

## **Carbon Allocation Task Force Subcommittee Meeting**

August 11, 2006

Two World Trade Center, River Room  
121 SW Salmon, Portland, OR

Attendees: Angus Duncan, chair; Jim Edelson, Steve Grover, Kyle Davis,  
Wayne Lei, Michael Early, Mike Burnett, Bill Edmonds  
Staff: Phil Carver, Sam Sadler, Bill Drumheller  
Technical Advisor: Hal Nelson

### **Other Sectors**

We clarified that the subcommittee is not looking at transportation as a sector to be covered by the Carbon Allocation proposal. The GHG vehicle standards have addressed that sector for now. Kyle Davis requested that Oregon Department of Energy consider the cost-effectiveness of a fleet rule governing emissions from publicly-funded fleets (regulatory authority for such an emissions rule, although for criteria pollutants, was upheld by the U.S. Supreme Court in 2003). This proposal was supported by Early as a way to demonstrate that state and local governments were partners in efforts to reduce carbon dioxide emissions. Bill Drumheller pointed out the difference between the California experience with which Davis was familiar and the current situation in Oregon. Davis agreed that the issue of public fleets should not be part of the legislation on a carbon cap that CATF is discussing and that ODOE should look at it separately.

There was a discussion of fugitive emissions from natural gas pipelines and distribution systems. There is problem with measuring them. Phil Carver said they should be considered.

### **Capping Other Gases**

Angus Duncan recommended that there be rule-making for all six GHG: CO<sub>2</sub>, CH<sub>4</sub>, N<sub>2</sub>O, PFCs, HFCs, and SF<sub>6</sub>. Michael Early said there should be equal specificity for any GHG included in legislation. He was not comfortable with leaving other GHG to rule-making. Duncan also said that there should be a better understanding of the sources of emissions and economic impact of capping other GHG emissions before going to legislation. Carver noted that in California there was a provision in the Pavley rule that brought it back to the legislature before it could go into effect.

Davis asked if all GHG would be treated as part of a unified system, and Sam Sadler replied that it was staff's recommendation that they be treated the same as CO<sub>2</sub> equivalents. Duncan added that any allocations issued by the state for any GHG should be tradable within the Oregon system.

Duncan suggested there were three ways to deal with other GHG:

- 1) adopt rules, but provide for legislative review
- 2) leave for later legislative action, perhaps after a legislatively-established task force came back with a report with recommended legislation.

Early supported a task force coming back with a report, not recommended legislation.

Jim Edelson asked whether bringing in other GHG would be concurrent or sequential. Duncan proposed that they be dealt with sequentially, after CO<sub>2</sub>.

### **Interaction with Federal Legislation Some Day**

Bill Edmonds said the CATF needs to consider how any state regulations would fit with the up-stream model that is being considered on the federal level. Davis noted that some electric utilities supported up-stream regulation of carbon (e.g., carbon price signal set at the point fuels are introduced into the economy) within comments on the Senate “white paper.” Sadler stated that since one can’t know how an eventual federal system may be structured, one can’t design for it.

Davis stated that he would like a “contingency clause” or “pause” that would be triggered when federal regulations target the same sources of emissions (including federal carbon regulation of fuels supplying power plants) as the proposed state rule targets. The pause would require the state to review and possibly reconcile the state rule with the newly adopted federal rule. Kyle went further to suggest the group consider a stringency clause, which would obligate the state to be no more stringent than any new federal rule targeting the same sources, but there was no consensus on this proposal..

Duncan proposed that any action that counted under federal legislation should count for state compliance. Hal Nelson noted that under other federal systems, such as the EU ETS, member states are allowed not to participate if they can show comparable regulations. We should anticipate that any federal legislation will deal with state systems.

Jim Edelson said we’re just guessing at what federal legislation might do and that he doesn’t accept the concept of blindly deferring to federal legislation before we know what it is. Sadler agreed that there should be no voluntary preemption by the state. He noted that the current federal government has a record on not implementing laws and undermining regulations.

Wayne Lei agreed with Davis that there should be a pause in implementation of a state cap if there is federal legislation. Both did not want Oregon utilities to have to meet standards tougher than federal standards, if any existed. Edmonds also supported consideration of federal rules to ensure consistency.

Carver noted that it would be beneficial for Oregon to be ahead of the curve in preparing for and adapting to climate change. He pointed out that programmatic changes take time. Early stated that if Oregon attempted to reduce load, then businesses would leave the state.

Early saw having a pause as offering regulatory certainty. Sadler saw a pause as adding uncertainty because of the problem of knowing what would justify a pause and the problem of multiple, or compounding pauses as federal laws and regulations changed.

He noted that it could take years for a final court decision on whether an administration was legally implementing laws passed by Congress. Duncan noted that if pauses were instituted, a pause could be indefinitely continued with each nuance of federal action.

Davis said his main point is that the state legislature should consider the implications of any federal legislation on climate change. He proposed that there be a group that followed federal rulemaking and that would recommend actions to the state legislature to match federal initiatives. Davis suggested a regulatory agency administrator or a task force could be charged with reviewing the federal legislation and determining whether a pause in the cap was warranted. The administrator or task force should also be empowered to order a pause instead of having to go back to the legislature. He said industry might support an automatic sunset on the state rule if the legislation didn't provide some guidance on how to reconcile overlapping state and federal rules. Duncan suggested that ODOE could review federal action and it could determine whether there should be a pause in implementing the state cap. He was "not uncomfortable" with ODOE being able to order a pause until the state legislature met, but a pause would not be automatic.

Edelson said that no pause should be triggered automatically. We shouldn't define a trigger when we don't know what it will be. He was comfortable with a task force to review federal legislation, but not with any automatic pause. Lei recommended dropping the reference to a pause, but that the state needs a mandatory reflection if there is federal action.

Early thought there should be a presumption that federal action would preempt state action. Duncan disagreed

Duncan summarized the points he had heard:

- 1) Federal action that requires absolute, mandatory reductions should result in a state review, but there would be no delegated authority to pause the cap
- 2) ODOE director could pause the cap until the next legislative session.

### **Emissions from Natural Gas**

Staff proposed that natural gas utilities not be capped, but that a public purpose charge be set as an adder at a level equivalent to the market price of allowances in the electric-load based cap. This would apply to non-transport customers of natural gas utilities. Later in the discussion, it was modified to apply to transport customers with CO<sub>2</sub> emissions below a threshold, such as 15,000 tonnes annually.

Edmonds noted that NW Natural can promote efficiency and combined heat and power (CHP), but there is not much it can do on the supply side. He said there are data gaps. He was concerned with how any potential regulation of NW Natural would affect its transport customers and the potential for fuel switching to higher carbon intensity fuel such as oil that would result in increased carbon emissions. He said oil and propane should be included in the same system as natural gas so there will not be unintended consequences from fuel switching to higher carbon fuels. Carver noted that there is a

state program for residential oil and propane customers that could be modified to work with the concept of a public purpose charge based on revealed price of carbon allowances.

Edmonds also suggested any carbon requirements on the gas side should treat gas users uniformly, so as not to create incentives to bypass a gas utility.

Edelson said there should be a firm cap, not just an adder for efficiency. Davis said electric LSEs have the option of changing their supply mix, but gas utilities don't have that option, plus they have an obligation to serve. Edelson asked if there were any way to regulate gas "upstream" at the state level. He noted that including natural gas in the cap-and-trade will both assist in meeting the Governor's goals and will eventually facilitate a larger and more robust market for allowances. Davis said he didn't see how it could work within a state cap-and-trade rule. Carver noted the potential commerce clause problems with directly limiting the import of natural gas.

Duncan said he did not see why NW Natural would be excluded from a carbon cap. He said gas utilities would have the option of changing to biogas sources and offsets as well as increasing efficiency. Gas utilities might have lower-cost option than a public purpose charge set by the electricity allowance market. Early opposed having a cap on emissions from gas. He distinguished between carbon and efficiency. Edmonds agreed stating that a cap on emissions was really a limit on the quantity of gas that could be used to serve customers. Biogas (from cows and landfills) does offer an opportunity on the supply side, but NWN expects it to be a tiny percentage of total supply, even when it is fully developed.

Edmonds stated that the allocation task force had previously recommended that the electric utilities would be regulated first through a carbon cap and that other sectors and fuels (e.g., gas utilities, oil, propane, large customers, etc) would be taken up in a second phase. He still supports moving in this fashion, pointing out that the recommended path links the dollar amount of the public benefits charge to the price "revealed" in the electric sector. It also appears that the data needed to regulated large customers is not yet available and will take some time to gather.

Davis argued for natural gas utility inclusion within the initial legislation, although not necessarily within the initial cap-and-trade program, to prevent carbon price signals that favored fuel switching from electricity to fossil-fired fuels (natural gas, propane, and fuel oil), with the simplest examples being residential heating and kitchen appliances. If only electricity carried a carbon price signal, customers may opt for alternative products because operating costs would presumably be lower. The risk is an Oregon law that increases customers' costs for electricity, while also having the unintended consequence of actually increasing carbon emissions. One option for addressing this unintended consequence—since it is unrealistic to regulate thousands of small sources within a cap-and-trade program—is to normalize the carbon price signal between electricity and the other fossil fuels. The price signal applied to the other fuels could be derived from an allowance auction price cleared through the electricity cap-and-trade program. The idea

would be to convert that price signal into essentially a tariff on the other fossil fuels. The revenues collected from the tariff could then be reinvested in projects to reduce carbon emissions.

Carver said the staff proposal is to have a system where small emitters, e.g. less than 15,000 tonnes, pay a public purpose charge for energy efficiency and large emitters, e.g. large stationary sources, are ultimately regulated directly.

Edmonds said that with decoupling, increased efficiency could work. He also suggested there should be some flexibility in how the public benefits charge dollars are spent to maximize the carbon benefit. Additional thinking is still required to allow for a system that would allow for additional efficiency work by the ETO or by the utility itself, but also could include lower cost carbon reductions through offsets. Edmonds commented that NW Natural will have a carbon adder in its IRP. He asked how carbon regulation could be an incentive for combined heat and power, noting this may be more efficiently done through programs such as an enhanced BETC for CHP. He also commented that a comprehensive approach to carbon needs to include incentives for IGCC with carbon capture and storage so that electric utilities aren't forced to build additional gas plants, thus competing with gas customers for gas in the ground.

Duncan summarized by saying there should be a public purpose charge rather than a cap for small stationary emitters.

### **Large Stationary Emitters**

Early said there aren't options for increased efficiency among large stationary sources. Their only option would be to purchase allowances at auction or from others.

In discussing how a cap might apply to other sectors, Carver said ODOE does not have enough data yet to identify specific emitters. Mike Burnett recommended having a public purpose charge for large emitters as well. Early said there is no connection between a public purpose charge used to increase efficiency and reduction of GHG.

[ODOE staff notes that a public purpose charge does not provide incentives to choose low carbon fuels. That is likely a serious flaw for industrial emitters that can use coal and petroleum coke, which have much higher carbon content than oil or natural gas.]

Davis said there should be one market in allowances for all covered entities. As far as including other large stationary emitters, Davis agreed there was insufficient data to establish emissions baselines, and that a delayed entry into the cap-and-trade program was reasonable while the state gathered the information. Davis also commented that their inclusion might best be handled through subsequent legislation rather than within initial legislation that addressed electric and natural gas utilities as well as self-generators.

Carver said we need to identify who will be covered, if only eventually, so those who may try to sell offsets in the interim will understand that they will be covered and they will not be able to sell offsets indefinitely.

Duncan said the three approaches are: load based cap for electric LSEs, enhanced public purpose charge for natural gas utilities and smaller transport customers, small oil and propane users, at first, then large emitter caps later.,

Early said he would not support public purpose charge on gas users.

Duncan asked Carver to do a graph that shows how the allowance market price in a load-based system translates into an adder for a public purpose charge for natural gas, oil and propane.

There was a discussion of why gas and large emitters were being brought up at the point. Staff pointed out that at the first meeting of the task force there was agreement that sectors other than the load based system would be deferred to the end. More specifically, the subcommittee put natural gas and large emitters on the August 11 agenda when it set the agenda for each meeting over the summer. These topics have been on today's agenda since June.

### **Threshold for Self-Generators**

Carver reported that a 5MW capacity threshold for self-generators is equivalent to about 15,000 tonnes of CO<sub>2</sub> using natural gas with an 8,000 Btu heat rate and an 80 percent capacity factor.

There was discussion of needing more information about who would be covered at different thresholds. Duncan recommended leaving the threshold for self-generators at 25 MW. Edelson suggested setting the threshold on tonnes emitted. He noted the problem of plants that would come in at 24.9 MW to say out of the cap.

Carver brought up the potential that coke-burning emitters could come in at 10 MW and avoid a cap. Duncan suggested modifying the threshold so that it applies at 25 MW for existing plants and 5 MW for new facilities. He noted baseline years may not be the same as those used for utilities, because data may not be available for the same years.

Davis said as far as including self-generators, there was an acknowledgement that insufficient data existed to establish emissions baselines, and that a delayed entry into the cap-and-trade program was reasonable while the state gathered the information, but that there was no reason not to include them within the initial legislation. Davis also clarified his assumption that any allowances eventually allocated to self-generators would be additions to the overall emissions cap. Duncan asked how mandatory self-reporting would work. How would the state know that all the covered entities were actually reporting. Davis said there might be info in Title V operating permits that could identify those who should report. Edelson said that mandatory reporting defers the question of whether those who are reporting would ever be brought under a cap. Davis said units could be brought in when data were available rather than having to go back to legislation.

Duncan summarized the proposal as being mandatory reporting for self-generators in the 5 MW to 25 MW range with a rule being developed later when data were sufficient. He suggested that there be comparable thresholds for COUs and self-generators. He also proposed that the rule for the threshold be defined in tonnes rather than MW. Davis mentioned the concept of a boiler's "potential to emit" using different fuel types as a means to address fuel switching concerns, drawing an analogy to how facilities that already use multiple fuels are permitted for emissions of criteria pollutants. Carver suggested 2005 and 2006 base years for setting baselines to avoid future actions to avoid the cap.

### **Administration**

Carver said there were two options for administration for a cap system: a state agency, i.e. ODOE, or an independent commission, which would be staffed by ODOE. Carver said there might be a role for the Energy Trust of Oregon in obtaining certain types of efficiency or renewables with funds generated in the auction, but Edelson said he was uncomfortable discussing ETO without Margie Harris present.

Davis and Early said they didn't like the idea of a citizen board. Both preferred rules to be adopted and administered by a state agency. Also, both reiterated their support for returning any auctions revenues back to the regulated entities.

Edmonds said that ETO has told NW Natural it can't spend any more funds on gas efficiency at the moment. He supported the use of a state agency to administer the cap system, but noted that the customer funds raised on the gas side might be spent in a variety of ways including energy efficiency by ETO, for utility GHG reductions programs as well of offsets.

On the topic of administering incentives, Davis suggested looking at the stakeholder dialogue taking place on the California Solar Initiative as a possible example. It has flexible administrative approaches based upon different types of customers, with the agency staff supporting an independent organization, such as the ETO, to manage residential incentive programs, while the utilities would be expected to handle the commercial/industrial incentive programs.

On covering admin costs, Duncan summarized the proposal as using auction proceeds, using a percentage of utility revenues, or a nominal fee for each allowance.

### **PUC Treatment of a Carbon Cap**

Duncan said the PUC would have to take into account that investor-owned utilities would have to comply with a carbon cap. Davis suggested a "safe harbor" based upon the price cap or perhaps a cost that is no more than X percent of the previous year's allowance auction price would be deemed prudent. He wants a bright line for what's prudent. Duncan suggested that the PUC should have discretion in deciding what a safe harbor rule would be. Early objected to the concept of a safe harbor. He said if there were a legislatively imposed cap, the PUC would have implicit authority to allow recovering in rates. Carver said the implementing the carbon cap would make requisite decoupling.

Edelson, speaking on behalf of the Oregon Interfaith Global Warming Campaign (OIGWC) only, stated that OIGWC would insist on prudence review and demonstrated carbon reduction in any cost recovery mechanism. It would also insist on an examination to ensure that low-income rate-payers get the same benefits from carbon reduction programs as other classes of rate payers. He added that there should only be cost recovery for new generating facilities or contracted power purchases from facilities that have emissions no higher than the most efficient combined cycle gas turbines. There would be no cost recovery for plants or purchases that emit at a higher rate because it would be imprudent for a utility to add resources that emit more CO<sub>2</sub> than the most efficient combined-cycle gas turbine and then burden its customers with carbon mitigation risks and costs in excess of those from resources that do meet the standard.

Carver noted that if a new coal plant had lower emissions than an old one, it could lower a utility's average emissions.

Davis objected to an emissions rate-based cost recovery criterion for new capacity. He believes this is essentially an emissions performance standard, which is beyond the scope of a load-based cap and trade rule. Davis pointed out that a utility would still be subject to the carbon cap, and as long as they stayed in compliance, the rule should be indifferent as to the underlying generation mix. He did not think an emission performance standard added anything to the final result, and would not guarantee any additional emissions reductions beyond those already achieved as part of the cap. As long as a utility meets its cap, that should be enough. There wouldn't need to be an emissions performance standard as well.

### **Next Steps**

Davis suggested delaying any action on crafting legislative language for a proposed carbon rule until after there had been a legislative decision on a renewable portfolio standard. Duncan was not willing to concede that there would be no legislative action on a cap, even if one were not passed. Davis also indicated that modeling of any draft rule was critical before drafting legislative language. The group could likely agree on the mechanics of a rule, but there are certain criteria that heavily impact any rule's overall costs. He also suggested modeling different versions of the rule was necessary and would better inform the eventual debate on the costs and emissions benefits of any rule. Davis said he did not believe PacifiCorp would be prepared to endorse any legislation in 2007 that had not been thoroughly vetted. He noted that his comments during these Subcommittee meetings were on the mechanics of a rule and are his opinions. Any position PacifiCorp might eventually take on a proposed rule would depend on the totality of the rule with a heavy emphasis on the impact to customer electricity rates and cost recovery.

Edmonds agreed, pointing out on the gas side that it is not well understood what rate impacts would result from a public benefits charge (based on certain carbon adder levels) and that these would need to be understood by both the gas utilities and their customers before the proposal could be supported.

Duncan recommended that the CATF see how far it could get by the October 5<sup>th</sup> meeting. He asked staff to do an issues matrix. The CATF would be able to discuss what the subcommittee had accomplished by the September 7<sup>th</sup> meeting. The subcommittee might meet again in September after that meeting.

Davis asked when model results would be ready. Carver said there would be preliminary runs by September, but that people would probably not agree on base case scenarios. He said the model is transparent. Davis agreed that there was not a need for group consensus on the reference case model run that is based upon the rule mechanics discussed during the Subcommittee deliberations. Davis hoped the ODOE would release the reference case soon for comment so stakeholders would be able to adjust assumptions within the rule and compare results against the reference case.