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INDEPENDENT REGULATORY
REVIEW COMMISSION

June 29, 2007

2607

Environmental Quality Board
P.O. Box 8477
Harrisburg, PA 17105-8477
RegComments@state.pa.us

Re: Comments on Pennsylvania's Proposed Rule to Implement the Clean Air Interstate Rule (CAIR) Trading Programs

Dear Sir or Madam:

Conectiv Energy (Conectiv) is a competitive energy generation, marketing, and supply business. Conectiv is responsible for operating approximately 1,100 total megawatts of generating capacity within Pennsylvania, is in the process of permitting another 1,100 megawatt facility, and has tolling agreements with certain generating facilities within the state. All of Conectiv's Pennsylvania generating units are subject to the proposed Clean Air Interstate Rule (CAIR) Trading Programs. As such, Conectiv wishes to take this opportunity to provide comment regarding the April 28, 2007 Pennsylvania Department of Environmental Protection's (PADEP's) regulatory proposal to implement the CAIR Trading Programs in the state.

Specifically, Conectiv offers the following comments concerning the proposed CAIR NO_x Trading Program:

1. Adoption of Federal CAIR Programs. [§145.201, §145.204]

PADEP has proposed to adopt the federal CAIR NO_x Annual Trading Program, CAIR NO_x Ozone Season Trading Program and CAIR SO₂ Trading Program by reference, with several exceptions. Conectiv supports the adoption of the federal model trading programs and urges PADEP to minimize the number and extent of variations from those programs in the final Pennsylvania rulemaking.

The CAIR trading programs are multi-state regulatory programs applicable to roughly one-half of the states in the U.S. Deviations from the federal model trading programs, if not

carefully crafted and based on sound scientific data, could put Pennsylvania businesses at a competitive disadvantage, and drive business away from Pennsylvania. Because Conectiv owns and operates CAIR units in multiple states across the mid-Atlantic Region, it is important to Conectiv that the CAIR requirements be consistent across those states to the extent possible. Consistency across multi-state regulatory programs simplifies compliance and minimizes costs for affected businesses.

2. Transition of Nonelectric Generating Units. [§145.101]

PADEP has proposed that nonelectric generating units (non-EGUs) subject to the NOx Budget Trading Program in Subchapter A of 25 PA Code Chapter 145 (NOx SIP Call program) would transition out of that program in one of two ways. Under §145.101(b)(1), non-EGUs would receive a NOx permit limit equivalent to their 2008 NOx Budget Trading Program allocation; if actual emissions exceeded the permit limit, they would be required to retire CAIR NOx ozone season allowances to account for the excess emissions. Under §145.101(b)(2), non-EGUs would be allocated CAIR NOx ozone season allowances in an amount equivalent to their 2008 NOx Budget Trading Program allocation. As with the first transition approach, non-EGUs would retire CAIR NOx Ozone Season allowances for compliance.

Conectiv does not support PADEP's permit limit approach for the transition of non-EGUs out of the NOx Budget Trading Program. It is generally accepted that, as a group, non-EGUs have a higher cost of control than EGUS and as such, are net buyers of NOx allowances in order to comply with the NOx Budget Trading Program. Under PADEP's proposed permit limit approach, these non-EGUs would be required to buy CAIR NOx Ozone Season allowances from the pool of allowances allocated to EGUs under the CAIR NOx Ozone Season Trading Program. This will effectively reduce the size of the allowance pool, which will increase the stringency of the NOx reductions necessary for EGUs to comply with CAIR, thereby by increasing the cost of compliance. To be equitable and minimize the cost of compliance for both non-EGUs and EGUs, the NOx Budget Trading Program non-EGU

and CAIR NO_x ozone season EGU allowance budgets should be combined as PADEP has proposed in the second transition option for non-EGUs.

3. **NO_x Allocations.** [§145.211, §145.212, §145.221, §145.222]

PADEP has not proposed to incorporate by reference the allocation methodology of U.S. EPA's model CAIR NO_x trading programs. PADEP's proposed rule specifies how allocations would be made to new units, existing units, qualifying resources, and CAIR SO₂ units that did not receive SO₂ allowance allocations.

a. **Timing of NO_x Allocations.** [§145.211, §145.221]

PADEP has proposed to make regular NO_x allowances to CAIR units every two years for the control periods three and four years after the allocation year. U.S. EPA's model trading rules specified the annual allocation of allowances for the control period six years after the allocation year. Conectiv would prefer that Pennsylvania adopt the allocation timing specified in the model trading rules because the allocations are more frequent and the vintage of the allowances allocated each year are later (six years versus PADEP's proposal of four). Allocating allowances further in advanced sends a price signal sooner for future years, which provides companies more time to plan for compliance costs. This is extremely important when planning capital investments in the power sector.

b. **NO_x Allocations to New and Existing Units.** [§145.212]

The proposed rule includes provisions to allocate NO_x allowances to "new" and "existing" units, however, these terms are not defined in (1) the proposed regulation, (2) the federal CAIR programs that are proposed to be incorporated by reference, (3) the definitions in Subchapter A of Chapter §145, or (4) in the definitions specified in §121.1 of the General Provisions. In the federal CAIR model NO_x trading programs, the NO_x allocation methodology is not based on a unit's status as "new" or "existing", although these terms are used in the preamble to the federal CAIR rulemaking. In the federal CAIR model NO_x trading rules, allowances are allocated based on whether the unit

commenced operation before or after January 1, 2001. Those sources that commenced operation before January 1, 2001 are referred to as “existing” sources in U.S. EPA’s preamble, and those commencing operation on or after January 1, 2001 are referred to as “new” sources. PADEP should either define the terms “new unit” and “existing unit” in the CAIR rulemaking or adopt EPA’s approach of specifying within the regulatory language the units to which each allocation methodology applies.

c. Allocation to Qualifying Resources. [§145.212, §145.222]

PADEP has proposed to allocate NO_x allowances to qualifying resources that have generated renewable energy certificates under Pennsylvania’s Alternative Energy Portfolio Standards Act. Conectiv supports this approach as long as it includes new or existing sources that add qualifying renewable energy feedstocks to their capabilities. This will promote the use of renewable feedstocks in existing units that most likely employ more restrictive NO_x control technologies than newer smaller units built specifically to use renewable feedstocks. It will also be a more cost effective approach than building new units, and will most likely result in the use of more renewable feedstocks, supporting the states initiative on energy independence and security.

d. New Source Set-Aside.

PADEP has not proposed to utilize a new source set-aside such as is incorporated into U.S. EPA’s model CAIR NO_x trading program rules. In the model trading programs, CAIR NO_x units that have not established a baseline heat input and NO_x emission rate receive NO_x allowances from the new source set-aside instead of the main state allowance budget. PADEP’s proposal is that new units would receive no NO_x allowance allocation to cover their first 6 years of operation, but following its first control period of operation, would receive a new source NO_x allocation each year in an amount equivalent to its actual NO_x emissions—however, the allowances would be for the control period (or vintage year) 6 years after the actual NO_x emissions occurred (i.e. in 2011, a new source would receive vintage-2015 allowances in an amount equivalent to actual emissions in 2010). New sources would also receive a regular allocation every second year along with

the existing sources and qualifying resources (regular allocations are allowances for the control periods three and four years in the future). The new source allocation would continue until such time as the source has received a regular allocation for the control period for which the new source allocation would have been calculated. The new source allocations are to be made from the total state budget before the regular source allocations are made (after making new sources allocations, the remaining budget will be apportioned to all sources for the regular allocations). In the preamble, PADEP provides the following reasoning for their new source allocation approach: new sources are allocated as existing sources faster than under the EPA CAIR rules (5 or 6 years versus 9 years), new source operators can swap or sell their future-year allowances for current-year allowances to cover their first years of operation when they get no current-year allowances, it will prevent the problem of over-subscription of the new source set-aside experienced under the NO_x Budget Trading Program. Conectiv is willing to support this innovative approach to NO_x allocation to new units because it will provide an earlier price signal than the EPA plan and an earlier transition to existing unit status than the EPA plan, but notes that its success depends on market liquidity, which in emissions markets has shown to be questionable at times.

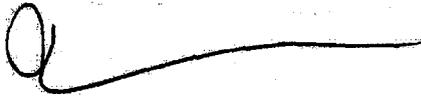
e. Allocation of NO_x Allowances to Certain CAIR SO₂ Units. [§145.212(f)]

PADEP has proposed to allocate one CAIR NO_x (annual) allowance for every 8 tons of SO₂ emitted by a CAIR SO₂ unit that did not receive an SO₂ allocation because it was exempt from the Acid Rain program under section 405(g)(6)(A) of the Clean Air Act. This section of the Clean Air Act exempted “qualifying small power production facilities,” “qualifying cogeneration facilities,” and “new independent power production facilities” from the requirements of the Acid Rain Program. In the preamble to the proposal, PADEP states that “To make up for the absence of SO₂ allowances, the Department is proposing to allocate additional CAIR NO_x allowances to these facilities, the proceeds from the sale of which the facilities may use to purchase the needed CAIR SO₂ allowances.” Conectiv will support this proposal if it is modified to include new combined cycle facilities that are not receiving SO₂ allowances, because as proposed it

will reward older, less efficient units with NO_x allowances, putting newer more efficient units at a competitive disadvantage.

Thank you for the opportunity to comment on the proposed regulation. Please contact me should you have any questions, or require any additional information.

Kind regards,

A handwritten signature in black ink, consisting of a stylized initial 'M' followed by a long horizontal line extending to the right.

M. Gary Helm
Senior Environmental Coordinator
Conectiv Energy
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Newark, DE 19714