STATE OF NEW YORK
DEPARTMENT OF ENVIRONMENTAL CONSERVATION
625 BROADWAY
ALBANY, NEW YORK 12233-1550

In the Matter

- of the -

PROPOSED REVISIONS TO PART 242 (CO_2 Budget Trading Program), AND PROPOSED REVISIONS TO PART 200 (General Provisions) OF TITLE 6 OF THE OFFICIAL COMPILATION OF CODES, RULES AND REGULATIONS OF THE STATE OF NEW YORK, AND PROPOSED REVISIONS TO PART 507 (CO_2 Allowance Auction Program) OF TITLE 21 OF THE OFFICIAL COMPILATION OF CODES, RULES AND REGULATIONS OF THE STATE OF NEW YORK, AND ACCEPTANCE OF THE SUPPLEMENTAL DRAFT GENERIC ENVIRONMENTAL IMPACT STATEMENT

Hearing Report

-by -

/s/
Maria E. Villa
Administrative Law Judge

/s/
Richard R. Wissler
Administrative Law Judge

July 2, 2008

PROCEEDINGS

Background

The New York State Department of Environmental Conservation ("Department" or "DEC") and the New York State Energy Research and Development Authority ("NYSERDA" or "Authority") scheduled public comment hearings on the proposed revisions to Part 242 of Title 6 of the Official Compilation of Codes, Rules and Regulations of the State of New York ("6 NYCRR"), carbon dioxide (CO_2) Budget Trading Program; revisions to 6 NYCRR Part 200, General Provisions; proposed revisions to Title 21 of the Official Compilation of Codes, Rules and Regulations of the State of New York ("21 NYCRR") Part 507, CO_2 Allowance Auction Program; and Acceptance of the Supplemental Draft Generic Environmental Impact Statement ("DGEIS").

On December 20, 2005, New York State entered into a regional agreement to reduce greenhouse gas ("GHG") emissions from power plants in order to address climate change. The Governors of ten northeast and mid-Atlantic states have committed to propose the Regional Greenhouse Gas Initiative ("RGGI"). In order to carry out New York's commitment to this program, this joint rulemaking has been proposed.

The Department and the Authority proposed Parts 242 and 507 on October 24, 2007. Hearings were held during the week of December 10, 2007 and the public comment period closed on December 24, 2007. The Department reviewed the public comments received, and based on those comments, the Department and the Authority are proposing these revisions and have accepted the Supplemental DGEIS, which analyzes the revisions.

Revised Part 242 establishes a market-based program designed to cap and reduce CO_2 emissions from power plants by 10 percent by 2019. Certain revisions to Table 1 of 6 NYCRR 200.9, Referenced Material, are necessary in order to implement these programs and are included as part of the rulemaking package. Revised Part 507 of 21 NYCRR establishes the rules for conducting auctions of CO_2 allowances to be administered by the Authority or its designee, as part of the New York CO_2 Budget Trading Program, and for the administration of the Energy Efficiency and Clean Energy Technology Account.

DEC's Division of Air Resources ("DAR") requested that the Department's Office of Hearings and Mediation Services ("OHMS") assign administrative law judges ("ALJs") to conduct the legislative hearing sessions and to provide a report summarizing the comments.

On April 28, 2008, ALJ Richard R. Wissler was assigned to conduct the June 9, 2008 hearing in Stony Brook, and ALJ Maria E. Villa was assigned to the hearing in Albany on that same date.

Prior to the hearings, the DAR staff provided each ALJ with a copy of the Department's notice of proposed rulemaking and proof of publication of this notice. This notice appeared in the May 7, 2008 editions of the *State Register*, *Environmental Notice Bulletin*, Albany *Times Union*, *Buffalo Evening News*, Glens Falls *Post Star*, *New York Post*, *Newsday*, Rochester *Democrat & Chronicle*, and the Syracuse *Post-Standard*.

The Department accepted written comments on this rulemaking and the Supplemental DGEIS until Monday, June 23, 2008.

Public Hearings

Albany Hearing

There were approximately 50 people in attendance at the Albany hearing. Nine persons gave oral statements.

The first two speakers, Kevin P. McGarry from DAR, and Kevin Hale, of NYSERDA, read statements explaining the proposed revisions and the regulations. The next speaker, Chris Trabold, is the Executive Director of Brooklyn Navy Yard Cogeneration Partners ("BNYCP"), which owns a 286-megawatt natural gas-fired co-generation facility in the Brooklyn Navy Yard. Mr. Trabold stated that BNYCP supports the principles of RGGI, and then went on to discuss the long term contract set-aside provision in Section 242-5.3(d) of the rule. Mr. Trabold indicated that BNYCP's long-term contract with ConEdison will not expire until 2006, and that contract does not permit the cost of RGGI allowances to be passed on to consumers.

According to Mr. Trabold, power generating facilities that cannot recover the cost of CO_2 allowances will suffer enormous financial hardship. Mr. Trabold characterized the lack of recovery as "punitive," and went on to state that this is the worst possible outcome for the State, inasmuch as many of the plants under long-term contracts without cost recovery are gas-fired and very efficient. Mr. Trabold indicated that BNYCP's plants average an almost 70 percent efficiency, in contrast to a conventional plant which would be expected to be about 30 percent efficient.

Mr. Trabold stated that it appears that the 1.5 million ton allowance in the set-aside account will not be adequate to allow eligible generators, without cost recovery, to operate.

Mr. Trabold took the position that the Department should consult with these generators to assure that there are sufficient allowances in the set-aside account to avoid harm to such generators.

Mr. Trabold stated further that it appears that the number of generating facilities without cost recovery in their contracts was underestimated, and that a 1.5 million ton limit on allowances available from the set-aside account will have a devastating effect on such generators. The account may represent only 43 percent of the tons of CO_2 such generators would need to offset the significant increase in operating costs that would be imposed by RGGI. According to Mr. Trabold, an increase in the set-aside is consistent with good environmental policy because these are co-generation facilities that, in serving their hosts, avoid the pollution that the host would otherwise emit from on-site industrial boilers. This speaker went on to point out that because the allocation needs of long-term contract generators are temporary, as the long-term contracts expire, the number of allowances needed in the set-aside account will decrease.

In conclusion, Mr. Trabold stated that the portion of the rule that establishes the information to be included in a financial hardship demonstration should be more specific. As the language now stands, Mr. Trabold stated that it is impossible to tell how the various criteria will be balanced against one another. Mr. Trabold stated that this lack of clarity introduces a risk of arbitrariness in its application.

Michael Minnolera, plant manager of the Indeck-Corinth Limited Partnership, offered remarks similar to those of Mr. Trebold.

Alanah Keddell spoke on behalf of The Adirondack Council, stating that climate change will drastically affect communities within the Adirondack and the State if the amount of CO_2 emitted by power plants is not limited. According to Ms. Keddell, the Adirondack Council remains concerned over the inclusion in the draft regulations of long-term contract set-asides of 1.5 million tons of CO_2 annually for power plants which meet certain conditions. Ms. Keddell stated that while The Adirondack Council is “somewhat intrigued” by the revisions that would limit the use of set-asides by requiring the allowances to be used for compliance purposes, it remains “unimpressed” with the set-aside program. The speaker said that the Department has failed to provide compelling reasons why the State should cover lost revenues of polluters, and that The Adirondack Council takes the position that given the low market price for allowances, the likelihood of economic harm to power companies is slight.

Ms. Keddell reiterated The Adirondack Council's concerns with respect to the over-allocation of region-wide CO_2 emissions, urging the Department to reconsider its decision not to revisit the current cap. Ms. Keddell stated that an accurate, binding CO_2 cap is crucial to the program, and it should be addressed immediately to ensure that the desired reductions are, in fact, achieved.

Ms. Keddell said that The Adirondack Council is also concerned with the early reduction program, which, if implemented, would increase the number of allowances on the market, damaging the integrity of RGGI and calling into question whether significant reductions will actually occur within the allotted time period. In addition, Ms. Keddell voiced concerns with respect to the use of RGGI proceeds, stating that the categories into which auction proceeds will be disbursed lack sufficient specificity, and that The Adirondack Council believes that funding for programs to address adaptation to limit the effects of climate change should be included as a category. Ms. Keddell expressed disappointment that the State's RGGI program will not be implemented in time to participate in the first RGGI auction on September 10, 2008.

Jackson Morris, Air and Energy Program Associate at Environmental Advocates of New York, spoke next. Mr. Morris commended the Department and other RGGI stakeholders for their hard work, and stated that Environmental Advocates maintains its position that 100 percent of the State's emission allowances should be auctioned. Environmental Advocates opposes the Department's 1.5 million ton set-aside for long-term contract holders, stating that this measure would allow those generators to pollute for free, thereby shortchanging the general public. According to Mr. Morris, Environmental Advocates continues to oppose the exemption of units that supply less than or equal to ten percent of the power generated on-site to the grid, as such facilities account for a significant portion of Statewide CO_2 emissions, and should be required to purchase and trade emissions allowances like every other source.

Mr. Morris stated that while Environmental Advocates fully supports the Department's proposed set-aside for voluntary purchases of renewable energy, the organization has concerns that the 700,000 ton number may fall short of the demand for such allowances, and the Department should reserve the right to increase that number if necessary. According to Mr. Morris, this would obviate the need for a formal rule revision process if such an adjustment is necessary in the future. Mr. Morris stated that Environmental Advocates strongly supports using RGGI proceeds for investment in energy conservation and efficiency, and the development of clean renewable technologies. Nevertheless, the organization objects to any use of these funds to subsidize "clean coal" demonstration projects or the nuclear power industry because, in Environmental Advocates' opinion, such projects pose significant risks to human health and the environment.

The next speaker, Donald Neal, is the Vice-President of Environmental Health and Safety for Calpine Corporation ("Calpine"). Mr. Neal stated that the long-term contract set-aside is insufficient and should be increased. Mr. Neal stated that the amount of CO_2 emissions currently under long-term contract is more on the order of 3.5 million tons.

Mr. Neal went on to state that there is a major loophole in the emission rate threshold in the long-term set-aside. According to Mr. Neal, the new draft has a subtle language change related to the emission rate threshold that significantly increase the number of generators that would be eligible for long-term contract allowances, and would allow any generator with a long-term contract to apply for the allowances, whatever their emission rate, as long as that generator uses natural gas as its primary fuel. In Calpine's view, this would allow about 1000 megawatts of additional generation to become eligible for the allowances, and this is highly objectionable, inasmuch as Calpine believes that the proposed set-aside is already too small. Calpine took the position that the Department should set the emission rate at 1100 pounds per megawatt hour, without exception.

According to Mr. Neal, the financial hardship test is confusing, and fails to set an objective and transparent standard for compliance. Calpine noted that the test does not provide any sort of confidentiality treatment for commercially sensitive information that Calpine would be required to submit. According to Mr. Neal, at a minimum the rule must offer the same level of protection for this type of data as any other State agency would afford in a similar situation. Mr. Neal noted that while the rule would require Calpine to submit "reams of data," it is completely silent as to how that data will be used to determine long-term contract eligibility. Calpine believes that an applicant should have to provide a copy of the contract to demonstrate that the agreement does not allow for the recovery of RGGI costs. In addition, according to Mr. Neal, Calpine believes that generators must make a showing that they have made good faith efforts to renegotiate those contracts.

Mr. Neal stated that it would be sensible to collect only the data necessary to ensure that long-term contract allowances are provided for power sales that occur under contract, not for any other power sales into the grid. According to Mr. Neal, Calpine believes that there is still a serious problem with the rule’s requirement that generators must show that they will suffer losses in excess of value of allowances sought. Calpine believes that the financial impact of not being able to recover RGGI costs is equal to that cost. This is particularly difficult, according to Calpine, because the rule does not define the concept of loss, or the value of allowances. Mr. Neal pointed out that any such definition would need to show how that value is calculated, which would fluctuate depending upon what time the value was taken.

This speaker went on to observe that the allocation method for the long-term contract allowances should be output-based, consistent with the overall premise of RGGI. According to Calpine, there is a problem with the allocation formula, which states that allowances will be awarded based on a plant’s applicable emission rate times its total net output. Mr. Neal stated that the practical effect of this calculation is that dirtier plants would receive more allowances than less polluting facilities.

Mr. Neal stated that an auction is the epitome of an output-based allocation methodology, which rewards plants that have lower CO_2 emissions per megawatt hour. Nevertheless, Mr. Neal stated that when the set-aside is increased to a sufficient level, this new formula would reward dirtier plants with higher emission rates, and penalize cleaner plants. Consequently, Calpine strongly objects to giving a higher percentage of limited long-term contract allowances to plants with higher emission rates. Moreover, Calpine pointed out that the definition of applicable emission rate in the draft rule for long-term contract eligibility is unclear.

Mr. Neal stated that the draft rule penalizes combined heat and power facilities, or CHP units, by inappropriately including CO_2 emissions from thermal sales under the RGGI program. Calpine recommends that with respect to CHP facilities, the calculated emission rate should be done on a steam-adjusted basis. According to Mr. Neal, this is a more accurate reflection of the overall efficiency and environmental characteristics of a CHP facility in terms of its CO_2 emissions per megawatt hour of electricity produced. Calpine stated that unfortunately, under the proposed formula, using a steam-adjusted emission rate would actually penalize the company for having an efficient plant. Therefore, Calpine does not want the Department to use such a calculation if the current formula remains in place.

Mr. Neal went on to say that thermal sales related to CHP operations should be entirely exempt from the RGGI program, and that Calpine should only receive long-term contract allowances, or have to buy allowances for CO_2 emissions related to power production, not for CO_2 emissions related to thermal energy production. According to Mr. Neal, this is because RGGI is not a multi-sector approach to carbon regulation. RGGI only applies to electric generators, whereas thermal production is an inherently industrial activity. Mr. Neal said that Calpine did not see why it should be penalized, simply because its plants happen to produce thermal energy as well as electricity, especially since CHP plants have a lower overall carbon footprint than separate stand-alone power and thermal energy production units.

Finally, Mr. Neal stated that the Department should modify the criteria for the applicability of the limited exemption for generators that only sell a small percentage of their power into the grid. Calpine believes that it makes sense to exempt smaller generating units that essentially serve a single customer, such as a university campus that has a very cyclical and seasonal energy load. Calpine asked that the Department increase the size of the set-aside, stating that if there were enough allowances to go around, Calpine would not be overly concerned with the other technical concepts of the rule, except for the concept of loss being greater than value, which Mr. Neal stated must be addressed.

Carl Carlson, of Suez Energy Generation North America (“Suez”), spoke next. Mr. Carlson indicated that unlike generators that sell their power on the competitive market and can include the cost of allowances in their bid price, companies such as Suez that have facilities under long-term contract cannot recover the cost of RGGI allowances. Mr. Carlson said that Suez has serious objections to the long-term contract set-aside provision, as it currently is written.

Mr. Carlson said that the set-aside is too small, because at least 3.5 million tons are needed, in contrast to the 1.5 million tons proposed. Mr. Carlson stated further that the requirements for qualifying for the set-aside are unnecessarily onerous and confusing, in that entities will be required to show that they will suffer a loss in excess of the value of the allowances sought. Suez has already expressed a willingness to prohibit resale of long-term contract allowances, in order to satisfy concerns that such allowances would result in a windfall profit for some generators.

Mr. Carlson went on to state that the modified definition of eligible entities is too broad. The earlier version created a threshold of 1100 pounds per megawatt hour, while the current draft exempts facilities from that requirement as long as they use natural gas as their primary fuel. According to Mr. Carlson, the unintended consequence of this change is that additional entities will be competing for a set-aside that has already been demonstrated to be too small. Mr. Carlson stated that this would reward plants with higher emissions. Suez prefers that the original definition be used.

The last speaker was Radmila Miletich, of the Independent Power Producers of New York (“IPPNY”). This speaker noted that throughout this process, IPPNY raised concerns about the reliability impact of this rulemaking. Ms. Miletich contended that the cost impacts of the RGGI program should be re-evaluated, in light of higher fuel prices, and the fact that allowances that were predicted to be trading at certain levels are pre-trading at much higher levels.

According to IPPNY, the RGGI allowance auction should be conducted in two phases. The first phase would be open to generators with effective RGGI facilities, with the second phase open to all interested participants. This would ensure that the generators would have the ability to supply the power needs of the State. Ms. Miletich went on to assert that the allowance auction design must include an allowances auction price cap, to limit the impact of high allowance auction prices on consumer rates and economic development.

IPPNY also contended that the development of carbon capture and sequestration technology should be made explicitly eligible to receive funding from the allowance auction proceeds. According to IPPNY, this would help develop the essential tools to achieve emission reductions at power plants. IPPNY took the position that offsets should not be limited, and that the Department should include in the rule categories for which protocols already exist, to transition New York’s program into a federal program, if and when such a program is established. Finally, Ms. Miletich urged that the rule be revised to explicitly include the steps to address leakage. According to Ms. Miletich, discussion of leakage in the Environmental Impact Statement is insufficient, and the language addressing leakage should be included in the rule itself.

Stony Brook Hearing

Approximately 25 people attended the Stony Brook hearing, which commenced at 1:02 PM and concluded at 1:48 PM. The ALJ provided introductory remarks setting forth the purpose of the hearing and noting its required and published public notice.

Thereafter, statements explaining the proposed revisions and regulations were made by Douglas Mitarotonda, an economist with DEC's Office of Climate Change, and by Peter Keane, Associate Counsel, with the NYSERDA. Mr. Mitarotonda addressed the proposed changes to 6 NYCRR, while Mr. Keane addressed the proposed changes to 21 NYCRR. Following these remarks, two members of the public spoke.

Bruce Miller, a local school board official, spoke on behalf of the Village of Port Jefferson and the Village of Belle Terre. He spoke of the older power plants located in the two villages and their impact on the communities. He expressed the hope that the proposed carbon trading program might be a revenue source leading to the repowering of the existing facilities in such a manner as to make them more environmentally efficient.

John Flumerfelt, director of government and regulatory affairs for Calpine Corporation, indicated his company's strong support for carbon regulations and for RGGI, as they pertain to power plants. However, addressing his remarks to the DEC portion of the proposed revisions and regulations, he articulated six concerns. First, as to the long term contract (LTC) provisions, he asserted, the set-aside amount of 1.5 million tons is insufficient and needs to be increased to 3.5 million tons. Second, as proposed, he said, the emission threshold would allow a significant amount of new generation to come into the LTC program. Third, the financial hardship test is confusing, he argued, and fails to set an objective and transparent standard to determine eligibility under the proposed program. Fourth, the allocation method for LTC allowances, he said, should be output-based, not input-based. Fifth, the proposed rule penalizes combined heat and power or cogeneration units, he asserted, because it inappropriately includes CO-2 emissions related to thermal output along with CO-2 emissions related solely to electric output. And sixth, he stated, the DEC should modify the criteria for the applicability of the limit exemption that is available for generators which only sell a very small amount of their total output into the grid.