

State GHG programs could see legal hurdles

State-based greenhouse gas programs are steadily building momentum as regulators move past the mere setting of targets and start working out how best to meet them. But some opponents of these programs are quietly preparing to bring progress to a screeching halt.

Those working against state-based GHG programs have so far been content to voice their opposition in stakeholder meetings and press releases. Regulators and legislators still have not carved anything in stone, and public pressure may still persuade them to alter or abandon their GHG proposals.

But some within the business and industry lobbies are working out of the spotlight on a much more aggressive approach: taking the states to court.

“Someone will file a lawsuit over this,” New England Council (NEC) General Counsel Kevin Conroy told *Argus*.

The NEC represents business interests in the Northeast, which may become host to the Regional Greenhouse Gas Initiative (RGGI) in 2009. RGGI would create a carbon cap-and-trade program targeting power generation in seven states — New York, New Jersey, Delaware, Connecticut, Vermont, New Hampshire and Maine. The RGGI draft model rule is currently out for public comment, and once a final version is settled upon, each state will decide either through regulations or legislation how it will be enforced. For the moment, NEC believes it can use persuasion to win concessions from the RGGI states, but some within the industry lobby are starting to develop a legal strategy against the program.

“Most of us are focused on trying to improve the RGGI program through the political and the regulatory environment. Not a lot of us are focused on the legal side,” Conroy said. “I would think the legal efforts will increase if industry believes that the program was going to do some detrimental harm.”

The beginnings of what may become an industry-led strategy to derail RGGI and other state-based programs can be found in a small number of articles in legal journals and court briefs.

These legal opinions try to build a constitutional case against state-based GHG programs, on three major grounds. Firstly, industry lawyers argue that Congress and President Bush have decided to favor voluntary GHG programs, which overrules any state-based mandatory program.

Secondly, the lawyers argue climate change is an international problem, and states that unilaterally make GHG cuts illegally undermine Bush’s ability to resist making reductions at home until developing nations agree to cut their own emissions output.

Thirdly, the lawyers argue any effort to prevent leakage — where power from a state without GHG controls is allowed into a state with GHG regulations — would tread on the federal government’s constitutional authority to regulate commerce between the states. A related argument claims any attempt to link a state-based GHG trading program to an overseas carbon market, such as the EU emissions trading scheme, illegally undermines the federal government’s authority to regulate foreign commerce.

The Washington Legal Foundation (WLF), a conservative think-tank, published two legal opinions in late 2005 that argue RGGI and other state-based programs, like the Western Governors’ Initiative, are on shaky legal ground.

The foundation is helping to develop a legal strategy to defeat RGGI on constitutional grounds, WLF Senior Executive Counsel Paul Kamenar said. WLF and other conservative legal groups are developing legal arguments they hope will defeat state-based GHG programs in court, Kamenar said. Groups like WLF often do the groundwork on these legal strategies, which are later picked up by individual companies and industry groups, Kamenar said.

Continued on p4

In this issue

- 1** State GHG programs could see legal hurdles
- 2** Are we there yet?
- 3** RGGI seeks balance of authority
- 3** Progress to install controls on Fla. units
- 4** Maryland bill pushing RGGI progresses

- 5** Financial players dominate SO₂ auction
- 5** Rule would ease MACT restrictions
- 6** Enforcement Briefs
- 8** SO₂ auction provides little guidance
- 8** NO_x still quiet as ozone season nears



Argus Clean Air
Compliance is
published by
Argus Media Ltd.

www.argusmediagroup.com

Main offices:

Washington: 1012 14th Street NW,
Suite 1500, Washington, DC 20005
Tel: +1 202 775 0240 Fax: +1 202 872 8045

Houston: 3040 Post Oak Boulevard,
Suite 550, Houston, Texas 77056
Tel: +1 713 968 0000 Fax: +1 713 622 2991

London (head office): 175 St John Street,
London EC1V 4LW. Tel: +44 20 7780 4200
Fax: +44 20 7780 4201

Singapore: 22 Malacca Street, #10-02
Royal Brothers Building, Singapore 048980z
Tel: +65 6533 3638 Fax: +65 6533 4181

Moscow: Suite 53, ul. Petrovka 17/4,
Moscow 103031, Russia. Tel: (+7) 495 933 7571
Fax: (+7) 495 933 7572

Senior Editor:

Caroline Gentry

Editors:

Michael Ball, Carrie Sisto, Simon Lomax

Production Editors:

Andrew Sutton, Yuri German

email: airdaily@argusmediagroup.com

Contributing Editors:

Ross Allen, Abby Caplan, Jamie Webster,
Peter Gardett, Steve Campbell, Carli Flippen,
Christopher Newman, Milena Yordanova,
Marcin Skomial, Elizabeth Rosenberg,
Funda Saygin, Stefan Stoynov

Subscriptions:

For information on multiple subscription rates
or site licensing contact Robin Saikin at
(713) 968-0000 x121 or email
sales@argusmediagroup.com.

Customer Service:

For questions regarding subscriptions
or circulation, please contact
Zachary Rhonheimer at (202) 775-0240 x255.
1012 14th Street, NW, Suite 1500
Washington, DC 20005
email: support@argusmediagroup.com

Business Development:

Daniel Massey, Miles Weigel

Publisher and CEO:

Adrian Binks

© Copyright 2006 by Argus Media Ltd.

All rights reserved. (ISSN 0732-8397)
Reproduction, retransmission or storage
of this publication in any form is forbidden
without prior written permission from
Argus Media.

Are we there yet?

After years of going slow on greenhouse gas regulation, and protecting coal-fired power plants in the process, Congress found itself in a strange position this week. A group of lawmakers invited some power generators to speak about climate change, but instead of accepting a pat on the back, they received a slap on the wrist.

“The committee has held hearings on climate change issues for nearly 30 years,” an executive with Exelon told the Senate Energy and Natural Resources Committee. “It’s time to act.”

Exelon was one of four utilities who spoke in favor of a carbon cap-and-trade program for the US at the committee’s April 4 climate change conference. The committee is drafting a bill to regulate GHG in the US, and as far as these four utilities are concerned, the sooner the better.

A program that starts now can tighten its targets “gradually over time,” Duke Energy’s representative told the committee. According to the top executive at PNM Resources, “now is the time for a healthy debate at the federal level on climate change.” And the federal government needs to take charge of the GHG issue before power companies are forced to comply with “a patchwork of state regulatory programs,” Sempra Energy said.

These power companies view some form of GHG regulation as inevitable, and they are about to invest in new power stations to meet the economy’s growing thirst for energy. They want to know how these plants will be treated under the coming GHG regime before committing billions of dollars upfront. Adding to their sense of urgency is the chance that Republicans may lose control of the White House in less than three years and Congress this November.

But before he was told to hurry up on cap-and-trade this week, Sen. Pete Domenici (R-N.M.), the chairman of the energy committee, warned that there is still plenty of waiting to be

done. Last year, Domenici convinced the committee’s ranking member, Sen. Jeff Bingaman (D-N.M.), to pull a cap-and-trade proposal based on the recommendations of the National Commission on Energy Policy. Bingaman raised the proposal during the debate over energy bill, and Domenici argued the GHG issue required more research before legislation was offered.

“I felt then and I feel now that designing and implementing a mandatory system would be very difficult both politically and economically. Consensus will be a very difficult thing,” Domenici said at the opening of the conference. “But I also feel ... we need to start somewhere and this conference is our starting point.”

One possible starting point for cap-and-trade supporters within the power sector could be forming a consensus within their own industry. Although the list of speakers at this week’s conference was heavily stacked with advocates of mandatory GHG programs, a few dissenters were allowed.

Southern Co. and AEP voiced their support for voluntary action on climate change at the conference. “Our nation’s efforts and resources ought to be committed to the development of new technologies to address climate change rather than being focused on mandatory caps and taxes,” a Southern executive told the conference.

A representative of the Edison Electric Institute echoed these sentiments, after senior officials with the power industry’s peak group reaffirmed the organization’s stance on climate change last week.

With one part of the power sector lobbying for GHG regulation, and the other pressing for the same kind of protection from carbon caps it received in the past — to say nothing of the division over climate change within other industries like oil and chemicals — there is little wonder Domenici is counseling patience.

RGGI seeks balance of authority

A draft model rule of what may become the first mandatory US carbon market does not yet adequately identify which provisions of the rule must be regionally uniform and what issues states should have flexibility to address individually, stakeholders say.

The seven Northeastern states involved in developing the Regional Greenhouse Gas Initiative (RGGI) have the authority to implement the program in a state-specific manner, but stakeholders are concerned that too much flexibility could hinder the development of a well-functioning market for compliance with the regional cap-and-trade scheme to reduce GHG emissions.

The RGGI staff working group (SWG) released a draft model rule March 23 that targets the utility sector and aims to stabilize GHG emissions from fossil fuel-fired power generation from 2009, then reduce emissions 10 pct by 2020.

“While it is great the states have released the draft according to their timetable, and they are plowing forward on this according to schedule, with additional states such as Massachusetts and Maryland looking to join legislatively, there are still some concerns about the specificity of the guidelines,” said Dale Bryk, lawyer with the Natural Resource Defense Council.

The baseline for the region’s carbon dioxide emissions is set at nearly 123.3 million tons/yr. The seven states will allocate this number of allowances each year from 2009-2014, and then ratchet down the supply by 2.5 pct/yr from

2015-2018. The allocation for 2018 and 2019 will be around 109.1 million tons/yr, or 10 pct less than the baseline.

Additionality of offset projects remains a big concern among stakeholders on all sides, said Madeleine Tan, lawyer with Brown Rudnick’s Climate and Energy Group. The standards associated with offsets are still relatively vague, Tan said, raising concerns about what will qualify as an offset, how those qualifications may vary among states, and how a project can be verified to be applicable under any state’s specific plan to implement the rule.

Of major concern is that RGGI will be implemented in a “patchwork-quilt” fashion, much like the individual states’ renewable energy initiative programs that all have individual standards and guidelines for offset qualification so projects are not fungible between states, Tan said. Although the model rule is being developed to give the states flexibility to implement the program specific to their needs, the development of the model is to encourage the seven states to design similar rules and guidelines so their programs can interact on a regional scale, Tan said. Otherwise, there would be no way to realize economies of scale in GHG reductions and technology transfer.

The seven states’ governors agreed when laying out the basic structure of RGGI in their memorandum of understanding (MOU) last year that 25 pct of each state’s allowance budget would be auctioned off, with revenue from

Continued on p7

Progress to install controls on Florida units

Progress Energy Florida plans to spend \$736 million on new pollution controls and switch to low-sulfur fuels at two generating facilities as part of the company’s plans to meet new federal regulations taking effect over the next few years.

The Progress Energy subsidiary said March 31 it will install low-NO_x burners with separated over-fire air to reduce nitrogen oxide emissions from both units of the 993MW Anclote generating station. And it will install low-NO_x burners and selective catalytic reduction (SCR) units to reduce NO_x emissions from units 4 and 5 of the 2,300MW Crystal River station. The company also will install scrubbers on Crystal River units 4 and 5 and switch to low-sulfur coal to fire units 1 and 2. Progress will switch to low-sulfur oil and natural gas to reduce SO₂ emissions from the Aclote units. And it will install a powder-activated carbon (PAC) injection system to lower mercury emissions from Crystal River unit 2.

The scrubbers and SCRs at Crystal River will cut SO₂ by 97 pct and NO_x by 90 pct, Progress spokeswoman Cherie

Jacobs said. An 80 pct reduction in mercury is expected from the PAC system and co-benefits from the scrubbers and SCRs, she said. No reduction numbers were available for the controls and fuel changes at Anclote.

The scrubbers and SCRs will be installed by 2008 and 2009. The PAC system will be in place by 2017. The fuel switching will take place by 2010. The company today also filed a petition to recover the cost of the controls with the Florida Public Service Commission.

The company said it was installing the controls in response to major federal regulations, including the Clean Air Interstate Rule (CAIR), Clean Air Mercury Rule and Clean Air Visibility Rule.

Progress is one of several utilities challenging parts of CAIR in the DC Circuit Court of Appeals. Progress is protesting the inclusion of Florida in CAIR for ozone. Earlier this month, EPA upheld its decision to place Florida in the program. The state is part of the CAIR region for both ozone and particulates. EPA projects the state will reduce NO_x emissions 76 pct and SO₂ 65 pct by 2015.

Md. bill pushing RGGI progresses

A bill requiring Maryland to join what may become the nation's first mandatory carbon market has progressed through the Maryland General Assembly, with the bill's fate now resting on Gov. Robert Ehrlich's (R) approval.

The Healthy Air Act (HAA), as passed by the state Senate on March 21 and by the House Committee on Economic Matters on March 30, has been amended from the original proposal in an attempt to "veto-proof" the bill, adopting limits for criteria pollutants that largely reflect a rule proposed by Ehrlich as an alternative to the four-pollutant bill. But the version passed by both branches is expected to emerge from the General Assembly with a provision that would force Maryland to cut carbon emissions from coal-fired power plants.

The carbon limit is included through a provision that would force Ehrlich to sign onto the Regional Greenhouse Gas Initiative (RGGI). The governors of the seven RGGI states — New York, New Jersey, Delaware, Connecticut, New Hampshire, Vermont and Maine — signed a memorandum of understanding last year agreeing on the basics. The MOU agreed the governors would adopt programs in their states targeting the utility sector and aiming to stabilize GHG emissions from fossil fuel-fired power generation from 2009, then to reduce emissions 10 pct by 2020.

The HAA passed the full House March 31 in a vote of 107 - 27, and has been returned to the Senate floor to "iron out a few differences," said Pamela Shurkin, legislative director for Sen. Paul Pinsky (D), who sponsored the HAA. It will then go to Ehrlich for approval, she said.

"The two branches should be able to sort out any differ-

ences between the two versions of the bill quickly, and the bill should proceed to the governor's desk in short order," said Chris Fick, policy associate with the Maryland Public Interest Research Group.

The House debated more than 30 amendments, but made only two major substantive changes. The committee agreed to commission an independent economic study before most of the RGGI requirements come into force. The bill as it passed the Senate would require the state to be included as a full participant in RGGI no later than June 30, 2007, but allows for withdrawal from RGGI if participation is found to compromise the reliability of the electric system. The Senate bill would put carbon limits and caps on criteria pollutants on Allegheny Energy's RP Smith station; Constellation Energy's Brandon Shores, Crane and Wagner plants; and Mirant's Chalk Point, Morgantown and Dickerson plants. The House bill provides that RP Smith be exempted should the limits cause technical or financial difficulties.

The legislative session ends on April 10.

If the HAA passes through the assembly as expected and is signed by Ehrlich, Maryland would then have to design a state plan for adopting the RGGI model rule, released March 23, in order to participate in the regional carbon market.

The Ehrlich administration has said it would not agree to sign on to RGGI, instead pushing for a Clean Power Rule that, while more stringent than the federal standards for sulfur dioxide, nitrogen oxides and mercury, does not include a cap on GHG emissions. Ehrlich is concerned that, given the expiration of the rate freeze in Maryland, any additional emissions adders could hurt electric consumers in the state.

State GHG programs could see legal hurdles

Continued from p1

"We give them additional resources, information, research — ammunition if you will — to mount any legal challenge, if it should come to that," he said.

But while lawyers working against state-based GHG programs are happy to talk about the legal arguments that might be used, they are tight-lipped about who is planning to take legal action, when the lawsuit will be filed and where the case may be heard. Companies and organizations who may ultimately take the states to court do not want to "tip their hand," said Lawrence Kogan, the co-author of one of the WLF papers. The potential plaintiffs are also unsure about the timing of a lawsuit, because in the case of RGGI, they cannot start legal action until the states start creating regulations and passing laws to implement the model rule, Kogan said.

"The reason you haven't seen a lawsuit yet is that [RGGI] isn't concrete yet," he said. "It's a moving target."

While some within the industry might be getting ready for a legal battle now, in the case of RGGI, a potential legal challenge is probably more than a year away given the time it takes to finalize and implement a model rule across seven states, Conroy said.

"The lawsuits would begin somewhere in the late 2007 and 2008 period," he said.

But the RGGI states are confident that if a legal challenge comes, their cap-and-trade program will prevail.

"The RGGI states and New York state are highly confident that the process could withstand any legal challenge mounted against it. And that goes for both state and federal law," New York Department of Environmental Conservation spokeswoman Maureen Wren said.

"We are confident that RGGI was carefully crafted to stand up to any legal challenges," said Doyal Siddell, spokesman for the New Jersey Board of Public Utilities.

Financial players dominate SO₂ auction

Financial players won the majority of SO₂ allowances sold by EPA in this year's allowance auction, according to results released March 28. Bids were lower than expected and utility participation was down compared with last year.

The weighted average of successful bids was \$883.10/ton, below the closing price of \$900 on March 21, when bids were due. The market had retreated from highs of \$1,600 last December in advance of the auction, and some had predicted an aggressive push for allowances by utilities. That failed to materialize, and only 22 bidders took part, 14 of whom were successful. Eight placed bids below the clearing price of \$860.07, the lowest price at which a successful bid was made. Last year there were 31 bidders, only 17 of whom were successful.

Morgan Stanley secured 56 pct of the 125,000 available spot allowances. Its highest bid was \$905.13 and its lowest successful bid was \$866.17. JP Morgan, Alpha Energy Master and Evolution Markets each won 8 pct. Edison Mission, a subsidiary of Edison International, was the biggest utility buyer, winning 12 pct, with bids ranging from \$885 to \$910. Constellation and South Carolina Public Service Authority also put in successful bids. AEP and Ameren, who were both active bidders in previous auctions, did not bid for tons in this year's auction.

Some environmental groups bought up small volumes at higher prices, with the highest bid at \$1,700 by the Clean Air Conservancy.

Prices in the over-the-counter (OTC) market initially backed off, but came back to end the day at \$870-\$890. With such lackluster interest in the auction from players

with physical positions, last year's post-auction spike looks unlikely to be repeated.

One source speculated that after a mild winter, utilities may have less demand for spot allowances, and also may have depleted cash reserves due to low power sales. EPA requires bidders to post cash to cover their requests, which is returned later if bids are unsuccessful.

Utilities may be playing a wait-and-see game after noticing that in previous years prices spiked as unsuccessful bidders turned to the OTC market to cover positions. But this may be a dangerous tactic now so much control is in the hands of purely speculative players. "Hedge funds and financial traders can afford to ride out any dips, and as they take tons off the market they will hold them until people who need to buy will come in and have to buy at higher prices," one trader said.

Traders said that current prices still represent the low end rather than the high end of the near-term range. Although a huge wave of scrubber projects is under construction, this will not make a significant dent in yearly emissions — which still exceed the cap by 700,000 tons — until after 2008. The cost of scrubber projects going in now is in the region of \$400-\$700, but generators will have to climb the marginal cost curve to achieve deeper cuts. Some scrubber projects that were accelerated when prices shot over \$1,000 may now be postponed.

But long-term, forecasters are beginning to predict that the value of SO₂ allowances will be eroded as scrubbers come on line and replenish the bank, which stands at just more than 6 million.

Continued on p7

Rule would ease MACT restrictions

EPA is considering regulations that would make it easier for sources of toxic air pollutants to avoid stricter emissions standards by reclassifying them as minor sources, according to a draft of the proposed rule.

The draft proposal would allow major sources of air toxics to escape regulation under maximum achievable control technology (MACT) standards by seeking a change in classification from a "major" source to an "area" source at any time. Current policy allows the request to be made up until the first MACT compliance deadline for a facility. To become an area source, a facility would have to limit its emissions to less than 10 tons/yr of any single hazardous air pollutant (HAP) or less than 25 tons/yr of any combination of HAPs.

This would allow facilities subject to strict MACT requirements to increase emissions, according to envi-

ronmentalists. It would also allow companies to avoid monitoring, recordkeeping and reporting requirements associated with MACT standards, said John Walke, clean air director for the Natural Resources Defense Council (NRDC), which provided a copy of the draft rule.

The Clean Air Act requires EPA to set MACT standards for 188 different toxic substances emitted by more than 170 industrial sectors.

EPA was not available for comment by press time.

The proposal is also encountering resistance from EPA's regional staff. Officials at nine of the 10 EPA regional offices have told the agency that the proposal would allow industrial sources to "virtually avoid regulation and greatly complicate any enforcement action against them." EPA dismissed this concern by arguing in the draft

Continued on p6

Enforcement Briefs

East

The Massachusetts Department of Environmental Protection has cited 10 truck operators for violating state anti-idling regulations. The agency cited nine companies and a hospital during a recent enforcement sweep in several cities, most in the Boston metropolitan area. Twelve of 50 trucks observed were found to be idling for too long during stops. Cited for violations were: A&M Equipment, Campbell Electric, Costa Fruit & Produce, Finagle-A-Bagel, J&L Trucking, Monadnock Mountain Spring Water, NEMF/New England Motor Freight, Rutland Nurseries, Spaulding Rehabilitation Hospital and STP Logistics.

The Massachusetts Department of Environmental Protection has fined Hazen Paper of Holyoke \$3,000 for violating state air regulations. The company failed to follow internal procedures and permit requirements to ensure that fumes from a printing machine were vented to an oxidizer for destruction prior to being discharged into the air. The violations were self-reported by the company last year. The company has modified its operating procedures to prevent future violations. The fine includes a \$1,000 penalty and a \$2,000 contribution to a local vehicle recycling program.

EPA Region 1 is seeking a fine of up to \$325,000 against

Sikorsky Aircraft for violations of federal air standards and ozone protection regulations. EPA alleges that two refrigeration units at the Sikorsky plant in Stratford, Conn., violated the leak repair and follow-up repair verification requirements of the ozone protection regulations. As a result, the units emitted excess levels of ozone-depleting substances. The company also failed to document the type of service performed on the units, EPA said.

Midwest

EPA Region 5 has cited Perma-Fix of Dayton, Ohio, for violating air regulations at the company's wastewater and used oil processing plant. According to the agency, Perma-Fix modified its used oil operations and constructed wastewater treatment equipment without applying for the necessary air pollution control permits.

West

EPA Region 10 has filed a complaint against Altex Distributing for Clean Air Act and emergency planning violations. EPA claims that Altex, a supplier of chlorine and sulfur dioxide, failed to develop a risk management program, as required by the Clean Air Act. EPA is seeking a penalty of \$67,000.

Rule would ease MACT restrictions

Continued from p5

proposal that sources would not seek a reclassification and increase their emissions from MACT levels in order to avoid negative publicity and "maintain their appearance as responsible businesses."

But this is "overly optimistic," the regional officers said in a Dec. 13, 2005, memo to EPA headquarters, also provided by NRDC. "Regional experience indicates that sources requesting synthetic minor limits to avoid a MACT standard typically request, and are frequently given, limits of at least 24 tpy [tons/yr] for a combination of HAPs and 9 tpy for a single HAP. The regional offices anticipate that many sources would take less stringent than MACT requirements, if allowed," the regional officials said.

"Such objections underscore how the EPA would weaken the law and allow even more cancer-causing pollution into the air we breathe," Walke said.

Industries that may be able to benefit from the change say it will give companies the incentive to reduce emissions.

"According to a draft of the rule we have seen, major sources of HAPs would have to make actual emissions reductions through pollution prevention, installation of emission control systems, or a combination of both, in order to take advantage of the policy. Without the proposal, powerful disincentives would exist to make these reductions," National Petrochemical and Refiners Association President Bob Slaughter said.

The proposal is likely to become an issue at an April 5 confirmation hearing for Bill Wehrum, President Bush's nominee to be assistant administrator for Air and Radiation. The rule was drafted after Wehrum became acting assistant administrator.

"Once again, it appears that the EPA is looking for ways to make the Clean Air Act more friendly for polluters at the expense of public health. The rationale and ramifications of this rule will be front and center at Mr. Wehrum's nomination hearing," said Sen. James Jeffords (I-Vt.), ranking member on the Senate Environment and Public Works Committee, which is holding the hearing.

RGGI seeks balance of authority

Continued from p3

the sale going towards rebates for electricity consumers or funding energy efficiency and renewable power projects. Individual states should determine how to allocate the remaining 75 pct of their allowances between power plants for the years 2009-2012 no later than Jan. 1, 2009.

Tan was concerned that, because RGGI is such a small market with so few major stakeholders, 25 pct was too large a proportion of the market to go up for auction. "It could be monopolized, with one player coming in to corner and distort the market," Tan said.

This would make a secondary tool for compliance even more attractive. The MOU also specified that there will be no price cap under RGGI. Instead, the model rule has an offset trigger, or "safety valve," that allows a higher percentage of a company's compliance budget to be met with offsets rather than on-site GHG reductions. As the price for allowances goes up, more offsets will be allowed in the RGGI market. So, the additionality, qualification and fungibility of offsets are particularly important for stakeholders on all sides — environmentalists who want to be sure real GHG reductions are achieved and utilities that want to make sure they are buying projects that will put them in compliance with the rules.

The model rule must be sufficiently specific on offset guidelines, so there is no opportunity for discretionary decision making, Bryk said. She said vagueness has plagued the attractiveness of investment in offset projects in other cap-and-trade schemes for GHG reductions, such as the Clean Development Mechanism (CDM) under the Kyoto Protocol and the Oregon offset requirement for new power plants. "For CDM and the Oregon program, the general rules were laid out, but investors had no certainty their projects would qualify," Bryk said.

The model rule must lay out a uniform set of offset standards that all states accept and recognize for compliance purposes, in order to provide certainty and confidence in the offset market, Bryk said. Otherwise, there will be few incentives for renewable energy investors to get involved in the RGGI market.

But, as the model rule stands now renewable energy projects in states with existing renewable energy credit (REC) markets would not qualify as RGGI offsets, Tan said. Because renewable projects already would be developed for compliance with an existing incentive program, those projects are not "additional" as offsets are intended to be under the RGGI scheme, she said.

A broad variety of stakeholders, both environmental advocates and utility representatives, want to simplify the offset trigger, Bryk said. "If you are trying to attract investment in offset projects, the trigger gives no price stability," Bryk said. You would be dependent on the price of allowances reaching and maintaining a certain level in order to ensure some return on your investment, she said. "No one will buy an offset if allowances are cheaper, and right now modeling at even high natural gas prices [from last December] suggested a price range of around \$2-\$6/ton for allowances," Bryk added. She said this was because the cap on GHG emissions is relatively modest, so the required reductions should be relatively cheap.

Even if uniform standards are agreed upon, Tan said, there will still be a question of overall project screening. For the CDM program under the Kyoto Protocol, there is a detailed, bureaucratic and administrative process that qualifies a project as a credible offset that will be recognized by the international GHG market. "Without some sort of centralized body setting parameters and screening the projects, it is hard to see how the offset credits could be fungible between states," Tan said. She said many stakeholders are interested in making sure RGGI allowances and offsets are fungible in the international market, but without some sort of centralized body ensuring all the states are following the MOU, it would hard to garner international confidence.

The draft model rule is open for public comment until May 22. Tomorrow's stakeholders' meeting will be at the New York County Lawyers' Association in New York. A second stakeholders' meeting has been scheduled for May 2 at the Connecticut Department of Environmental Protection.

Financial players dominate SO₂ auction

Continued from p5

The average price for the 125,000 2013 allowances was \$275.13. Again, utilities were conspicuously absent among the 20 bidders. Missouri River Energy Services put in the highest bid at \$635. DTE won 10 pct of the allowances on offer from \$290.15 to \$337.15. But financial traders Morgan Stanley and JP Morgan secured the lion's share of the advance allowances. Future allowances under the Clean Air Interstate Rule will lose some of their compliance value, as

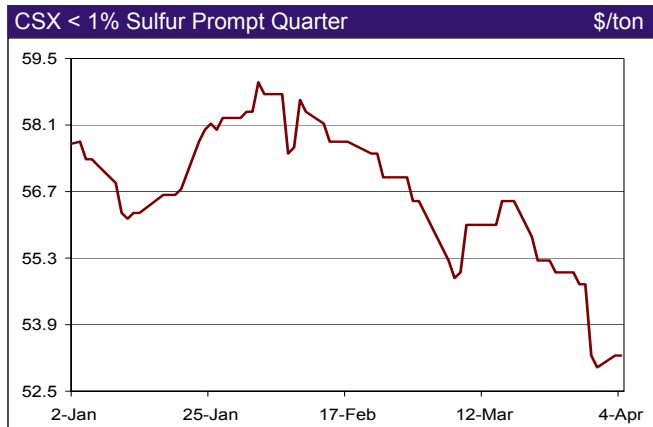
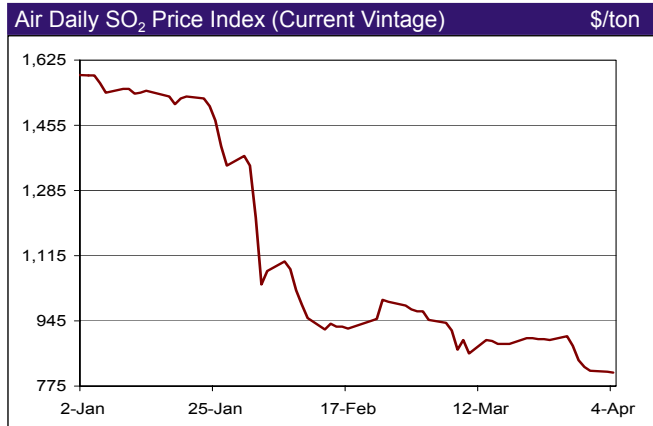
companies in certain states will be required to trade in two allowances for each ton of SO₂ from 2010-2015, and almost three allowances after 2015.

EPA each year reserves 2.8 pct of the allowances allocated under the Acid Rain program and auctions them off to the highest bidders to help with price discovery and to ensure a source of allowances for new electric generating units, according to the agency. Allowances are sold to the highest bidder until none are available.

SO₂ auction provides little guidance

The SO₂ market remains hesitant after EPA's annual auction attracted fewer utility bids than expected. The majority of the bids for the 125,000 spot SO₂ allowances and 125,000 vintage 2013 allowances that EPA did receive were below spot prices. This has pressured prices on the over-the-counter market since the results were announced on March 28, with spot trading lower on thin volumes. Spot SO₂ last traded at \$812.50/ton on April 4.

Options and futures contracts may become more attractive to utility traders as a hedge against future price spikes as warmer weather creeps in through the shoulder season, but few participants are willing to speculate what direction the market will take. Short term prices may be dragged down further as natural gas supply bottlenecks are eased by infrastructure developments in the producing regions. Longer-term, traders expect the results, which handed well more than half of the allowances auctioned to financial traders, will be a bullish force on the market. Players holding physical positions will have to comply at any price, one trader said. Those holding out of the market now may risk a repeat of last year when prices spike to record highs of \$1,600/ton in December. One trader speculated that \$1,200 was fair market value for allowances, given alternative compliance costs.



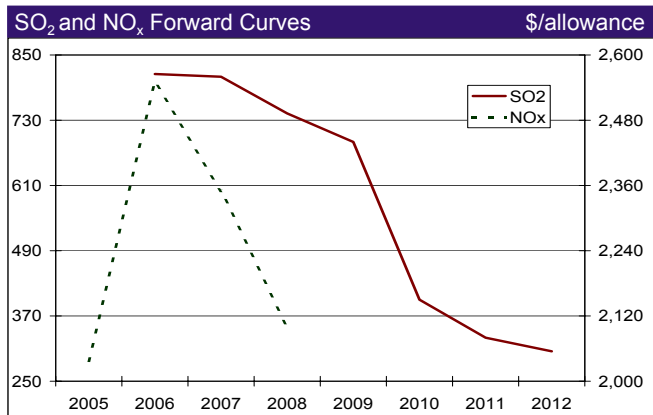
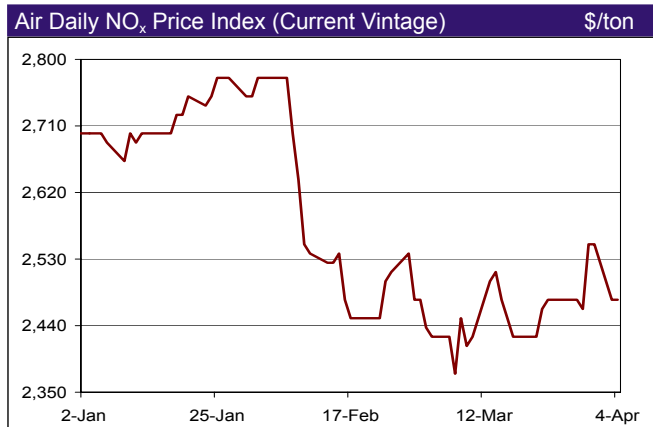
NO_x still quiet as ozone season nears

The NO_x market still has very little direction, despite the onset of the shoulder season. Current vintage NO_x has hovered in a range of \$2,400 - \$2,575/ton since early February, last trading at \$2,475/ton on April 3.

Options will likely become more popular as the weather heats up, especially after last year's late ozone season price spikes. A July call option traded on April 3 for a strike price of \$2,750 at a premium of \$65/ton.

Banked NO_x last traded at \$2,000/ton on March 28. The large bank of allowances available for compliance this year, combined with well functioning NO_x controls through last ozone season, suggest that generators will have little trouble meeting their limits this year. The bank of allowances was not drawn down as much as expected through last year's steamier-than-average summer, and most participants agree the bank will be large enough to trigger flow control through the beginning of EPA's Clean Air Interstate Rule (CAIR). But the bank continues to be valued higher than its implied discount rate because once CAIR takes effect in 2009, flow control will cease.

Few participants are quoting the forward years, and the 2007 vintage pattered around \$2,350/ton for much of the month, last trading there on March 21.





Argus Scrubber Report

Updated for 2006, the Argus Scrubber Report

From the publishers of *Argus Air Daily*, *Argus Coal Daily*, and the *Argus NO_x/SCR Report*.

The *Argus Scrubber Report* is an invaluable analysis tool for everyone interested in the power, emissions and fuels markets. At this critical time, when sulfur dioxide emissions allowances have surged above \$1,000/ton, the *Argus Scrubber Report* tracks current installations and future planning by generators to control their SO₂ emissions. The *Argus Scrubber Report* also provides insights into the future of fuel buying, as coal requirements will shift dramatically.

Owner	Plant	ORISPL	Unit No.	County	State	Nerc	MW	Control	Status	Year
AES	AES Beaver Valley	10676	1	Beaver	PA	ECAR	125	FGD	I	
AES	AES Cayuga (Milliken)	2535	2	Tompkins	NY	NPCC	167	WLS	I	1995
AES	AES Cayuga (Milliken)	2535	1	Tompkins	NY	NPCC	483	WLS	I	1995
AES	Petersburg	994	1	Pike	IN	ECAR	253	WLS	I	1996
AES	Petersburg	994	4	Pike	IN	ECAR	574	WLS	I	1986
AES	Petersburg	994	2	Pike	IN	ECAR	471	WLS	I	1996
AES	Petersburg	994	3	Pike	IN	ECAR	574	WLS	I	1977
AES	Somerset (Kintigh)	6082	1	Niagara	NY	NPCC	685	WLS	I	1984
Alabama Electric Coop	Charles R Lowman	56	2	Washington	AL	SERC	236	WL	I	
Alabama Electric Coop	Charles R Lowman	56	3	Washington	AL	SERC	236	WL	I	
Allegheny Energy	Harrison	3944	1	Harrison	WV	ECAR	684	WL	I	
Allegheny Energy	Harrison	3944	2	Harrison	WV	ECAR	684	WL	I	
Allegheny Energy	Harrison	3944	3	Harrison	WV	ECAR	684	WL	I	

SAMPLE

The list details the type of scrubbers and includes such key data as county, state, MW capacity and the ORISPL # (a key government ID for tracking plants).

Argus Media contacted more than 1,000 plants or their owners and discovered:

- More than 30 new scrubbers are currently being built across the US, mostly in the Southeast and Midwest, including 20 on which construction began in 2005.
- More than 150 sulfur dioxide-cutting units are planned, being considered, or under construction in the US and Canada.
- This year's list includes more than two dozen installations not included in the prior year report, mostly due to a wave of construction in the Ohio Valley.

Major generators AEP, Duke, Cinergy, TVA and LG&E all have scrubbers being built.

- More than 115GW of capacity could be in line to get scrubbers or other SO₂ controls in the next decade, with more announcements coming since EPA finalized its Clean Air Interstate Rule last March.
- The data also includes not only plants which are installing scrubbers, but ones that have them already and those which are considering them in the future.

**Know the facts. Have the information at your fingertips.
Order the Argus Scrubber Database TODAY!**

For pricing or other information, please contact:

Karen Johnson • 713-968-0022 • Karen.Johnson@argusmediagroup.com