

**Commonwealth of Massachusetts
Executive Office of Energy and Environmental Affairs
and
Department of Environmental Protection**

**Technical Support Document on Proposed Regulatory Amendments to:
310 CMR 7.74 *Reducing CO₂ Emissions from Electricity Generating Facilities***

April 6, 2018

Regulatory Authority:

**M.G.L. c. 21A, §§ 2, 8, and 16
M.G.L. c. 21N, §§ 2(a)(5), 3(b)-(d), 4, and 7
and M.G.L. c. 111, §§ 2C and 142A – 142E**

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I. INTRODUCTION

The Massachusetts Executive Office of Energy and Environmental Affairs (EEA) and the Massachusetts Department of Environmental Protection (MassDEP), in consultation with the Department of Energy Resources, are proposing to amend 310 CMR 7.74: *Reducing CO₂ Emissions from Electricity Generating Facilities*. The proposed amendments are responsive to stakeholder input received regarding the design of allowance auctions, allowance banking, and compliance flexibility. Instructions for commenting on this proposed regulation are provided at the end of this Technical Support Document (TSD).

II. BACKGROUND AND PURPOSE

On August 11, 2017, EEA and MassDEP promulgated two final regulations under, inter alia, the Global Warming Solutions Act (GWSA), to assist in reducing emissions of greenhouse gases associated with the electricity generation sector: 310 C.M.R. § 7.74 (Reducing CO₂ Emissions from Electricity Generating Facilities) and 310 C.M.R. § 7.75 (Clean Energy Standard).¹ One aspect of these regulations is the allowance trading program, which is codified in 310 CMR 7.74 and requires large power plants in Massachusetts to purchase carbon dioxide (CO₂) allowances at auctions to comply with an annually declining limit on CO₂ emissions.² Beginning in 2019, the current regulation requires the use of an auction to distribute allowances to regulated electricity generating

¹ 310 CMR 7.74 and 7.75 were designed to work together and in conjunction with other Commonwealth policies to put the electric sector on track to meet the 2020 and 2050 goals of the GWSA. See, Technical Support Document, December 16, 2016, <https://www.mass.gov/guides/reducing-ghg-emissions-under-section-3d-of-the-global-warming-solutions-act>, p. 11; Response to Comments, August 2017, <http://www.mass.gov/eea/docs/dep/air/climate/3drtc-electricity.pdf>, p. 3, 14-16.

² Additional information about 310 CMR 7.74 is available at <https://www.mass.gov/guides/electricity-generator-emissions-limits-310-cmr-774>. Posted documents include an auction design Stakeholder Discussion Document, stakeholder comments referenced in this Technical Support Document, and the Response to Comments document published when the regulation was finalized in August (see link for 310 CMR 7.75).

facilities. EEA and MassDEP are proposing amendments to 310 CMR 7.74 related to the allowance auctions, allowance banking, and compliance flexibility. The proposed amendments are based on feedback the agencies received from stakeholders during the stakeholder process discussed below.

When EEA and MassDEP finalized 310 CMR 7.74 in August 2017, the agencies announced in their Response to Comments on 310 CMR 7.74 and 7.75 an intention to conduct a stakeholder process to finalize auction design details before the auction would go into effect in 2019, and acknowledged the possible need for additional rulemaking in 2018 to address outcomes of that process. The initial phase of this stakeholder process was conducted in October and November 2017, and consisted of the publication of a stakeholder discussions document, a stakeholder meeting, and two written comment periods.

EEA and MassDEP have reviewed comments submitted during the stakeholder process and determined that many of the comments received can be addressed under the existing regulations. The existing regulations allow flexibility regarding issues such as auction timing, bid limits, and the use of a minimum reserve price to recover at least the costs of administering 310 CMR 7.74. Because of this flexibility, EEA and MassDEP are not proposing any regulatory changes to address these issues, and instead intend to address them in auction design documents under the existing regulations that the agencies will develop in consultation with an independent market monitor and auction administrator.

The comments did, however, identify four issues that could require amending 310 CMR 7.74. For the first three issues (timeline for transitioning to an auction, banking of allowances, and compliance flexibility) EEA and MassDEP are proposing specific regulatory text at this time. For the fourth issue (participation of third parties in the auction), EEA and MassDEP are not proposing any specific regulatory language at this time. The four issues are:

- (1) Timeline for transitioning from free allocations to auctions: 310 CMR 7.74 currently requires MassDEP to auction all allowances beginning in 2019. Several stakeholders proposed a gradual transition to auctions, whereby an increasing fraction of allowances would be auctioned over several years. Even stakeholders that did not strongly support this option acknowledged potential benefits, and no stakeholder identified any disadvantages of such a transition. Therefore, to address these comments, the agencies are proposing a two-year transition period. Under this proposal, a fraction of allowances will be auctioned in 2019 and 2020, with a full auction beginning in 2021. This proposed schedule would create two transition years to facilitate the transition to a full auction in 2021. The transition period will also afford EEA and MassDEP with the ability to collect more data and information on the auction process and make any additional adjustments deemed necessary by the agencies as the program moves toward a full auction of all available allowances in 2021. Two years should be sufficient to address this purpose, and largely accommodate the ISO-NE forward capacity market schedule referenced by some commenters. Commenters are encouraged to address the potential value of a third transition year in their written comments.

- (2) Compliance Flexibility: MassDEP is proposing to eliminate language that limits the use of “emergency deferred compliance” to the last 45 days of each calendar year and replace it with a provision that extends that flexibility to the entire calendar year. Under the current emergency deferred compliance provision, and as described in the RTC, “a facility that does not fully comply with 310 CMR 7.74 for a particular year because its availability was needed to ensure the reliable operation of the electric grid during the last 45 days of any calendar year may elect to postpone a portion of its compliance obligation until the following year’s compliance deadline.” RTC, p. 46. The trigger for that option, as also described in the RTC, is an “emergency,” which is defined “based on the issuance by ISO-NE of an alert to market participants that ‘an abnormal condition affecting the reliability of the power system exists or is anticipated’ (i.e. “Master Control Center Procedure No. 2” under current ISO-NE operating procedures).” Id. The proposed change would address stakeholder comments regarding the availability of allowances in January 2018, when ISO-NE issued such an alert, and other defined emergencies that may occur in the future.
- (3) Participation of entities that are not regulated power plants: 310 CMR 7.74 does not currently allow “third parties” to participate in the allowance auctions. Several stakeholders suggested that allowing third party participation could support market liquidity. However, other stakeholders disagreed, citing concerns about price volatility and distorted price discovery. Some supportive commenters also noted a need to place limits on the participation of third parties to prevent such impacts. No comments were received from potential third-party market participants. EEA and MassDEP considered the conflicting nature of these comments, the administrative burden of significantly increasing the number and type of regulated entities, and potential impacts on the secondary allowance market, and concluded that it would be most prudent not to propose to amend 310 CMR 7.74 to allow participation by third parties at this time. While EEA and MassDEP do not plan to make any changes on this issue at this time, the agencies nonetheless welcome any additional comments on the topic as they will continue to assess this issue as the program matures with the assistance of an independent market monitor.
- (4) Banking of allowances: Several commenters expressed opposition to a provision in the current regulation that limits “banking” of unused allowances. At least one of these commenters expressed concern about the current banking structure of the regulation because excess allowances are removed from facility accounts without compensation. Other commenters supported the use of unlimited banking, but acknowledged that the agencies’ use of limits on banking might be needed to ensure an annually declining GHG emissions limit and also might be useful to prevent over-procurement of allowances.

The current regulation limits the number of allowances that each facility can bank for future use to a small fraction ($\approx 2.5\%$ in 2018-2019) of allowance holdings. Any allowances held

by facilities at the compliance deadline are deducted from accounts to enforce the banking limit, and also to encourage facilities to trade excess allowances in advance of the compliance deadline. This structure is designed to ensure that no more than 223,876 banked allowances are available for use by facilities in any year. Because the aggregate emissions limit declines by 223,876 each year ($\approx 2.5\%$ of the 2018 limit), this has the effect of ensuring that, even if facilities use banked allowances, each year's emissions are below the prior year's regulatory emissions limit (though the current year's limit could be exceeded by up to 223,876 allowances if banking occurs). In other words, 310 CMR 7.74 is currently written to allow limited banking and to allow small increases in the annual limit, while ensuring that emissions still continue to decline each year.

In response to comments on the current banking limits, EEA and MassDEP are proposing to amend 310 CMR 7.74 to allow unlimited banking without changing the total allowable amount of emissions from all regulated facilities each year. Under the proposed approach, unlimited banking by facilities would be allowed, but the number of allowances offered for sale at auction each year would be set to ensure that emissions do not exceed the amount allowable under the current regulation and, therefore, still continue to decline each year. Specifically, EEA and MassDEP are seeking comment on removing regulatory limits on banking by individual facilities, but, in the event that the total number of banked allowances exceeds 223,876 (the total allowable number of banked allowances under the current regulation) in any year, the Agencies would reduce the number of allowances auctioned by the number of excess banked allowances above 223,876 in the auction(s) for the following year.³

This option would ensure annual emissions reductions, while addressing concerns raised by commenters and offering increased compliance flexibility. EEA and MassDEP invite comment on this approach, including but not limited to, the following questions:

- What are the pros and cons of this proposed option?
- One commenter suggested that facility-specific auction bid limits could be necessary to deter “over procurement” if the banking limits were removed. Would such limits be necessary under the approach described above? Are they viable?
- Are there other options for removing limits on banking that continue to ensure compliance with the current regulations' annual declining emissions limits? For example:
 - One alternative is to reduce the number of allowances auctioned by the full number of banked allowances the previous compliance year. What are the pros and cons of this option as compared to the option above?

³ To ensure that emissions decline annually (vs. remain constant), the proposed regulatory language references 223,275 allowances instead of 223,276 allowances.

- Another alternative would be to require similar limits on the use of banked allowances for compliance.⁴ What are the pros and cons of this option as compared to the other options?
- How would any of these unlimited banking options affect the allowance market, demand for allowances, allowance prices and emissions? If there are any such effects, how would unlimited banking affect the program's ability to meet its emission reduction requirements?

EEA and MassDEP request comment on all aspects of banking, include the specific approach and questions listed above.

EEA and MassDEP's proposed amendments are described in detail below. In addition to commenting on the specific proposed amendments and questions listed above, commenters are encouraged to comment on whether any additional regulatory amendments are needed to address auctions. Such comments may include suggestions that reduce flexibility in administration of auctions, for example by requiring the use of a particular reserve price calibrated to cover the agencies' administrative costs of implementing 310 CMR 7.74, or specifying that unsold allowances will be re-offered for sale during subsequent auctions during the same year but not in later years. EEA and MassDEP will consider such comments, potentially with the input of a market monitor, and the agencies may finalize additional changes to the regulation to address relevant comments in this rulemaking.

EEA and MassDEP are not proposing, considering, or soliciting comment on any changes that could increase the aggregate amount of emissions allowable in 2018, 2019, 2020, or any other year.

III. DESCRIPTION OF THE PROPOSED AMENDMENTS

310 CMR 7.74 requires MassDEP, on behalf of itself and EEA, to auction all allowances beginning in 2019. Under the transition approach supported by commenters, there would be two years during which only a portion of allowances are auctioned, with the remainder distributed through free allocations. The specific approach included in the proposed regulation would:

- Require MassDEP to auction 25% of the 2019 total aggregate CO₂ emissions limit, and 50% of the 2020 limit. Full auctioning (100% of the total aggregate CO₂ emissions limit) would begin in 2021 and remain in place for all later years;
- Set the new facility allocation to 75% and 50% of the 2018 new facility aggregate CO₂ emissions limit in 2019 and 2020, respectively, matching the auction transition schedule; and

⁴ Under this approach, there would be no limits on banking of allowances by individual facilities, but facilities would only be allowed to use banked allowance to cover a small fraction (≈2.5% in 2019) of their compliance obligations.

- Set the combined existing facility allocation for 2019 and 2020 equal to the remaining quantity of allowances after accounting for auctioned allowances and the new facility allocation. The allowances would be allocated among existing facilities based on each facility's share of the 2018 existing facility CO₂ emissions limit.

Specific allocations for 2018 and 2019 are included in the regulation, and a spreadsheet showing the calculation of these allocations is included in this TSD as attachment A.

The draft regulatory text also includes amendments to address banking and emergency deferred compliance, discussed in detail above, and several other proposed clarifying edits.

IV. IMPACTS OF PROPOSED AMENDMENTS

Economic Impacts: The amendments will have minimal economic impacts during 2019 and 2020, if any, and will not have any impact after 2020. If stakeholders are correct regarding the benefits of a transition, then the amendments could reduce any economic impacts of 310 CMR 7.74 by improving the efficiency of the allowance market. However, given projected low allowance prices, possibly equal to zero, significant impacts are not anticipated. Another possible impact could be a reduction in the amount of auction proceeds during the two year transition period, which, if otherwise received, would be invested in programs and projects designed to mitigate electricity generating facility CO₂ emissions allowed under the regulation. No small businesses are regulated under 310 CMR 7.74 and the proposed amendments will not have any negative impact on small businesses.

Impact on Massachusetts Municipalities: Cities and towns that own regulated electricity generating facilities could experience lower compliance costs in 2019 and 2020 because of the free allocation of allowances that they would otherwise need to purchase at auction.

V. MASSACHUSETTS ENVIRONMENTAL POLICY ACT (MEPA)

Pursuant to 301 CMR 11.03(12) (MEPA Regulations), these proposed regulatory amendments will not reduce standards for environmental protection, opportunities for public participation in permitting or other review processes, or public access to information generated or provided in accordance with these regulations. Promulgation of these regulatory amendments, therefore, does not require the filing of an Environmental Notification Form under MEPA.

VI. PUBLIC HEARING AND COMMENT

EEA and MassDEP are providing the opportunity to review the proposed amendments to 310 CMR 7.74, the background document and any technical information. A public hearing will be held in accordance with the procedures of M.G.L. Chapter 30A. The hearing notice and proposed

amendments are available on MassDEP's website at www.mass.gov/eea/agencies/massdep/news/comment/. Questions about this document may be addressed to Will Space at 617-292-5610 or william.space@state.ma.us.