Technical Workshop 4: Distribution of Compliance Instruments

Meeting Summary

State of Oregon
Department of Environmental Quality

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DEQ is a leader in restoring, maintaining, and enhancing the quality of Oregon's air, land, and water.

Sept. 9, 2020, 9 a.m. to 1:30 p.m.
Zoom webinar

I. Meeting in brief

The Oregon Department of Environmental (DEQ) hosted the fourth of six virtual technical workshops on September 9, 2020 as part of the public engagement process for a program to cap and reduce greenhouse gas (GHG) emissions in Oregon. The purpose of the technical workshops is to introduce and frame key policy constructs and issues prior to beginning formal rulemaking. The fourth workshop was focused on how compliance instruments are distributed by DEQ.

The meeting was held from 9:00 am to 1:30 pm and included a combination of presentations from DEQ regarding program scope and opportunities for participants ask questions and provide comment. Agenda topics included:

- An opportunity for those who could not attend the entire meeting to provide comment
- Considerations for large stationary sources
- Considerations for the natural gas sector
- Considerations for non-natural gas fuel suppliers
- Connection to other program design elements
- Emerging issues and remaining questions
- Adjourn meeting

All meeting materials and the presentation are posted on DEQ's website:
https://www.oregon.gov/deq/ghgp/Pages/capandreduce.aspx

II. Introduction

Sylvia Ciborowski, Kearns & West, opened the meeting by welcoming participants and reviewing webinar logistics. Sylvia acknowledged the wildfires occurring around the state and emphasized participants should take care of their safety first. She then invited Colin McConnaha, DEQ, to introduce the DEQ staff leading the development of the program. Richard Whitman, Director of Oregon DEQ, provided brief opening remarks, expressing concern for the safety of Oregonians affected by the wildfires and appreciation for the participation of those on the call.

Matthew Espie, DEQ, then explained that the Executive Order (EO) 20-04, signed by Governor Kate Brown, directs state agencies to develop a suite of new programs to address climate change. DEQ is working to implement directives from the EO, including capping and reducing GHG emissions from key sectors. Specifically, DEQ is charged with taking actions necessary to cap and reduce GHG emissions consistent with science-based emissions reduction goals from sectors including large stationary sources, transportation fuels, including gasoline and diesel, and all other liquid and gaseous fuels including natural gas.

Matthew then shared additional details about the pre-rulemaking public engagement opportunities, including technical workshops that will take place in August and September and Town Halls that will take place in October. In addition to those formal opportunities for comment, DEQ is accepting written comments and conducting focused stakeholder meetings to address specific issues of interest and briefing organizations, as requested.

Next, Sylvia discussed the purpose and goals of the technical workshops. Specifically, DEQ hopes these workshops will be a place to discuss program design features and identify areas for attention during the rulemaking. DEQ is looking to gather input and establish a common understanding of priority issues, legal constraints, potential policy mechanisms, and implications.

Sylvia then reviewed the workshop agenda and laid out meeting ground rules designed to allow for open and respectful dialogue.

Matthew Espie, DEQ, then provided a brief overview to frame the conversation around the potential distribution of compliance instruments. Matthew defined a compliance instrument as a permit/allowance for a regulated entity to emit greenhouse gases and noted that compliance instruments demonstrate allowable emissions under the cap. As the cap decreases, available compliance instruments would decrease as well. He next touched on the topic of distribution, noting that DEQ does not believe the EQC has the authority to auction or sell rights to emit greenhouses gases. Instead, DEQ is considering methods for free allocation. Matthew also stated that DEQ is evaluating options to develop a system to manage tracking and distribution of compliance instruments.

Finally, Matthew touched on a few key considerations when thinking about the distribution of compliance instruments:

- Identifying the baseline period for establishing initial distribution of compliance instruments and process for distribution over time
- Reducing leakage of operations and emissions outside of Oregon
- Addressing changes in market share and emissions year-over-year, including through new entrants and exits from the market

III. Early input

Sylvia Ciborowski, Kearns & West, invited anyone who would not be able to stay for the duration of the meeting to provide early comment.
No attendees provided comment.

IV. Considerations for large stationary sources

Matthew Espie, DEQ, shared a brief presentation, beginning with reviewing key sector characteristics for stationary sources. Matthew stated that there are over 260 permitted air contamination sources reporting GHG emissions in Oregon. These sources include industrial manufacturers, power plants, and institutional facilities, among others. Matthew then laid out several key considerations for thinking about the distribution of compliance instruments for stationary sources, including the initial baseline period, the ongoing distribution method, mass-based versus intensity-based metrics, and leakage.

To help guide conversation, Sylvia Ciborowski provided the following discussion questions to the group:

- Is there a historic baseline period DEQ should consider for the initial distribution of compliance instruments? Which years should be considered?
- How should distribution of compliance instruments change over time? How should DEQ distribute to entrants?
- Should compliance instruments be distributed using a mass-based or intensity-based methodology? Why? What are the key considerations?

Meeting attendees provided the following comments and questions:

- An attendee representing an environmental organization said they were curious about other alternatives since direct distribution is not how stationary sources are currently regulated. Understanding pros and cons would be helpful to provide input on design of the process. If direct distribution is the preferred direction, they were concerned industry may be able to profit from the compliance instruments.
    - Colin McConnaha, DEQ, noted that air regulation by DEQ is through the issuance of emission permits, which is fairly similar to the free distribution of compliance instruments. However, if there is a fundamentally different approach, they would be interested in hearing about it.
- Another attendee from an environmental organization stated that they did not understand why DEQ wouldn't have authority to facilitate an auction. From their perspective, it is the activity of raising revenue where legal concerns would arise, whereas holding an auction or consignment auctions would have a number of program benefits. Additionally, for some sectors the best choice might be to not the have the point of regulation at the point of allocation.
    - Colin McConnaha said it is DEQ's understanding that an auction may be off the table, but it was a legal matter. He also mentioned that he would be interested in hearing more on detaching the point of allocation from point of regulation, or other ideas and ways to allocate to different sources.
- An attendee stated that market liquidity would be important, since an entity's ability to comply would be dependent either on a generous allocation of allowances or sufficient flexibility, but also cautioned that program design should avoid potential windfall profits for

these entities. The attendee suggested that DEQ provide illustrative examples to support more detailed discussions, especially around the issue of mass vs. intensity-based standards.

- Another attendee asked if the concept of offering allowances is any different than if they were thought of as a license to emit greenhouse gases. They wondered if it made any difference to DEQ's legal authority to consider it as a license rather than an allowance.
    - Colin McConnaha said he is not aware of any specific technical difference between the terms and that referring to them as licenses wouldn't change or bring new authority to the Environmental Quality Commission.
- An attendee from an environmental organization stated that it should be more expensive to not comply. If an emitter decides not to comply, it needs to be linked to an impact.
- Another attendee said that the trading of compliance instruments is a blunt way of equalizing the playing field and recommended evaluating each emissions source to determine what was feasible. Since some companies may not be able to buy compliance instruments, they should not be penalized if they are doing everything they can.
- An attendee representing an environmental justice organization stated that if a market is established that generates revenues toward community benefits, there would need to be certainty about the amount of revenue generated, citing volatility in California markets. The more complex a market-based solution is, the harder it is to control. If there is a trading option, it needs to be designed strongly and clearly with strong bounds. From an environmental justice perspective, the preferred route is to establish clear bounds and more direct regulation as a way to provide certainty in reducing emissions.
- An attendee asked when DEQ would consider the mechanisms to use in cases of non-compliance.
    - Colin McConnaha, DEQ, said that enforcement authority of noncompliance would need to be articulated in the rules.
- An attendee representing an electric power company stated they had no preference on whether to use a mass-based or intensity-based distribution method, however they saw a need to consider how their system emissions are allocated to Oregon. These allocations are generally addressed in how they report similar emissions. Additionally, a lot of utilities are in the process of reducing emissions, therefore a three-year base at a current level may not be a good representation. They recommended using forecasts for the sector or a current baseline set for the last three years average with a straight-line reduction.
- An attendee suggested that DEQ could consider looking at the type of permit by permit analysis in terms of geographic zones, similar to hunting or fishing licenses. This type of approach would be one way to allow some form of trading with more certainty and local control, while minimizing trades that do not result in emissions reductions at the source.
- Another attendee from an environmental organization stated that direct allocation is a huge risk for DEQ as it won't be appropriate for everyone. He suggested DEQ establish clear criteria for how allowances are created to address concerns with some receiving windfall profits and others feeling unfairly treated.
- An attendee wondered how the 260 permitted sources reporting GHG intermixed with those permitting processes.

- Colin McConnaha said that one potential enforcement mechanism may be to require compliance with a GHG reduction program as a condition of those permits.

V. Considerations for natural gas

Matthew Espie, DEQ, introduced the next discussion topic by reviewing key sector characteristics for natural gas. Matthew stated that there are three investor-owned utilities distributing natural gas in Oregon in addition to multiple gas marketers selling gas that is transported on local distribution company systems. Matthew also noted that there is a generally stable market share of emissions from year to year. Point of regulation is utility, marketer, or on-site end user such as a large stationary source. He added that natural gas deliveries form marketers are less stable from year to year. Matthew then laid out several key considerations for thinking about the distribution of compliance instruments for natural gas, including the initial baseline period, mass-based or intensity-based metric, and the point of regulation.

To help guide conversation, Sylvia Ciborowski provided the following discussion questions to the group:

- Is there a historic baseline period DEQ should consider for the initial distribution of compliance instruments? Which years should be considered?
- How should distribution of compliance instruments change over time?
- Should compliance instruments be distributed using a mass-based or intensity-based methodology? Why? What are the key considerations?
- What considerations are there for distribution of compliance instruments for natural gas sold by marketers?

Meeting attendees provided the following comments and questions:

- An attendee representing an environmental organization stated that the notion of distinguishing between markets that are stable and more dynamic is risky. They cautioned DEQ about having different design frameworks for different types of markets. A stable market five years ago may become unstable, especially as the economy shifts towards greener fuels.
- An attendee representing a natural gas supplier stated that the point of regulation should be at the meter, due to variability associated with natural gas marketers. He suggested it is better to look at the contracts with the industrial customer to determine the carbon intensity of fuels.
- Another attendee representing an environmental group responded to an idea mentioned previously to come up with equivalent values between mass-based and intensity-based if different systems are used for differed sectors. They believed it would be very difficult to do with integrity and there are many reasons to apply a uniform system across sectors.
- Another attendee from a natural gas supplier noted that compliance will be more difficult for regulated entities because DEQ must design a program that does not have raising revenue for investments. It is hard to see a scenario where the natural gas suppliers have enough allowances to sell and they did not believe suppliers profiting from allowances was a real

concern.   They suggested holding discussions with different sectors to address these issues. Different sectors probably have more room to reduce emissions, which is important to remember as a compliance market is developed.

  - Colin McConnaha, DEQ, noted that DEQ is very open to invitations to have sector specific discussions, not just with entities but any type of interest group.

- An attendee representing the natural gas industry noted that they were concerned by some comments that seemed to assume utilities might profit, which they did not believe would be the case. Regarding the compliance instruments that utilities must use to reduce emissions, utilities are constrained from selling those instruments because they have an obligation to serve their customers and are limited in controlling what their customers demand from them. They also noted that the current emissions budget in Oregon is significantly lower than it would otherwise have been if there hadn't been a push to convert people from coal-powered electricity to natural gas. When establishing a baseline, consider that early action, since the emissions budget for natural gas is higher, but overall budget is lower.
- An attendee representing an environmental group stated that they understood much of the interest in doing direct distribution and allowing trading is to allow entities to buy and sell based on level of emissions they need or want to have. If someone is going to be selling or buying these allowances, there will be revenue generation not going into the State's hands. The allowance allocation should be below the emissions baseline to avoid windfall profits and gaming of system and the allocation should also decline over the years.
- An attendee asked how DEQ planned to intersect with the PUC on this topic.
  - Colin McConnaha stated that DEQ continues to be in regular conversation with the PUC on implications of this program. He added that those conversations will elevate to a new level once the program is further fleshed out.
- Another attendee representing a natural gas supplier suggested the baseline be weather-normalized and recommended using multi-year compliance periods and looking at other places that have dealt with this issue. A cold year will result in higher emissions and something that could look like a decline could just be mild weather. They noted that issue of weather-normalization should be considered as distinct from general impacts of climate change.
- An attendee stated that they are not sure how much control or influence exists to reduce emissions at such a high level. They said they consider what motivates end users to reduce their GHG emissions, one is higher price, another is generous incentives, third is altruism or survival, and lastly enforceable regulation.
- An attendee representing a large fuel supplier suggested designing the program to provide holistic flexibility across many potential events, rather than trying to predict individual impacts. They cited the cost containment reserves in RGGI program in the Northeast United States as a possible model. It is important to make sure the market is sustainable whether demand is slow or high and to account for many fluctuations.
- An attendee representing the propane gas industry noted that weather variations are difficult to figure out year over year. They believed that 33% of the fuel they provide is weather dependent, both residential and agricultural. Looking anecdotally over at 2017-2018 data, they saw a 48% increase in residential fuel, underscoring the elasticity of demand.

- Another attendee asked if DEQ would issue a permit that would designate the level of emissions permitted by each source, and if so, if DEQ would issue a fine for each entity that exceeds the allowable emissions.
    - Colin McConnaha stated that there was not a determination on that at this time. Enforcement is an important part of regulation but won't be a focus until the rulemaking process.
- An attendee asked how DEQ would have the authority to raise a fine and raise funds in that way but would not have the authority to raise funds through pricing permits.
    - Colin McConnaha stated that the restriction on the EQC to raise revenue via the sale of an emissions allowance is different than the ability to enforce and the accompanying fines for non-compliance. He also clarified that DEQ does have authority to charge fees to cover the cost of program implementation.

VI. Considerations for non-natural gas fuel suppliers

Next, Matthew Espie, DEQ, reviewed key sector characteristics for non-natural gas fuel suppliers. Matthew stated that there are nearly 100 fuel suppliers bringing fossil fuels in Oregon in a given year and that emissions from suppliers are variable from year to year. Additionally, emissions may be above or below the threshold for inclusion in the program from one year to the next. Matthew then laid out several key considerations for thinking about the distribution of compliance instruments for non-natural gas fuel suppliers, including leakage, new entrants, and variability from year to year, among others.

To help guide conversation, Sylvia Ciborowski provided the following discussion questions to the group:

- Is there a historic baseline period DEQ should consider for the initial distribution of compliance instruments? Which years should be considered?
- How should distribution of compliance instruments change over time?
- Should compliance instruments be distributed using a mass-based or intensity-based methodology? Why? What are the key considerations?
- How should DEQ address variable market shares in this sector?

Meeting attendees provided the following comments and questions:

- An attendee representing a large fuel supplier stated that the existing Oregon Clean Fuels Program already outlines a strong rule that applies to fuel suppliers. For the most part, they agreed with the structure in the brief for distribution of compliance instruments. Additionally, they mentioned the importance of liquidity and the necessity of having a conversation around mass-based versus intensity-based metrics. The answer depends on the structure of the program.
    - Colin McConnaha, DEQ, mentioned that the relative market shares for companies shift dramatically year over year. As a result, the basis by which DEQ allocates permits is a real challenge and he hoped for ideas and thoughts on how DEQ would issue permits.

- An attendee stated that to provide a program that is functional and fair as possible for entities, it would need flexibility and a recognition of the diversity of the companies and the products. It also requires openness to an intensity-based allocation, adjusting over time. The problem with all of these concessions to flexibility and functionality is that the easiest way to accomplish them is to over allocate. The solution to complaints about inequities has simply been to allocate more allowances. It has tended to push the trajectory of the cap horizontally rather than downward.
- An attendee representing a large fuel supplier stated that, regarding the baseline period, 2020 was not under consideration due to reporting restrictions and COVID-19 implications. They recommended a historic baseline average of at least three years to consider supply impacts and variations, such as the 2015-2019 timeframe. Additionally, they agreed with previous comments that an intensity-based standard may be fairer, but cautioned that it may also be very burdensome administratively. They suggested using a reserve for new entrants and multi-year compliance periods to account for variability of market shares, citing California's program as an example.
- Another attendee representing an environmental organization suggested that an out of the box idea would be to abandon the whole idea of compliance instruments, set the target at zero, and then everything beyond that is a penalty. Then a rising penalty could be considered, sort of like the standard approach that is taken with a carbon tax.
    - Another attendee agreed that this should be considered.
- An attendee representing an environmental organization stated that variable market share is incredibly hard to predict and that DEQ should focus on setting a cap that reflects the fuels sectors share of emissions and make sure it declines over time, then source specific caps, and allow entities to trade or use alternative compliance instruments to meet obligations. Additionally, standards should be mass-based and not intensity-based.
- Another attendee representing an environmental organization stated that a mass-based cap is needed, so that as the cap declines there is an amount of emissions above that cap. Additionally, solutions such as more transit, electric bikes, and electric vehicles are not as widely deployed as needed. They suggested that instead of a system where allowances are freely distributed to fuel suppliers, DEQ could award tradeable credits to entities for reductions, similar to Washington's Clean Air Rule.
- An attendee representing a large fuel supplier stated that a mass-based standard could work if the right kind of alternative compliance options, such as credits or offsets, are offered for a realistic compliance pathway. A consideration is that gasoline is limited by federal standards to no more than 15% biofuel. As long as people buy gasoline, it will limit compliance flexibility.
- Another attendee representing an environmental justice organization reflected on the overall goals of the program to try and serve impacted communities and mitigate the climate crisis. They expressed support for the idea raised earlier of awarding reduction credits instead of distributing free allowances to emission sources, and further suggested that prioritizing credits to rural impacted communities with higher fuel cost impacts and electrification projects for medium and heavy-duty vehicles. By supporting those people first, it would address a longer term and bigger shift to a regenerative economy.

- An attendee stated that it was easier to under intensity-based approaches for industrial sources than for liquid fuels, where end use is difficult to track. DEQ could have very clear mass-based limits over time. If DEQ constructs a set of complex alternative compliance options, then investors will not make serious investments in direct emissions reduction projects.

VII. Connection to other program design elements

Next, Matthew Espie, DEQ, introduced the next topic, stating that the program(s) may include several cost containment design elements, such as holding some portion of compliance instruments in reserve. If these design elements are included, there are considerations relating to the distribution of compliance instruments. Additionally, he noted that specific considerations for whether these program elements are included will be discussed in Workshop 5 on Cost Containment. Matthew then provided a brief overview of reserves, stating that DEQ could hold some portion of compliance instruments in reserve to distribute on an as-needed basis. Compliance instruments in reserve may be under program cap(s) or may be in addition to cap(s).

To help guide conversation, Sylvia Ciborowski provided the following discussion questions to the group:

- If there is a compliance instrument reserve, how should DEQ distribute from the reserve?

Meeting attendees provided the following comments and questions:

- An attendee stated that in previous meetings there was discussion about the need for reserves to help make sure the cap is adhered to and to offer flexibility. The question they hoped to address is how DEQ would allocate from the reserve. They requested that entities should justify the need for allowances from the reserve.
- An attendee representing a large fuel supplier stated that they are in favor of having a reserve. It can help in sustaining a market and prices. Although it is hard to say how it will work, the actual design and how they could be allocated depends on the design of the cap and reduce program.
- Another attendee suggested that a compliance instrument reserve could be used very effectively to moderate situations where price increases compromise low-income Oregonians.
- An attendee representing industry said that the program still has to allow for innovation and business expansion for Oregon manufacturers to survive and thrive. This is especially the case for manufacturers that have process emissions, which would mean expanding process emissions to expand production.
- An attendee suggested that entities demonstrate they cannot further reduce emissions prior to receiving allowances from the reserve, and that a hearing could be held to review the request, including review by engineers
- An attendee representing a large natural gas supplier stated that to limit costs and achieve real emission reductions, industry will need a low-cost way to comply using offsets. When

considering containment elements, if more offsets are allowed it may impact the cost containment reserve as well.
- Another attendee suggested the idea of strategic reserves. Any facilities seeking access to the reserves would be required to show their plan to increase energy efficiency and the long-term viability of their approach.

VIII. Emerging issues and remaining questions

Sylvia Ciborowski invited attendees to bring up any remaining questions or comments they wanted to address or expand on any emerging issues that came up previously during the workshop.

To help guide conversation, Sylvia provided the following discussion questions to the group:
- What issues have been raised that should have continued discussions?
- What issues relating to this workshop topic were not raised that should be discussed?
- What issues remain or need further discussion that should be brought up during the rulemaking?

Meeting attendees provided the following comments:

- Multiple attendees stated that the wildfires impacting Oregon underscore the urgency of reducing GHG.
- Another attendee from a large stationary source mentioned that they were expecting to hear more about establishing a baseline setting and methodology for developing the cap. Additionally, they wanted to understand the regional emissions trajectory, since regulated entities would benefit from early and healthy compliance, while others who don't have that flexibility or options are allowed a pass.
- An attendee expressed interest in participating in any small discussion groups and asked when DEQ anticipated posting workshop summaries.
  - Colin McConnaha, DEQ, said they hoped to post summaries soon to the website and noted that DEQ was open to invitations to join any standing meetings from interest groups and in each case would abide by those existing meeting guidelines.

Colin McConnaha thanked participants for their comments and shared closing comments. Colin acknowledged the complexity of the topic and mentioned that the input from these workshops will help synthesize and inform the design of the upcoming town halls.

IX. Meeting wrap up and next steps

Sylvia Ciborowski, Kearns & West, reminded attendees of the two remaining technical workshops on September 15 and 17 and encouraged anyone with additional comments or questions to submit them directly to DEQ. She also encouraged attendees to sign up for email updates to receive notice of upcoming meetings and materials posted to the website.

Meeting adjourned at 1:30 pm PT.