

Carbon Allocation Task Force Subcommittee Meeting

July 27, 2006

Two World Trade Center, Mezzanine 5
121 SW Salmon, Portland, OR

Attendees: Angus Duncan, chair; Jim Edelson, Tom O'Connor, Kyle Davis,
Wayne Lei, Michael Early, Sean Clark
Staff: Phil Carver and Sam Sadler
Technical Advisor: Hal Nelson

Continuation of Offsets Discussion from July 6

Angus Duncan said he wanted credible, verified RECs from WECC, with a preference for those from WREGIS.

Tom O'Connor said that while a fluid, robust market may work, he doesn't see such a market happening in Oregon with two dominant players and many little ones. Small utilities may not fare well in an Oregon market. While the small utilities could join in a pool, that has extra administrative costs. Small utilities take no comfort in the assurance "don't worry, the market will take care of it." They have had bad experience with similar assurances in the past.

Duncan suggested there could be a safe harbor for an alternative, separate market for small LSEs. O'Connor agreed that it would probably take a JOA, but it would also take legislation to set it up. Duncan asked O'Connor to suggest a safe harbor structure that would work for small LSEs.

Kyle Davis said he could only support an auction if it purposed was to provide liquidity for small LSEs, but he was concerned about a design that might result in PacifiCorp subsidizing small LSEs. He suggested an alternative design that would allow the auction to set the price, but smaller players could buy first at that price.

Phil Carver suggested that the auction be limited to LSEs with provisions that prevent anyone LSE from cornering the market.

There was a discussion of the last paragraph of the July 6th draft minutes concerning dual use of RECs in an RPS and a carbon cap. Those minutes were corrected. (See posted minutes.)

Review of Matrix: "If Offsets Are Allowed for Compliance"

Staff distributed a matrix that recommended where authority for different types of decisions (statute, rules, administrative decisions) should rest if offsets are allowed. A revised matrix is at the end of this section.

O'Connor asked who would write rules. Carver said it would either be ODOE or an independent commission, which ODOE would staff, such as the way the Energy Facility Siting Council works.

Davis speculated that ICNU would want no changes over time because that would limit types of offset projects. He recommended there be no limit on the number of offset tonnes allowed. Sam Sadler disagreed with the idea that there should be no limit on the amount of offsets and supported the CCAP recommendation of keeping offsets to 25 percent of the required reduction below the baseline. Davis said that deciding on whether to have a limit would be a political decision that should be in statute. O'Connor agreed that whether and what a limit would be should be made by the legislature and that the legislature should set the parameters for evaluating offsets.

Duncan stated he preferred that the legislation give authority for evaluating offsets to an administrative body. Sadler added that it was not feasible to set specific evaluation criteria in legislation. The CO₂ standard defines offsets broadly and requires that they be quantifiable, verifiable and additional. Anything beyond that should be tailored to each specific type of offset proposed. EFSC has rules about how it will evaluate offsets, but even those are somewhat broad. They will be adjusted for particular types of projects. He also doubted that LSEs would invest in long-term offsets themselves.

Hal Nelson noted that offset crediting is a function of technology and legislatures are singularly unprepared to deal with that. Accounting for changes in technologies over time should be a rule-making or administrative function.

Davis said there should be constraints on how often an agency can change protocols. He wants regulatory predictability. Jim Edelson said there should also be provisions that require agencies to update protocols as well. Regulatory inertia can be as much of a problem as regulatory over-action.

Duncan suggested that there be legislated boundaries that incorporate fundamental prudence, regulatory predictability, and a prohibition against retroactive changes on approved projects. He recommended a scheme where the regulatory agency would have to revisit rules at least every five years, but that an agency could not change its rules more frequently than every X years. O'Connor noted there should be rules for performance criteria as well. Davis suggested there might be a minimum offset project application size.

Duncan said that a change in the allowable number or percentage of offsets should be in legislation. He prefers more offsets allowed early and fewer later. He thought it would be harder for LSEs to reduce their emissions at the beginning. Sadler pointed out that that would mean allowing more offsets when all cost-effective conservation and renewables still hadn't been tapped. Davis said the amount of offsets allowed should be weighed against the price of the alternative compliance payment. Increasing the offsets could discourage LSEs from relying on the ACP. Wayne Lei said there should be variable amounts of offsets allowed over time. Michael Early suggested that change in the amount of offsets be made by rule once authority for offsets was set in legislation.

IF OFFSETS ARE ALLOWED FOR COMPLIANCE

| Actions | Authority | | |
|--|-------------|-------|----------------|
| | Legislative | Rules | Administrative |
| Authorize offsets to be used to comply with cap | X | | |
| Allowable greenhouse gases that qualify to provide offsets | X | | |
| Requirement that offsets be real, quantifiable, additional | X | | |
| Allowable amount of offsets and whether it should decline over time | X | | |
| Defining credit for offsets | | X | X |
| Define eligible sources of offsets | | X | X |
| Protocols for evaluating offsets projects and performance criteria | | | X |
| Rules for permanence | | X | |
| Criteria for additionality | | X | |
| Define locations from which offsets can come: in-state, regional, national, international. | X | | |

Borrowing

The placeholder is that borrowing from future allowances should not be allowed. Early noted that having a 3-year compliance period in effect allows borrowing within the period. Sadler noted that borrowing between compliance periods in effect bursts the cap.

Back to Banking

Duncan said that banking also allows for the same type of flexibility. Edelson asked about Nelson’s comment on July 6th that no other cap allows unlimited banking. Would unlimited banking create instability? He was concerned about gaming in a small market.

Davis said he expected all LSEs to be short, therefore, it is unlikely that there would be hoarding under a first-in/first-out scheme. Since PGE and PacifiCorp are regulated by the PUC, their actions would be transparent and they would be held accountable.

Duncan said banking offers an incentive to early actors. He did not think it would distort the market if only an LSE can bank its allowances.

Nelson noted that offsets could become a factor in banking if they are surrendered in lieu of allowances. He also said unlimited banking can flood the market, which can lead to volatility that can impede rational planning.

Lei said first-in/first-out was an unnecessary complication and that there should be no limits on banking.

Duncan proposed that the committee endorse the placeholder proposal of unlimited banking with first-in/first-out requirement and no borrowing. Davis didn't want restrictions on borrowing.

Circuit Breaker/Accelerator

Davis suggested that an alternative to having a circuit breaker that increases the cap, as staff had proposed, would be to allow more offsets as a circuit breaker. Early said the trigger for more offsets could be tied to the cost of compliance.

Davis also wanted a blanket endorsement that the PUC should deem any energy efficiency or renewable action that is below the circuit breaker to be prudent. He suggested that LSEs should be able to recover costs up to the ACP. However, Early wanted some oversight on LSE compliance costs. He said with oversight, a numerical trigger could work, but he did not have a proposal for what that trigger would be. Lei liked Davis' proposal that the PUC deem certain costs to be prudent and suggested the \$7/ton proposed by the National Energy Commission.

Duncan suggested two options for a circuit breaker:

1. Hold the cap flat at the current compliance period level, or
2. Go back to the previous compliance period cap.

Davis said that an accelerator could be part of an interim review to see if the cap should be changed in either direction, but he wouldn't agree to the idea that there should be a minimum compliance cost. Duncan also supported an interim review if there were some significant change in the way the cap were operating. Lei said PGE would never agree to an accelerator.

Duncan said he was uncomfortable with using offsets as a "speed control device." Davis said he wanted regulatory certainty and couldn't plan on the future cost of offsets. He needs to know the cost of allowances over time. He prefers an offset-based circuit breaker, but could accept Duncan's two other options.

Duncan noted that if the price of the ACP were too low, there would be no reason to set up a cap in the first place. A low ACP would just act as substitute carbon payment that breaks the cap.

Adjustments

Davis suggested a new source set-aside of allowances that would be recycled if not claimed during a particular year. It would be taken off the top of all allowances. Carver said there should be symmetry of returning allowances for loss of large single load. Duncan didn't like the idea of an unassigned pool. Lei suggested holding a part of the auction for new loads, then returning that set aside into the pool if there weren't new entrants. Early said gains and losses should be treated equitably.

Davis said he didn't want to lose any allowances, even with the proposed transfer policy. Duncan said PGE and PacifiCorp could probably live with no adjustments, but small

LSEs couldn't. Early suggested breaking the cap to allow in large loads as an incentive mechanism. Duncan objected to the idea of offering a carbon-busting incentive.

Davis endorsed the idea of a new large single load set aside with recycling into the pool if not used. He also suggested that large losses should go back into the pool. He would like to see new large single loads and transfers dealt with in the same manner. Duncan suggested a decadal update, but Davis said that would create a perverse incentive not to meet the cap.

Nelson said not to conflate load growth with carbon growth. An LSE can plan for load growth. There should only be a mechanism for exceptional circumstances.

Lei said a carbon-intensity approach addresses load growth, but Sadler noted that doesn't provide a cap.

Edelson stated there is a distinction between unique events and planning. Adjustments should only be for unique events. He endorsed the pool approach. Anything increase in allowances tied to load growth would be an incentive against energy efficiency.

Early endorsed the idea of a pool, with losses going into it as well and unused allowances distributed proportionately. It could work with an auction.

Duncan suggested allowing some authority to make adjustments for location-specific growth every ten years, but couldn't define the mechanism to do that. Sadler noted that any changes are within a zero-sum game and that it is unlikely that location-specific growth would occur within an LSE's whole territory. Nelson noted that the key metric is energy efficiency per square foot, not the total square feet. A location-based mechanism would probably only catch the latter, inappropriate metric. Davis noted that a re-allocation would punish those LSEs who have done the best job of reducing emissions. Carver noted the accounting problem of reassigning allowances between slow and fast growing LSEs. Duncan withdrew his proposal for a 10-year adjustment for the time being.

Duncan suggested that allowances follow load with PUC oversight when the transfer is between IOUs and that it be adjudicated when the transfer is between a COU and an IOU.

Hydro Extension

The proposal is that there be a one-year-at-a-time extension of the cap for exceptional hydro conditions. It would not break the overall cap and it would be by rule because the factors that make a year exceptional might change over time. Carver noted that it would extend the averaging over a longer compliance period.

Use of Revenues from Auction

Davis said he would only support an auction if the revenues went back to the LSEs proportional to their baseline allowances. He does not support a pay-for-performance approach because he sees it as a cross-subsidy. He said some funds could go to the

regulatory agency to cover cost of administering the program, but any other funds should go back to LSEs to cover their compliance costs.

Duncan said funds could go to ETO as long as they were spent in the respective LSE territories to reduce their emissions. Davis agreed with that concept as long as they reduced the LSEs' compliance costs. Early said that LSEs, which are responsible for meeting the cap, should get the funds, not another entity such as the ETO. Lei agreed that the funds should go back to the LSEs directly, not to the ETO. He noted only 80 percent of ETO funds go back to specific utility territories now. He also said the funds should be targeted to energy efficiency.

Nelson said that if you recycle revenues back to the LSEs, you don't really have an auction. He added that using a grandfathering formula is the least equitable way to distribute auction revenues. You need the auction to recycle revenues help those producers or customers who are most disadvantaged by the cap.

Duncan said the options are that the net (after admin costs) auction revenues would go to one of the following:

1. ETO or other NGO.
2. Directly and proportionally (per grandfathered allowances) to LSEs with an obligation that they devote the funds to carbon reduction.

Edelson recommended an added specification that the funds be used only for efficiency, not for renewables that would also qualify for an RPS. Davis said that as long as the LSE complies with the cap, the funds should not be earmarked. Duncan said the object is less carbon, not picking winners from among measures.