

Arizona Department of Environmental Quality Comments on CEIP

December 15, 2015

Docket ID Number EPA-HQ-OAR-2015-0734

EPA has invited input to the above non-regulatory docket on certain questions relating to the Clean Energy Incentive Program (CEIP). The following are the responses of the Arizona Department of Environmental Quality (ADEQ) to two of those questions.

Please contact Steve Burr, 602-616-9210, sb5@azdeq.gov, with any questions regarding these comments.

I. What mechanisms should EPA consider for maintaining the stringency of rate-based emission standards during the compliance periods to account for the issuance of early action ERCs for MWh generated or avoided in 2020 and/or 2021?

ADEQ has identified the following options for addressing this issue. As the discussion makes clear, each option has advantages and disadvantages and none is clearly preferable from a policy standpoint. ADEQ therefore suggests that EPA allow states to choose the approach they believe will work best for their programs from this list of options and any others EPA may identify.

A. Withholding Early-Action ERCs from All ERC Recipients

1. Description

ADEQ believes this is the approach EPA had in mind when it stated that:

under a rate-based implementation, the state plan could require that early action ERCs issued to parties effectuating reductions in 2020 and 2021 would be “borrowed” from a pool of ERCs created by the state during the interim plan performance period.

80 Fed. Reg. at 64831, n. 776.

Under this approach, a state’s plan would require that a portion of the total early action ERCs earned for 2020-2021 be withheld from ERCs to be issued to all eligible resources and affected EGUs under 40 CFR 60.5805(e). If ERCs were issued annually, the number ERCs to be withheld from a particular EGU or resource (ERC_w) could be calculated using the following equation:

$$ERC_w = \frac{ERC_{Res}}{ERC_{Total}} \times \frac{ERC_{EA}}{Y}$$

Where:

- ERC_{EA} = The total number of early action ERCs (MWh) distributed by the state under its CEIP program.
- ERC_{Res} = The number of ERCs earned by the resource or EGU for the year in question, i.e. the ERCs that would have been issued to the resource or EGU in the absence of the CEIP.
- ERC_{Total} = The total number of ERCs earned by all resources and EGUs for the year.
- Y = The number of years during the interim period over which the state will withhold ERCs in order to recover the ERC_{EA}.

2. Advantages

This approach would spread the cost of the CEIP over a large number of eligible resources and EGUs.

3. Disadvantages

Withholding a portion of ERCs earned will reduce the incentive to generate renewable energy and provide energy efficiency programs during the interim period. In addition, effectively transferring ERCs otherwise earned from one group of eligible resources to another in order to encourage early action may seem unfair to some program participants.

B. Withholding Early-Action ERCs from CEIP Participants Only

1. Description

Rather than withholding a portion of the award of ERCs to *all* eligible resources and affected EGUs, as under the previous approach, a state pursuing this approach would withhold ERCs earned during the interim period only from participants in the CEIP.

Under this approach, a particular eligible resource participating in the CEIP would essentially pay for its early action ERCs with ERCs to be earned during the interim compliance period. Thus, this approach would have the same net effect as awarding *only* EPA matching allowances to CEIP participants for the 2020-2021 period.

2. Advantages

Unlike the previous approach, this approach would not require the owners or operators of other eligible resources to fund the CEIP.

3. Disadvantages

This approach would dilute the incentive provided by the CEIP. In particular, RE resources would effectively receive only ½ MWh in ERCs for every MWh generated during 2020-2021. The other ½ MWh would come out of the ERCs the resources otherwise would have received for generation during the interim period.

C. Adding Early-Action ERCs to EGU Compliance Obligation

1. Description

Under this approach, a state plan would require an affected EGU's compliance account to hold on the transfer deadline the number of ERCs required by 40 CFR 60.5790(c)(1) plus the affected EGU's pro rata share of the total early action ERCs issued by the state under its CEIP program. The pro rata share could be determined on the basis of generation, emissions or some other metric. To reduce the impact of the additional compliance obligation, it could be spread over multiple interim compliance periods.

2. Advantages

This approach, like an allowance set-aside under a mass-based program, would place the burden of funding the CEIP early action ERCs on affected EGUs. This is arguably more appropriate and equitable than requiring other eligible resource providers to fund the program.

3. Disadvantages

This approach would increase the total number of ERCs required for compliance. There is considerable uncertainty about the prospective liquidity of the ERC market. Adding to the total compliance obligation will only increase the risk of a shortfall in the supply of ERCs.

D. Adjusting Performance Rate to Reflect Issuance of Early Action ERCs

1. Description

The performance rate could be adjusted to reflect the issuance of early action ERCs by using something like the following formula for a subcategory-specific performance rate plan:

$$SC_{AR} = \frac{SC_{CO2}}{SC_{Gen} + ERC_{Req} + (ERC_{EA} \times SC\% \times CP\%)}$$

Where:

SC_{AR}	=	The adjusted performance rate for a subcategory (FFS or CT) for the relevant compliance period.
SC_{CO2}	=	Total CO ₂ emissions (lbs) from a subcategory during the relevant compliance period.
SC_{Gen}	=	Total generation (MWh) for the subcategory during the relevant compliance period.
ERC_{Req}	=	Total ERCs (MWh) required for all EGUs in a subcategory (FFS or CT) to comply with the applicable performance rate during the relevant compliance period (see equation below).

ERC _{EA}	=	Total early action ERCs (MWh) issued by the state under its CEIP program.
SC%	=	Percentage of ERC _{EA} that a particular subcategory is responsible for funding. This could be based on share of total CO ₂ emissions, total generation, total ERC _{Req} , or some other metric.
CP%	=	Share of set-aside to be recovered during the relevant compliance period (e.g. 37.5 %, or 3/8, during interim period 1 [2022-2024]). This adjustment can be omitted from plans that elect to recover the entire set-aside during a single compliance period.

ERC_{Req} can be calculated as follows:

$$ERC_{Req} = \frac{(SC_{CO2} - (SC_{PR} \times SC_{Gen}))}{SC_{PR}}$$

Where:

SC _{PR}	=	Unadjusted performance rate (lbs CO ₂ /MWh) applicable to the subcategory during the relevant compliance period
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Other variables are defined as above.

This approach would have the same effect on the compliance obligation of affected EGUs as the approach in C.

2. Advantages

Same as C

3. Disadvantages

Same as C.

In addition, because this approach provides for the imposition of a custom rate different from the subcategory-specific performance rates and the uniform state goals, it would appear to foreclose interstate trading under 40 CFR 60.5750(a)(1) and (d)(2).

II. What commencement date is appropriate for a project to qualify as eligible for the CEIP?

ADEQ urges EPA to consider amending 40 CFR 60.5737(a)(2) to establish a commencement date earlier than the date of plan submission.

Most states, including Arizona, will not be able to submit final plans until the extended deadline of September 6, 2018 or, at best, shortly before that date. Thus, to qualify for early action and matching ERCs for the entire 2020-2021 period, an RE project would have to commence and complete construction within a window of less than 16 months. In addition, by establishing a commencement date after the date of the final CPP rule, EPA

has given RE and EE projects an incentive to delay construction and implementation until the commencement date occurs.

EPA could provide a more reasonable window and remove the incentive to delay by amending 40 CFR 60.5737(a)(2) to establish the signature, publication or effective date of the final CPP rule as the commencement date.