STAFF DRAFT

EXCERPT FROM DECEMBER 2, 2005, PAPER ON BASELINES AND ALLOWANCE DISTRIBUTION METHODS[1]

***** [Original document has a discussion on baselines in the beginning.]**

Adjustments[2]

The baseline for an LSE could remain fixed; it could be adjusted periodically; or, it could be adjusted according to criteria for unique events. Unique events could be extraordinary load changes or shifts in an LSE provider. Adjustments could also be made when an LSE closes a plant that had self-generation. Because the term "updating" has particular connotations related to a cap-and-trade system for individual generating units that are not necessarily applicable to a load-based system, this discussion uses the concept of "adjustments" to distinguish changes in a baseline within load-based system. Updating the allocations based on changes in load or emissions on a pre-determined schedule would reward those entities that performed the worst in meeting the objectives of the allocation standard.

Because this is a load-based system, it will require each LSE to accommodate changes in load from normal economic activity. If there is growth in customers or use per customer, an LSE will have to meet CO_2 requirements with efficiency improvements or a change in the carbon intensity of its generation mix. While adjustments could account for unique circumstances, LSEs could also buy allowances from the auction or other LSEs to help accommodate for its load growth.

Whatever adjustments there are to the baseline of a particular LSE, the total emissions for the state would remain capped. Total free and auctioned allowances would decline on a predetermined schedule, perhaps after being fixed for an initial period, in order to meet 2020 and 2050 goals. Therefore, any adjustments would be a zero-sum game. For example, if allowances were held in reserve for large new loads or for new LSEs, they would have to come from within the cap. That would mean that fewer allowances would be distributed to other LSEs. Adjustments would also include transfers of allowances when loads shift from one LSE to another in specific circumstances. If adjustments result in some allowances being unallocated, such as with the closure of a self-generator, they could either be allocated to other LSEs or they could be retired. These cases are discussed below.

Adjusting the baseline is different from the issue of the rate of decline in the cap, which is discussed elsewhere. The rate of decline will be applied to each LSE's allocations.

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[1] The Oregon Department of Energy prepared this paper to aid the discussion of the Carbon Allocation Task Force in these issues. While some members of the Task Force reviewed an earlier draft, there is no implied endorsement by the Task Force or any of its members.

[2] This paper is written before the Carbon Allocation Task Force has discussed in detail how self-generators would be included in the carbon allocation standard. Later decisions about the scope of self-generators to be included might change some of the assumptions discussed in this paper.

Decision: Would the baseline remain fixed, would it be adjusted, or would it be updated?

Potential Adjustment Criteria
If the baseline were adjusted, several criteria might apply:

LSE Closing: The situation of an LSE closing would occur only for self-generators or Electricity Service Suppliers (ESS). A utility would not close per se because another LSE would serve the customers. Any movement of customers to another utility, including the sale of a utility, would be dealt with as a transfer, as discussed below.

If an LSE that was a self-generator went out of business, as opposed to closing its generator plant and putting its load onto another LSE, it would lose future allocations. The state issues allowances to serve the electrical loads in the state; therefore, there would be no grounds for continuing to give allowances to an entity that was no longer an LSE. The free allowances would not continue to be issued to a business that had no generation and load at the site that had previously received the allocation. Likewise, an ESS that served only a single customer that ceased operation would also not receive continued allocations.

If an LSE closed and its allowances were no longer allocated, there would need to be a policy for what happens to those allowances. They could be retired permanently, they could be added to a reserve for new large single loads, or they could be proportionally allocated to the other LSEs. Retiring the allocations permanently would be most consistent with the intent of the allocation standard.

It will be necessary to determine what constitutes "closure." For example, there could be a minimum level of generation or there could be a grace period, e.g. one year, after closure before the allowances cut off.

Decisions: If an LSE closes, would the allowances it would have received in the future be retired, added to a reserve for new large single loads, or allocated to other LSEs proportionally?

What defines closure?

Transfers of Load Between LSEs: The provisions dealing with load shifts attempt to resolve an equity problem and an efficiency problem. The equity problem is that under a load-based cap and trade system, allowances are associated with the loads. If the loads are transferred to a new LSE, emissions from resources to serve those loads are the responsibility of the new LSE. Without a provision for transferring allowances, the allowances to cover these emissions would remain with the old LSE. The efficiency problem is that a potential self-generator or ESS would be discouraged from serving a load if it had to buy all its allowances at auction.

If a customer's existing load is transferred to a different LSE or the customer begins to self-generate to provide for its own load, the allowances associated with that load would move with the load. The LSE transferee would receive allowances equal to its share of the former LSE's allowances associated with the load.

There can be three instances where a load transfers from one LSE to another:

1. Load is shifted between a self-generator and the local utility;
2. Load is shifted between PacifiCorp or Portland General Electric (PGE) and a retail Electricity Service Supplier (ESS) under ORS 757.600(16)); and,
3. Load is shifted through a change in the local utility serving a territory.

These should all be treated consistently. If less than a complete load were transferred, proportional allowances would transfer at the most recent allowance rate (metric tons of CO_2 per MWh) of the entity losing load, relative to the base period load. The allowance transfer is for tonnes of CO_2, whatever formula is used to determine proportionality.

It is necessary to define load reductions relative to the fixed load (presumably the base period load) because the allowance rates of the gaining and losing LSE will differ. If a load is shifted to another LSE and then shifted back to the original LSE, the proportional allowances would transfer back to the LSE at its original allowance rate until its load was equal to the base period load. Defining load loss or gain relative to the previous year's load for an LSE would mean that load shifted back and forth between two LSE's would ratchet the allowances of the two LSEs. The LSE with the lower allowance rate would see a net gain of allowances and the LSE with the higher rate would lose allowances by virtue of transferring if there were not a provision to prevent ratcheting.

This concern over ratcheting is most relevant if a self-generator serving its own load decides instead to sell the generation to the wholesale market and then asks the local utility to serve its load. This could go back and forth under existing law. This kind of back and forth could also occur between an ESS and either PGE or PacifiCorp.

Decision: Would allowances transfer when loads move between LSEs?

Reserve, or Set-Aside, for New Large Single Load: It may be appropriate to adjust an LSE's allocation to account for a new large electricity load at a single site other than by transfer. This would allow for major new industries to move into an area from out of state without placing the local LSE at a disadvantage. However, it is not intended as a mechanism to change the baseline to account for normal growth. On the other hand, flexibility mechanisms built into the standard, such as auctioning, trading and banking of allowances, and use of offsets, might be considered sufficient to meet any load changes. Furthermore, it might be considered inequitable to adjust allocations for adding large single loads without adjusting for losing large single loads. The standard is a zero-sum game, so any adjustments affect all other LSEs.

There is a precedent under the Regional Act for defining a new large single load as least 10 average megawatts added in a single calendar year. However, that would be relatively small for PacifiCorp and PGE and exceptionally large for a small COU. Another approach would be to set a threshold at a percentage of an LSE's load at a magnitude that would be truly exceptional, such as 20 percent. The higher the threshold, the less likely the adjustment will be used.

The allocation could be met by a withdrawal of allowances from the total allocations for the next year or there could be a set-aside to cover the need for such allowances. In either case, the newly allocated allowances would also come from within the cap of freely distributed allowances and would reduce the free allocations to all other LSEs. Also, reserves would have to be replenished as allowances are allocated to new large single loads.

There would have to be method for determining what would be an equitable allocation of allowances to a new large single load. The allowance rate could be based on a best available technology standard, the statewide allowance rate, the allowance rate of the local LSE, or some other formula. There might be consideration for a limit on the total amount free allowances that any new large single load could receive.

While "new entrants" are a concern for generation-based cap-and-trade systems, the transfer mechanism would account for new self-generators in an LSE's territory. Transfer would also account for new utilities serving a territory.

Decisions: **Should there be an adjustment to allocations to account for new large single loads or loss of large single loads?**

What would constitute a new large single load and would it vary by size of LSE?

Should an allowance reserve be established for new large single loads or should allowances for new large single loads come from the total pool of allowances as needed?

- **How large would a reserve be?**
- **How would allowances be distributed to meet a new large single load?**
- **Would there be an annual limit of allowances for new large single loads?**

***** [Original document had a discussion of distribution of allowances.]**