible and certainly prior to 2009 to provide business certainty so that wholesale electric market offers and commitments – both short and long term - can take into account CO<sub>2</sub> allowance costs with reasonable price certainty. Holding auctions early and covering longer

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<sup>6</sup> Holt, Charles; William, Shobe; Burtraw, Dallas; Palmer, Karen; Goeree, Jacob Auction Design for Selling CO<sub>2</sub> Emission Allowances Under the Regional Greenhouse Gas Initiative,” Final Report (October 2007), p. 55.  
[http://www.rggi.org/docs/rggi\\_auction\\_final.pdf](http://www.rggi.org/docs/rggi_auction_final.pdf)

periods of compliance needs (large auctions) are preferable and aid in prudent business planning and decision making for both suppliers and consumers. We request that the Department publicly commit to participate in the first RGGI regional auction on September 17, 2008 [*Note that the date of the regional auction is set as September 10, 2008*] and in all subsequent regional auctions.

We commend the Department for proposing to codify that Rhode Island is compelled to distribute their 2009, 2010, 2011 and 2012 allowances on or before January 1, 2009 to the Rhode Island Auction/Sale account.

**Response:** DEM intends to participate in the first regional auction on September 10, 2008. DEM is unable to commit to any future regional auctions at this time. As stated above, DEM does not believe its regulations should limit the flexibility provided in the statutory authority.

**Comment:** Similar to the recently re-promulgated proposed New York RGGI regulations, the Department should consider adding the following elements to the Rhode Island RGGI regulations:

- The Department shall maintain a calendar of anticipated auction dates on the Regional or Rhode Island CO<sub>2</sub> Allowance Auction Website.
- The calendar shall indicate the auction format and the number of allowances and allocation years of allowances to be auctioned at each auction.
- The Department may periodically revise the calendar, provided that the information relevant to the next scheduled CO<sub>2</sub> Allowance Auction shall be fixed no later than 45 calendar days prior to such auction.
- The calendar should include the dates of *at least* the next four (4) CO<sub>2</sub> Allowance Auctions and may also include the anticipated number of allowances to be auctioned at each Auction. The Department may periodically modify the anticipated dates of Auctions listed on such calendar.
- Upon payment in full by successful bidders, the Department shall transfer or have transferred the corresponding CO<sub>2</sub> Allowances to each successful bidder's applicable compliance or general account.
- Within 10 days of the transfer of CO<sub>2</sub> Allowances, the Department shall publish on the CO<sub>2</sub> Allowance Auction Website the auction clearing price and the total amount of Allowances sold in such Auction.

The Department should consider adding these aspects to their regulations in order to provide mechanisms for market transparency and market certainty both of which contribute to market liquidity.

**Response:** Participating states have set the dates of the first two (2) regional auctions as September 10, 2008 and December 17, 2008. DEM chooses to not include such language in its regulation since it is not regulatory in nature. Furthermore, the Notice of Auction and Sale will be published on the central auction website and/or DEM's website no later than forty five (45) days prior to each auction/sale and will include the auction/sale format and the quantity of allowances offered for

sale. Section 47.11 of APC Regulation No. 47 contains provisions for the transfer of CO<sub>2</sub> allowances. Based on a previous comment Section 47.12 of APC Regulation No. 47 will be revised in the final regulation as follows:

*47.12 Publication of Results*

*The Department or its agent ~~may publish the winning bids and/or allowance sales along with the corresponding dollar amounts of the bids and/or purchase price on the central auction website or Department's website, whichever is appropriate.~~ will publish on the central auction website or the Department's website, whichever is appropriate, the auction clearing price and the number of allowances sold in the auction.*

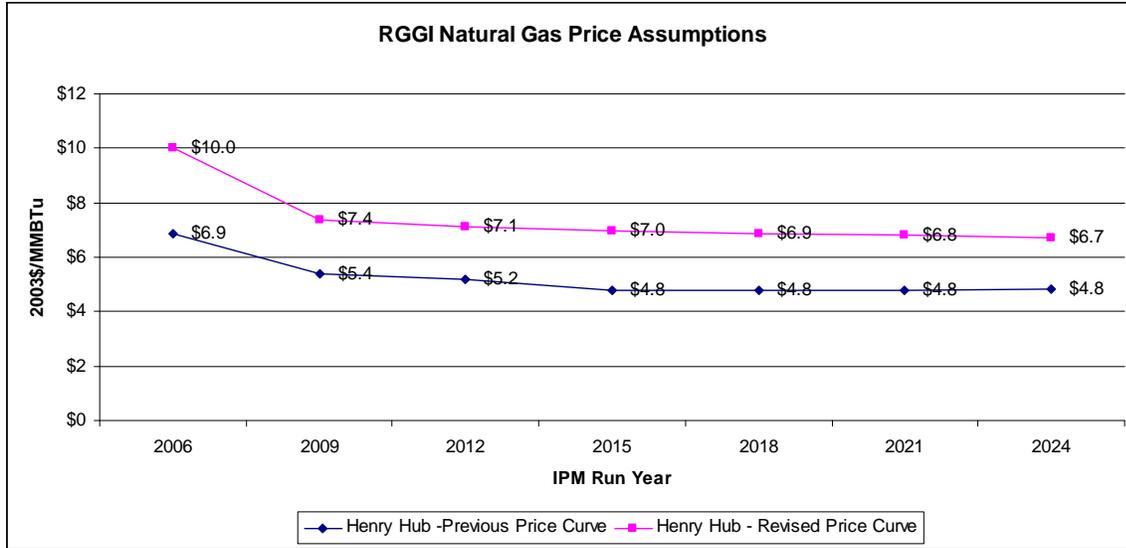
**Comment:** The Massachusetts Division of Energy Resources' (DOER's) 2005 REMI modeling analyses, which Rhode Island policymakers have relied upon to evaluate the economic impacts of RGGI, are now outdated. The IPM modeling results from late 2006 show two additional IPM modeling runs<sup>7</sup> which are meant to reflect the final RGGI Model Rule of August 2006. These are the runs that the RGGI staff working group holds as the most likely scenario for the reference case and RGGI scenario – the so called “package case” runs. The following assumptions were revised in the new IPM modeling:

1. electricity demand forecasts were updated based on revised ISO information,
2. offset cost curves were updated,
3. natural gas prices were revised, and
4. the new build assumptions were revised to include the addition of an IGCC coal plant (in 2015 in New York State) that captures and sequesters approximately 50% of its CO<sub>2</sub> emissions.

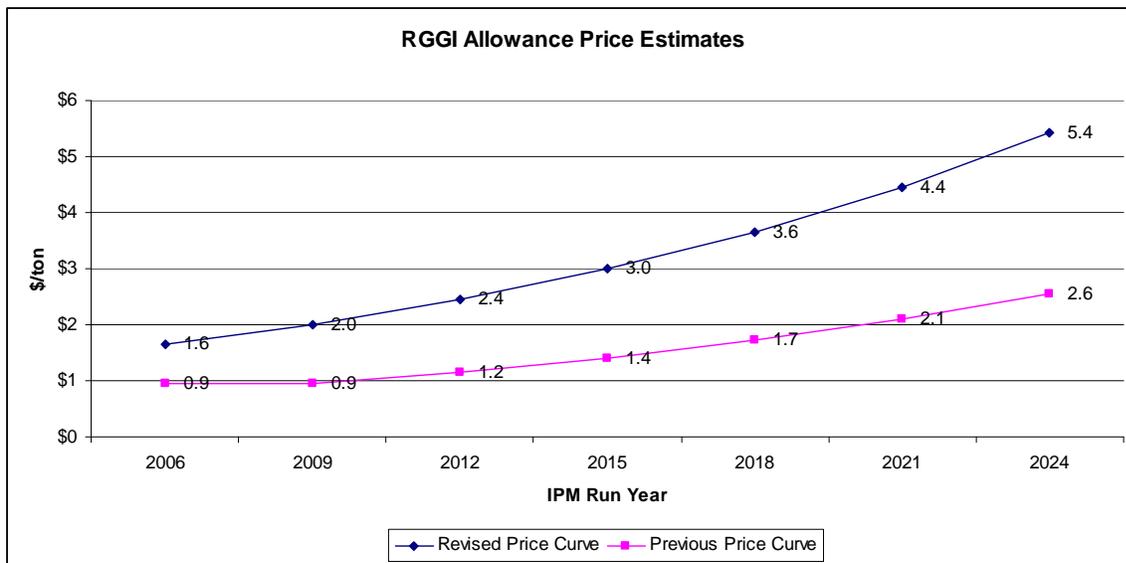
The natural gas price assumptions were updated to reflect the higher price trends in the market at that time, recognizing that actual natural gas prices are even higher today. The chart below illustrates the difference between the previous natural gas price assumptions and the revised assumptions used in these updated runs. As you can see, the natural gas prices for 2008 are predicted to be approximately \$8.25/MMBTU in 2003 dollars versus the previous forecast of \$6.00/MMBTU, or an increase of nearly 38%.

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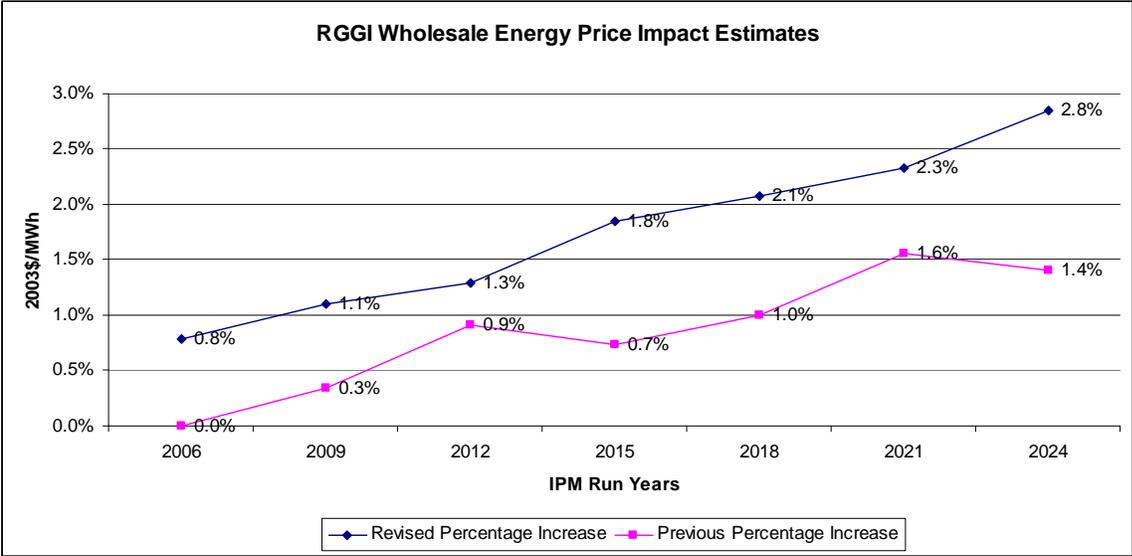
<sup>7</sup> See [http://rggi.org/docs/referencecase\\_10\\_11\\_06.xls](http://rggi.org/docs/referencecase_10_11_06.xls) and [http://rggi.org/docs/packagescenario\\_10\\_11\\_06.xls](http://rggi.org/docs/packagescenario_10_11_06.xls)



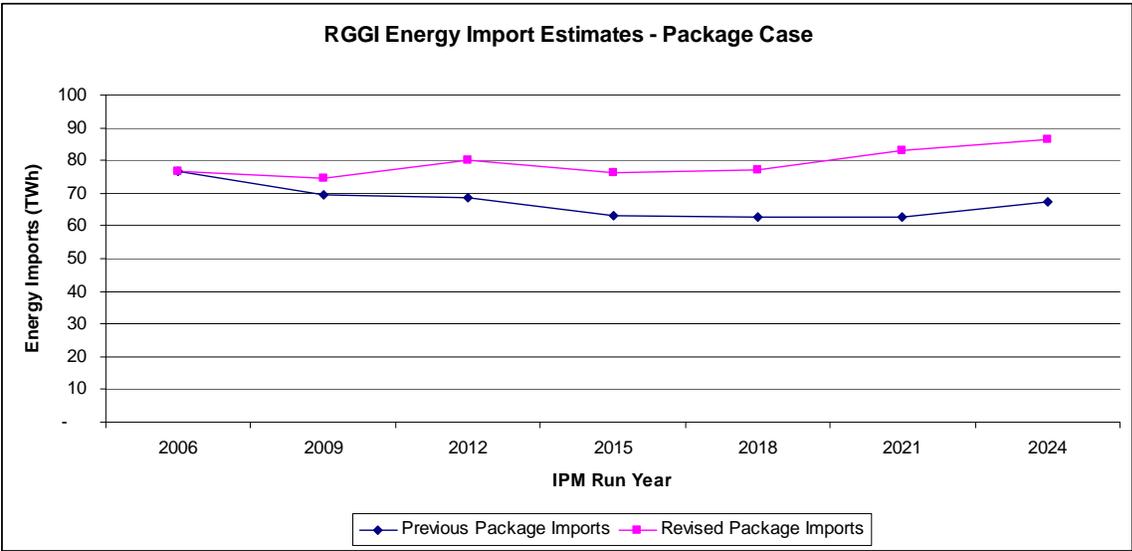
The net effect of the aforementioned increase in the gas price forecast was that the projected RGGI allowance prices were higher than previously predicted. For example, while the range of CO<sub>2</sub> allowance prices in RGGI under the previous modeling was projected to be **\$0.90-\$2.60** from 2010-2020, the new range of **\$1.60-\$5.40** means that CO<sub>2</sub> allowances price estimates have doubled since the first REMI modeling analysis by DOER. The chart below illustrates the differences between the previous and revised allowance price curves.



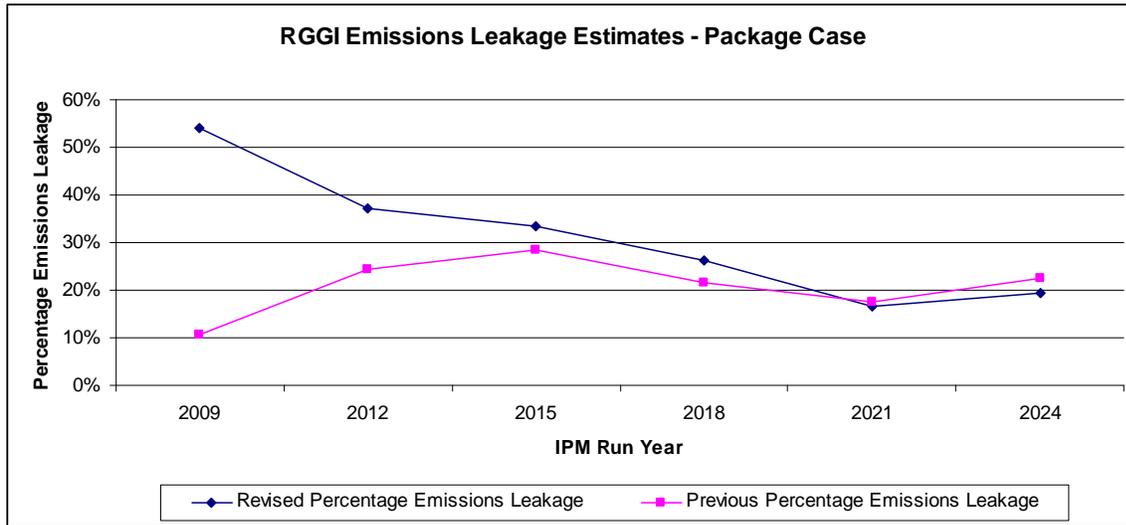
Based on the revised RGGI allowance price curve, the new modeling estimates a doubling of the annual percentage increase in forecasted wholesale electric prices. (See the chart below.)



In turn, the quantity of electricity imported into the RGGI region is also projected to increase in connection with the wholesale price increase as indicated in the chart below.



Correspondingly, forecasted CO2 emissions leakage increases above the previous estimate as indicated in the chart below.



To better understand the impact to consumers, RGGI Inc. should re-run the 2006 IPM Model with updated fuel pricing assumptions and, using those results, re-run the REMI model to show today's expected *retail electric price impacts* for commercial, industrial and residential consumers. If possible, these price impacts should be broken down on a state-by-state basis so Rhode Island predicted price impacts due to RGGI implementation are clearly understood.

Response: It is assumed that information provided by the previous IPM and REMI modeling was considered by the Rhode Island General Assembly when deciding whether or not to enact legislation directing DEM to participate in RGGI. Although newer analysis is always useful, new analysis is not determinate, since existing law directs DEM to participate in RGGI. Nonetheless, the proposed regulations include a number of provisions designed to limit price impacts. These provisions include three (3)-year compliance periods that mitigate impacts of year-to-year variation in weather and economic activity, and offset provisions that allow for limited compliance through off-sector emission reductions. In the event that prices exceed specified triggers, compliance periods will be expanded to four (4) years and the expanded use of offsets will be allowed as described above.

DEM is proceeding with plans to implement the Rhode Island CO<sub>2</sub> Budget Trading Program and intends to proceed with its regulations at this time. DEM anticipates that in 2012, as part of the first program review envisioned in the December 2005 RGGI MOU, additional economic modeling may be performed.

**Comment:** We observe that state implementation of the RGGI Model Rule *can be modified* since the MOU is not a legally binding document. Therefore, Rhode Island can implement flexibility mechanisms to the extent it sees fit to accommodate Rhode Island's needs and protect consumers. We request the Department consider incorporating the following flexibility mechanisms into the Rhode Island RGGI rules:

- Eliminate the provision in the current RGGI model rule that restricts the use of offsets to only 3.3% of a source's total emissions.
- Eliminate the 14-month market settling period required to trigger the expanded use of offsets.
- Eliminate trigger resets; once an offset trigger is invoked, the subsequent flexibility mechanism should remain in place.
- Eliminate allowances set aside for voluntary purchase of renewables.
- Provide credit for unit curtailments or shutdowns, even for those in another state.
- Modify the biomass definition in Rhode Island's RGGI rules to allow alternative, lower emitting fuels to be factored into a facility's compliance obligation.

**Response:** Although the MOU is not a legally binding document, each signatory state commits to propose a program substantially as reflected in the model rule that will reflect the understandings and commitments of the participating states. DEM believes the first four (4) specific recommendations made in this comment and the recommendation concerning the biomass definition are essential elements of the design of the Rhode Island CO<sub>2</sub> Budget Trading Program and RGGI. Therefore DEM will not make any changes to the proposed regulations to accommodate those recommendations. The recommendation to provide credit for unit curtailments or shutdowns is contrary to the basic structure of a cap and trade program, where the regulated community determines how the cap is achieved, and is contrary to the direction in RIGL §23-82 to sell almost one hundred percent (100%) of Rhode Island's CO<sub>2</sub> allowances. No changes to the proposed regulations will be made as a result of this comment.

**Comment:** We encourage the Department to carefully review the excess emission definition since the concept of '*CO<sub>2</sub> budget emissions limitation*' is not relevant under the RGGI program as proposed. Sources can only have excess emissions if they do not purchase enough allowances and/or offsets to cover their emissions. We suggest the following changes (in bold and strikeout) in Rhode Island's version of the RGGI regulations:

46.1.59 “Excess emissions” means any tonnage of CO<sub>2</sub> emitted by a CO<sub>2</sub> budget source, **accounting for eligible biomass fired**, during a control period that exceeds the **CO<sub>2</sub> source’s compliance account balance of allowances or offsets**. ~~budget emissions limitation for the source.~~

Response: In Regulation No. 46, “CO<sub>2</sub> budget emissions limitation” means for a CO<sub>2</sub> budget source, the tonnage equivalent, in CO<sub>2</sub> emissions in a control period, of the CO<sub>2</sub> allowances available for compliance deduction for the budget source for a control period. Therefore the definition of “excess emissions” as written is appropriate.

**Comment:** The Department may want to consider allocating the dollars collected from the auctions to specific localities. For example, the cities or communities that host the facilities subject to these rules should preferentially benefit from the RGGI auction dollars so that offset projects – like converting fleets of school busses or energy efficiency projects in public buildings, are pursued in those communities first; before considering spending those dollars somewhere else. This contributes to easing the energy costs burdens for these Rhode Island communities, while not affecting the overall cost of compliance for the facilities.

Response: RIGL §23-82-6 specifies use of the auction or sale proceeds. The use of auction proceeds is not within the purview of these proposed regulations and is not subject to DEM’s discretion. The proceeds from the auction or sale of the allowances must be used for the benefit of energy consumers through investment in the most cost-effective available projects that can reduce long-term consumer energy demands and costs.

The following comments were received on June 5, 2008 from Northeast Regional Greenhouse Gas Coalition to Stephen Majkut, of DEM.

**Comment:** The proposed APC Regulation No. 46 indicates that RI DEM is proposing to auction nearly 100% of its CO<sub>2</sub> allowances. The GHG Coalition is concerned with the emerging trend in the RGGI states in support of a 100% auction of the state’s RGGI CO<sub>2</sub> emissions budget. The regional CO<sub>2</sub> cap is the driver of the greenhouse gas emission reduction benefits of RGGI not the auctioning of allowances.

The GHG Coalition does not support a 100% auction, particularly at the start of the RGGI program in 2009 and especially if non-CO<sub>2</sub> Budget Sources are allowed to participate in the auctions as well. The GHG Coalition does not support a 100% auction for the following reasons:

1. The impacts on allowance prices and electricity markets are unknown;
2. Participation in the auction by non-CO<sub>2</sub> Budget Sources will likely increase uncertainty for CO<sub>2</sub> Budget Sources and increase allowance prices;

3. CO<sub>2</sub> Budget Sources would operate under increased uncertainty;
4. CO<sub>2</sub> Budget Sources in Rhode Island covered by the RGGI Program would be competitively disadvantaged; and
5. The financial impacts of the RGGI program on companies are potentially greatest under a 100% auction.

As an alternative, the GHG Coalition recommends phasing in the auction coupled with direct allocation to existing and new CO<sub>2</sub> Budget Sources. The allocation of allowances should be based upon a State defined allowance allocation methodology. A slow transition to a substantial auction would permit the auction design to be adjusted if any problems arise.

First, the auction should start at a percentage well below 100% in the First Compliance Period (2009-2011). The auction could then increase by a specified percentage in subsequent compliance periods. This phase-in should only occur if the comprehensive program review that the RGGI states agreed to in the RGGI MOU concludes that such a phase-in is warranted and would not have adverse impacts. This phased auction approach has several advantages including:

- gives a greater probability that allowance prices will be moderate, while at the same time not adversely affecting the regional electricity markets;
- provides a transitional path to implement allowance auctions into cap and trade programs and provides business certainty to CO<sub>2</sub> Budget Sources;
- provides at least a portion of the allowance value to the companies (through direct allocation), and can reduce the potential increases in electricity imports into the RGGI region; and
- is more realistic and easier to manage for all stakeholders if the auction design isn't "right".

Second, the auction should only be open to CO<sub>2</sub> Budget Sources or their agents, particularly in the First Compliance Period, to prevent undue market speculation at this early stage. Non-CO<sub>2</sub> Budget Sources could participate in the secondary market as well as auctions for future vintage allowances from 2012 onward. This will provide a transition to the significant RGGI auction for the CO<sub>2</sub> Budget Sources.

Third, the remaining allowances should be "allocated" to CO<sub>2</sub> Budget Sources based upon a State-defined allowance allocation methodology.

Response: The proposed regulations were written in accordance with RIGL §23-82 which directs that DEM will auction or sell one hundred percent (100%) of its CO<sub>2</sub> allowances and that the auctions/sales must be open to all who wish to participate. There are no provisions in §23-82 to allocate allowances to new or existing sources or to close the auction to CO<sub>2</sub> budget sources.

**Comment:** It is critically important that market participants be made aware of the auction schedule well in advance of the auction and for the auctions planned over the compliance period. The information should include the amount of allowances to be auctioned. For example, the final RGGI auction recommendation report included a recommended schedule for the allowance auctions, including the percentage of a given vintage offered for sale at any one auction.

While the GHG Coalition understands that Rhode Island is working on auction details for the regional auction, auction participants are also preparing for the start of the RGGI program. Auction participants will be required to mobilize significant cash outlays in order to participate in the auction and, for covered sources, to meet compliance obligations. These efforts also require extensive planning and approvals typically with a long-term view.

At present, an anticipated draft schedule (timing and allowance amounts) would be beneficial for business and compliance planning purposes and we urge Rhode Island and the RGGI States to establish a firm schedule for the first compliance period as soon as possible.

RI DEM should consider adding language in the rule that is similar to the New York State Energy Research and Development Authority's recent revised proposed rule. Similar language should include the following:

- RI DEM shall maintain a calendar of anticipated auction dates on the CO<sub>2</sub> Allowance Auction Website.
- The calendar shall indicate the auction format and the number of allowances and allocation years of allowances to be auctioned at each auction.
- RI DEM may periodically revise the calendar, provided that the information relevant to the next scheduled CO<sub>2</sub> Allowance Auction shall be fixed no later than 45 calendar days prior to such auction.
- The calendar shall include the dates of at least the next four CO<sub>2</sub> Allowance Auctions and may also include the anticipated number of allowances to be auctioned at each Auction. RI DEM may periodically modify the anticipated dates of Auctions listed on such calendar.

The GHG Coalition emphasizes that any revisions to the auction calendar should only be made with considerable care for the market. The importance of giving the market some certainty even if it's only in the form of the schedule (timing and allowance amounts) should not be underestimated.

**Response:** Participating states have set the dates of the first two regional auctions as September 10, 2008 and December 17, 2008. DEM chooses not to include the dates of auctions in its proposed regulation since it is not regulatory in nature. Furthermore, the Notice of Auction and Sale will be published on the central auction website and/or the DEM's website no later than forty five (45) days prior

to each auction/sale and will include the auction/sale format and the quantity of allowances offered for sale.

**Comment:** The GHG Coalition believes the 1,000-allowance lot size for the auction is reasonable. Furthermore, the single round, sealed bid, uniform price auction method seems reasonable as well. The GHG Coalition appreciates the signal that the RGGI States are open to alternative auction methods as the RGGI allowance market emerges and changes over time. However, it would be beneficial for the RGGI States to identify how such a decision would be made and how much input stakeholders will have in that process.

Furthermore, in light of the decision to have an open auction to all entities in all states that can financially qualify; the GHG Coalition supports the 25% limitation and finds it to be reasonable.

**Response:** DEM is open to alternative auction methods as the RGGI allowance market emerges and changes over time; however, these alternatives will not be identified at this time.

**Comment:** The GHG Coalition agrees with the methodology utilized by the RGGI states to identify the reserve price for the first RGGI auction.

However, basing the reserve price on the market price for subsequent auctions is problematic (especially at the outset of the program) for several reasons. First, as demonstrated from previous cap and trade programs, and early RGGI trading (announced trades are in the \$7/ton range), allowance prices at the outset of the program are often higher than expected as the market assimilates fundamentals into the price discovery process. Therefore, basing the reserve price on the higher allowance prices that may materialize at the outset could artificially escalate the price of RGGI allowances. Second, it is very likely that CO<sub>2</sub> Budget Sources will try to obtain as many allowances as possible in the early auctions in order to build an allowance account that will put them within reach of their compliance obligations. Therefore, there may be limited trading activity in the first few years of the program due to this dynamic. As a result, the market price will likely be set by a few transactions that may not be representative of the market.

As an alternative to basing the reserve price for subsequent auctions on 80 percent of the market price, the GHG Coalition recommends that the RGGI states consider using a similar methodology as the Stage 1 trigger event, which uses a 14 month market settling period. For example, if RGGI applied the same market settling period approach to the reserve price, RGGI could escalate the \$1.86 reserve price used in the first auction (by some percentage plus CPI) for the first 14 months of the compliance period (which would span the first seven auctions). After this “settling period” the reserve price could then transition to 80 percent of the market price.

The GHG Coalition appreciates that the Design Elements include the following sentence, “A reserve price based on the current market price will only be used if

RGGI states determine that there are sufficient, reliable market data available to establish a valid current market price.” However, the methodology that will be utilized and how this determination will be made should be explained further.

**Response:** DEM believes the proposed method to set a reserve price is prudent. Rhode Island's decision to propose the use of a reserve price was based on extensive analysis by the auction research team with stakeholder input. A reserve price protects against the possibility of collusion and provides a price signal that supports a minimum rate of investment in technologies and strategies that reduce CO<sub>2</sub> emissions. Rhode Island and other participating states have not fully defined the methodology that will be utilized to establish a valid market price, although Rhode Island and other participating states have stated they will not use a reserve price based on the current market price if there is insufficient or unreliable market data.

**Comment:** The ME DEP RGGI regulations provide the authority to the DEP Commissioner to waive or suspend compliance obligations for CO<sub>2</sub> Budget Sources if there are high allowance prices or if issues not under the control of the Budget Source occur. The GHG Coalition encourages RI DEM to review this proposed regulation (*Chapter 157, CO<sub>2</sub> Budget Trading Program Waiver and Suspension*) and add similar provisions in the RGGI APC regulations.

**Response:** As stated above, in response to comments about alternative compliance mechanisms, certainty about compliance obligations is a necessary component of the market-based system that will be created by the CO<sub>2</sub> Budget Trading Program. Conversely, uncertainty that would be caused by an opt-out provision would decrease incentive to plan for future emissions reductions and result in less emission reductions. Furthermore, the regulations include a number of provisions designed to limit price impacts including an expansion of the use of CO<sub>2</sub> offset allowances in the event that certain price triggers are exceeded. Expanded use of CO<sub>2</sub> offset allowances should increase the supply of CO<sub>2</sub> allowances available for the CO<sub>2</sub> Budget Trading Program (offset allowances are issued in addition to those allowances allocated to each state), lowering allowance prices, and the cost of compliance. Therefore, DEM is finalizing the proposed regulation without any additional components that would allow for waiver or suspension of compliance obligations.

The following comments were received on 5 June 2008 from Cynthia Giles, Conservation Law Foundation to Director W. Michael Sullivan, of DEM.

**Comment:** Although Rhode Island’s RGGI statute does allow for state auction or sale, in the interest of regional uniformity and cost-efficiency for the sale of allowances, CLF urges Rhode Island to participate in the regional auctions. Including all allowances in the regional auction promotes market stability and consistency among participating states, which will most effectively create market certainty and thus do the most to promote the ultimate goal of RGGI, which is cost - effective reduction of greenhouse gas emissions.

If DEM elects instead to hold a state auction or sale, the regulations should assure that the same objectives are achieved as would occur in a regional auction.

*State auction.* The regional auction will include a reserve price, for the many good and valid reasons outlined in the state auction plan, including the possibility that allowances have been over allocated. A state auction should also require the establishment of a reserve price, so that a state auction does not become a loophole in the regional market structure and does not undermine the purposes for which a regional auction was established. The reserve price set by the Department prior to a state auction should certainly be no lower than the reserve price at a regional auction. We therefore suggest the following changes to §47.5(c):

#### 47.5 Frequency and Quantity of CO<sub>2</sub> Allowances Offered for Auction

(c) Prior to the auction the Department or its agent ~~shall~~ may set a binding reserve price to be accepted for CO<sub>2</sub> allowances in any auction, which reserve price shall be the higher of the minimum reserve price and the current market reserve price. Such reserve price may or may not be disclosed to the public or prospective bidders.

**Response:** Section 47.5, Frequency and Quantity of CO<sub>2</sub> Allowances Offered for Auction, establishes the criteria for a regional auction or a state auction. Should DEM conduct a Rhode Island auction, it would follow the procedures outlined in this section. Reserve price is defined in the regulation so as not to be less than a regional reserve price, and therefore, does not need to be added to this condition. DEM agrees with your comment to change "may" to "shall" in subsection 47.5(c). In addition, based on a response to a previous comment, the reserve price shall be disclosed to the public or prospective bidders. The condition in the final regulation will be revised as follows:

*47.5(c) Prior to the auction the Department or its agent ~~may~~ shall set a binding reserve price to be accepted for CO<sub>2</sub> allowances in any auction. Such reserve price ~~may or may not~~ shall be disclosed to the public or prospective bidders.*

**Comment:** We appreciate that the regulations do provide that unsold allowances may be retired, and urge the Department to retire unsold allowances, so that the RGGI program achieves its fundamental purpose of reducing emissions.

**Response:** In 2012, as part of the first program review envisioned in the December 2005 RGGI Memorandum of Understanding, the DEM will decide, along with the other participating states, whether to retire any unsold allowances from the first compliance period, or to offer these allowances for sale in subsequent auctions during the second compliance period. As that decision making process is over three (3) years away, and may not be necessary, DEM will make no commitment about retirement at this time.

**Comment:** *State sale.* As previously stated, we recommend that Rhode Island participate in the regional auction. Should DEM instead decide to conduct a state sale, it is important that such sale at a minimum not undermine the regional auction or the purposes for which RGGI was established. Therefore, it is essential that any state sale have a fixed minimum price that is at least equal to the current market reserve price of the regional auction. For the same reasons that retiring unsold allowances from an auction advances the purposes of RGGI, we recommend that unsold allowances from a sale also be retired, and that DEM at least retain authority to do so. For these reasons we recommend the following changes to section 47.6 of the draft regulations:

47.6 Frequency and Quantity of CO<sub>2</sub> Allowances Offered for Sale

(c) Prior to each sale the Department or its agent shall set a price for allowances to be sold in the sale, which price shall be no lower than the reserve price at the prior regional auction.

(ed) Any CO<sub>2</sub> allowances left unsold in any sale may be made available for distribution in a subsequent sale, in quantities and in a manner determined by the Department. At the end of each control period, the Department may retire any unsold allowances.

**Response:** DEM agrees with your comments and will revise the language in section 47.6 in the final regulation as follows:

47.6 *Frequency and Quantity of CO<sub>2</sub> Allowances Offered for Sale*

(a) *The initial sale shall be conducted at such time and manner as determined by the Department.*

(b) *Sales will be held at least annually and may be held as often as necessary to effectuate the purposes of the CO<sub>2</sub> Budget Trading Program.*

(c) *Prior to each sale the Department or its agent shall set a price for allowances to be sold in the sale, which price shall be no lower than the reserve price at the prior multi-state auction.*

(d) *Any CO<sub>2</sub> allowances left unsold in any sale may be made available for distribution in a subsequent sale, in quantities and in a manner determined by the Department. At the end of each control period, the Department may retire any unsold allowances from the concluding control period.*

(e) *No buyer or combination of buyers that have related beneficial interest may buy more than 25% of the allowances available for sale in any given sale.*

(f) *The Department or its agent shall make CO<sub>2</sub> allowances available for sale in lot sizes of 1,000 allowances, except*

(1) *where available supply requires a smaller lot size, and*

(2) *when the procedure outlined in subsection 47.10(b) is used.*

**Comment:** Section 46.13.4(d)(1); concerning offsets for energy conservation measures, appears to inappropriately restrict eligible projects. Instead of allowing reductions in fossil fuel consumption through use of renewable energy, as provided in the Model Rule, DEM's rule restricts such reductions to use of solar and geothermal energy. There does not appear to be a good reason to restrict this provision, so CLF would recommend the following change to 46.13.4(d)(1)(a)(i):

Improvements in the energy efficiency of combustion equipment that provide space heating and hot water, including a reduction in fossil fuel consumption through the use of ~~solar and geothermal~~ renewable energy as defined in 39-26-5;

**Response:** This condition was changed from that in the Model Rule to be clear that the only kinds of renewable energy that apply to space heating and hot water are solar and geothermal energy. Other types of renewable energy, such as wind, biomass or hydroelectric, cannot be used to improve the energy efficiency of combustion equipment that provide space heating and hot water.

**Comment:** An essential part of establishing the market and assuring transparency and accountability is publishing the results of the auctions or sales. The design elements agreement for regional allowance auctions requires such publication, and so should DEM's rules. We therefore suggest the following change to §47.12.

The Department or its agent ~~may~~ shall publish the winning bids and/or allowance sales along with the corresponding dollar amounts of the bids and/or purchase price on the central auction website or Department's website, whichever is appropriate.

**Response:** Two other commenters had suggestions for this section. While we agree that the regulation should be clear about what information will be published, we agree with other commenters that only limited information should be published. Section 47.12 of APC Regulation No. 47 will be revised in the final regulation as follows:

*47.12 Publication of Results*

*The Department or its agent ~~may publish the winning bids and/or allowance sales along with the corresponding dollar amounts of the bids and/or purchase price on~~*

~~the central auction website or Department's website, whichever is appropriate.~~  
will publish on the central auction website or the Department's website,  
whichever is appropriate, the auction clearing price and the number of  
allowances sold in the auction.

The following comments were received on 5 June 2008 from Matt Auten of Environment Rhode Island and Denise Parrilo of Clean Water Action to Director W. Michael Sullivan, of DEM.

**Comment:** We believe Rhode Island should participate in the regional allowance auction. This is especially critical during the first several auctions where there is great uncertainty about what prices will be established for allowances and how many entities may participate. While we understand that the Department of Environmental Management and the Office of Energy Resources wish to maintain flexibility, we believe there is a substantial risk to acting independently or unilaterally, especially during the first several auctions.

Maintaining consistency with our other RGGI partners by joining the regional auction will also likely encourage more active participation in the auction as bidders familiar with one set of rules know what to expect. We think this consistency will also promote market forces to raise the prices for allowances, which will create sources of revenue for Rhode Island to invest in efficiency and renewable energy, as bidders who know what to expect will take part with more confidence and ease. Joining a regional auction would also save the Department the administrative burden of having to completely develop a new program.

If the Department of Environmental Management and the Office of Energy Resources do desire to hold an independent or unilateral sale or auction, the state should definitely set a reserve price for allowances. By setting a reserve price based on the results of previous regional auctions the Department of Environmental Management can ensure Rhode Islanders do not receive less value for their pollution allowances than our neighboring states who will be participating in the regional auction.

**Response:** DEM intends to participate in the first regional auction on September 10, 2008. We are unable to commit to any future regional auctions at this time. As stated above, DEM will include a reserve price in any state auction or sale.

**Comment:** [An] issue that we believe should be addressed has to deal with the terms "renewable energy" and "renewable fuels." Rhode Island's RGGI regulations should define renewable energy for offsets and use of auction proceeds as those resources already eligible by law in RIGL 39-26-5.

**Response:** DEM agrees that the term "renewable energy" should be defined for purposes of the offsets section. The final regulation will be revised to include a definition of renewable energy as follows:

46.1.97 “Renewable energy” means electricity generated from biomass, wind, solar thermal, photovoltaic, geothermal, hydroelectric facilities certified by Low Impact Hydropower Institute, wave and tidal action and fuel cells powered by renewable fuels.

Categories for the use of auction proceeds are determined by RIGL §23-82-6 and are not within the purview of APC Regulation No. 47, whose purpose is to define the mechanism of selling allowances.

**Comment:** Our final main issue is that allowances deducted for excess emissions should be retired to ensure the integrity of the overall emissions cap and to maintain a competitive market price for allowances. We already have grave concerns that RGGI may be over-allocated, and an over-allocated cap will not serve anyone’s purposes. Under that scenario, the price of allowances will be negligible and no meaningful pollution reductions will actually occur.

**Response:** Once an allowance is deducted for compliance purposes it is retired. This includes allowances deducted for excess emissions.

The following comments were received on 5 June 2008 from Eugenia Marks, Senior Director for Policy of Audubon Society of Rhode Island to Stephen Majkut, of DEM.

**Comment:** Audubon is concerned that a cap and trade program is established, any allocations or percentages derived from measurements of ambient air be taken during and calculated for the period October – April when ambient CO<sub>2</sub> levels are highest in the Northern Hemisphere due to effects of defoliation preventing photosynthesis of deciduous trees and shrubs and thus preventing sequestration of CO<sub>2</sub>. Does the allocation protocol based on thermal output recognize the efficiency of different combustions and different fuels? How precisely does thermal output represent CO<sub>2</sub> production?

**Response:** Rhode Island’s CO<sub>2</sub> budget was based roughly on a three (3)-year average of CO<sub>2</sub> emissions from RGGI units in Rhode Island in years 2000-2002. This methodology is consistent with the base methodology used by the other RGGI states.

**Comment:** What programs and conditions do you identify to justify the declining budget base from 2015-2018? What is the probability that these CO<sub>2</sub> values will be achieved?

**Response:** DEM’s proposed regulation calls for stabilizing power sector CO<sub>2</sub> emissions for the first six (6) years of program implementation (2009-2014) at a level roughly equal to current emissions before initiating an emissions decline of two and one-half percent (2.5%) per year for the years 2015-2018 (four (4) total). This approach will result in a 2018 annual emissions budget that is ten percent (10%)

smaller than the initial 2009 annual emissions budget. The regulated community will determine how the ten percent (10%) reduction is achieved through the cap and trade program as long as emissions for the region are below the regional budget.

**Comment:** We request DEM coordination with energy conservation programs of other government agencies where DEM has an opportunity to comment and support effective conservation programs administratively. In addition, projects of DEM forestry should be reviewed and coordinated for their impacts on carbon sequestration.

**Response:** In accordance with RIGL §23-82, DEM has consulted with the Public Utilities Commission, the Office of Energy Resources and the Energy Efficiency and Resources Management Council in drafting these proposed regulations. One (1) of the five (5) offset categories in Regulation No. 46 is sequestration of carbon due to afforestation. If DEM receives an offsets application in this category, the DEM's Division of Forestry will be consulted in the review of the offsets application.

**Comment:** Will the revenues from trading support adequate DEM personnel dedicated to this program to insulate the program from the vagaries of the state budget process? Will revenues be used to develop and encourage non-fossil fuel generation of electricity and conservation programs as eligible offset projects? How will the public and the regulated have review of the financial arrangements of this program?

**Response:** RIGL §23-82 requires that the Office of Energy Resources (OER), in consultation with DEM and the Energy Efficiency and Resources Management Council ("Council") draft a proposal on how the proceeds from the auction/sale of the allowances will be allocated on an annual basis. RIGL §23-82 requires the OER to hold a public hearing and accept public comment on the proposal. Once the proposal is final, the DEM will authorize disbursement of the funds in accordance with the final plan.

RIGL §23-82 also requires that the OER prepare a report by January 1 of each year, in consultation with DEM and the Council, describing implementation and operation of RGGI, the revenues collected and the expenditures made.

The following supplemental comments were received on 5 June 2008 from Cynthia Giles of Conservation Law Foundation, Matt Auten of Environment Rhode Island, and Denise Parrillo of Clean Water Action to Director W. Michael Sullivan, of DEM.

**Comment:** The Department has included in its draft regulations provision for the so-called "early reduction CO<sub>2</sub> allowances". Section 46.4.3(b) This provisions appears to be in conflict with authorizing legislation, which states at 23-82-5(a) that "The department shall provide in its regulation that one hundred percent (100%) of all

allowances issued under the program in the state of Rhode Island shall be sold.” This as a matter of law Rhode Island cannot award allowances for early reductions at no cost.

In addition, the Rhode Island statute requires that any sale of allowances be “public, competitive and open to all who wish to participate.” RIGL 23-82-5(b). This provision conflicts with any sale of allowances limited to early reductions.

Furthermore, the early reduction credits provision conflicts with the fundamental purpose of RGGI to reduce greenhouse gas emissions. Any early reductions that have occurred almost certainly would have occurred whether or not we had a RGGI program. Allowing credits for these early actions thus presents the same ‘additionality’ problems that RGGI has addressed under the offsets provisions. (See “additionality” discussion in the Overview of RGGI CO<sub>2</sub> Budget Trading program, October 2007.) Allowing such credits or additional allowances creates both an increase in the cap and a windfall to companies that undertook the reductions for other reasons. Early reduction allowances thus further undermine the program already burdened by over allocation of allowances. Allowing such credits or additional allowances creates both an increase in the cap and a windfall to companies that undertook the reductions for other reasons. Early reduction allowances thus further undermine the program already burdened by over allocation of allowances.

The early reduction credit provisions are not necessary to be consistent with the regional program. The appropriate solution – consistent with good policy to achieve the objectives of RGGI, and necessary to reconcile the regulations with the statute – would be to eliminate section 46.4.3(b) of the draft regulations.

Response: DEM does not agree with this comment. Therefore no change will be made to the final regulation.

In addition, DEM has made the following changes to APC Regulation No. 47 “CO<sub>2</sub> Budget Trading Program Allowance Distribution”:

An error was found in the formula used to determine the Minimum Reserve Price (MRP). The condition in the final regulation will be revised as follows:

47.1.16 **“Minimum Reserve Price (MRP)”** means the monetary amount of \$1.86 in 2008 and 2009. Thereafter, the monetary amount, established as of the first day of each calendar year, is derived annually from use of the following formula:

$$\text{MRP}(2009+n) = \text{MRP}(2009+(n-1)) \times \left[ \frac{1 + (\text{CPI}(2009+(n-1)) - \text{CPI}(2009+(n-2)))}{\text{CPI}(2009+(n-2))} \right]$$

MRP = the minimum reserve price  
MRP(2009) = \$1.86  
n = the number of years since 2009, and  
CPI = the Consumer Price Index.

Based on a revision to RIGL §23-82-5, all proceeds collected from the auction or sale of allowances shall be deposited as restricted receipts, Section 47.3 in the final regulation will be revised as follows:

### **47.3 General Requirements**

- (a) The Department shall establish and administer the Account.
- (b) The Department shall convey the allowances from the Account to an agent that shall receive, hold, auction and/or sell allowances in accordance with this regulation and under the oversight of the Department.
- ~~(c) The proceeds generated from the auction or sale of allowances will be deposited into a segregated account and held by the agent.~~
- ~~(d) The proceeds of the auction or sale of allowances will be distributed by the agent under the oversight of the Department.~~

Based on a previous comment regarding tie breaking options in Section 47.10(b), condition 47.6(e)(2) is no longer necessary. Condition 47.6(ef)(2) in the final regulation will be revised as follows:

### **47.6 Frequency and Quantity of CO<sub>2</sub> Allowances Offered for Sale**

- (ef) The Department or its agent shall make CO<sub>2</sub> allowances available for sale in lot sizes of 1,000 allowances, except
  - ~~(1) where available supply requires a smaller lot size. and~~
  - ~~(2) when the procedure outlined in subsection 47.10(b) is used.~~

Decision

It is the decision of the Hearing Officer to adopt Air Pollution Control Regulation No. 46 “CO<sub>2</sub> Budget Trading Program” and Air Pollution Control Regulation No. 47 “CO<sub>2</sub> Budget Trading Program Allowance Distribution” as proposed with the changes indicated above in the Response to Comments.

The final regulations are appended to this Response to Comments and Decision.

\_\_\_\_\_  
Date

\_\_\_\_\_  
Douglas L. McVay, Hearing Officer

Approved:

\_\_\_\_\_  
Date

\_\_\_\_\_  
W. Michael Sullivan, Director

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