



December 9, 2020

Colin McConnaha
Manager, Office of Greenhouse Gas Programs
Oregon Department of Environmental Quality
Via email to CapandReduce@deq.state.or.us

Re: Comments on Cap and Reduce Program Illustrative Scenarios

Dear Mr. McConnaha:

The Green Energy Institute at Lewis & Clark Law School is a nonprofit energy and climate law and policy institute within Lewis & Clark's top-ranked environmental, natural resources, and energy law program. Our team of attorneys and law students works to design comprehensive legal and policy strategies to address climate change and support a swift transition to a clean and renewable energy system. We appreciate the opportunity to comment on the Department of Environmental Quality's (DEQ) Cap and Reduce Program Illustrative Scenarios.

DEQ's illustrative scenarios apply several program design elements that would help the cap and reduce program reduce greenhouse gas (GHG) emissions in an equitable and economically feasible manner. In Part I of these comments, we highlight the scenario design options that have the greatest potential to achieve the program's goals. DEQ's illustrative scenarios also provide useful examples of the underlying tensions and trade-offs the agency must account for in developing cap and reduce rules. In Part II of these comments, we encourage the agency to consider and evaluate some additional implications that could also impact program outcomes and offer some potential strategies for addressing and balancing these tensions.

I. Scenario Design Choices that Best Achieve the Program Goals

DEQ's illustrative scenarios present several design choices that could help achieve the program's goals while addressing tensions that could impact the program's implementation and end results. Many variables and uncertainties could influence the program's ultimate outcomes and effectiveness of the program, and the interplay between design elements will also affect program outcomes. Out of the design options identified in DEQ's illustrative scenario analysis, the elements identified in the following sections have the greatest potential to achieve and further the program's goals of significantly reducing GHG emissions, prioritizing equity, and containing costs. However, we also want to urge DEQ to focus on identifying design options that help

achieve the program's climate and equity goals, and to place less emphasis on design options that constrain costs. While the program should be designed to protect businesses and consumers from burdensome cost increases, there is a significant amount of uncertainty around the program's potential cost impacts. There are also a variety of additional mechanisms that DEQ can instate to mitigate potential cost increases under the program. In contrast, there are fewer available mechanisms to ensure the program achieves its emissions and equity goals. Program design elements that establish a steep cap decline for actual in-state emissions, enable DEQ to redistribute compliance instruments in response to changing market dynamics, and allow regulated entities or specific sectors to invest in alternative compliance options that provide co-benefits to impacted communities will all help further the program's climate and equity goals, while also providing compliance flexibility to control costs for businesses and consumers.

A. Cap Decline Trajectory

The program should aim to significantly reduce Oregon's anthropogenic GHG emissions as quickly as possible, while limiting the availability of flexibility mechanisms that could undermine this objective. A steep cap decline that can be achieved through out-of-state offsets, such as the trajectory outlined in Scenario 1, would ultimately undermine the program's emissions reductions potential by allowing regulated entities to continue emitting GHGs at or near their current rates. The cap trajectory outlined in Scenario 2 does a better job of achieving in-state emissions reductions while also providing regulated entities with enough flexibility to meet their compliance obligations. While the exact rate of emissions decline required under the program will depend on real-world data, we appreciate that Scenario 2's trajectory reflects a balance between speed, flexibility, and the need to measurably reduce anthropogenic emissions in Oregon. We encourage DEQ to apply a similarly balanced approach to the cap decline trajectory established through the cap and reduce rulemaking, while also prioritizing the urgent need to reduce actual anthropogenic GHG emissions on the shortest timeframe possible.

B. Distribution of Compliance Instruments

The market shares and dynamics that exist today are unlikely to persist for the entirety of the program. Some sectors may experience dramatic reductions in emissions due to shifting consumer preferences or other market forces, which could leave some regulated entities with a glut of compliance instruments available to trade with other entities or sectors. The program should avoid locking-in the distribution of compliance instruments based on historic market shares or conditions. Instead, DEQ should include a mechanism for redistributing compliance obligations in response to shifting market dynamics and/or emissions trends. Illustrative scenarios 2 and 3 both provide good starting points for designing a compliance instrument redistribution mechanism. Scenario 3 also offers some additional design options that DEQ should explore further, including the potential to reallocate compliance instruments to reflect emissions reduction plans. However, there are some tensions and potential implications associated with the redistribution of compliance instruments that DEQ should also take into account. We discuss these tensions and implications in more detail in section II.C.

C. Alternative Compliance Options

As we asserted in previous comments on the cap and reduce technical workshops, it is imperative that DEQ develop alternative compliance mechanisms that enable and incentivize regulated entities to invest in programs and projects that accelerate an equitable transition to zero-emissions systems and technologies while mitigating the program's economic impacts on low-income and BIPOC communities.¹ DEQ's illustrative scenario 2 proposes a promising model for developing alternative compliance mechanisms. We fully support the development of DEQ-authorized alternative compliance protocols that reduce emissions, provide co-benefits in Oregon's communities, and prioritize investments in energy justice and impacted communities. The alternative compliance model outlined in Scenario 2 would further the program's emissions reduction goal by preventing regulated entities from satisfying their compliance obligations with out-of-state carbon offsets.

II. Additional Tensions and Strategies for Achieving Program Goals

DEQ has done a commendable job of identifying many of the key tensions and trade-offs that could impact the cap and reduce program's implementation and outcomes. In addition to the issues identified in the illustrative scenarios analysis, we encourage DEQ to consider the potential implications of program design options relating to available compliance pathways and the distribution, redistribution, trading, and banking of compliance instruments. We also encourage DEQ to evaluate additional equity-related risks and consider developing mechanisms to further ensure that the program will achieve its equity goals. The following sections describe some additional tensions that could affect the program's outcomes and offer potential strategies for addressing these issues.

A. Available Compliance Pathways

DEQ's illustrative scenarios generally apply the same design mechanisms to all regulated sources and sectors. This approach is effective at illustrating many key tensions and trade-offs under the program, it does not capture some tensions relating to available compliance pathways for different types of regulated sectors. The cap and reduce program will apply to sectors that have varying degrees of control over the direct emissions associated with their business models, and compliance pathways that are available to one regulated sector may not be available to another regulated sector. We encourage DEQ to evaluate tensions relating to where emissions are produced relative to the point of regulation, what kinds of compliance pathways are available to sources and sectors based on where their emissions occur, and how certain program design elements could achieve different outcomes when applied to sources of direct or indirect emissions.

The majority of Oregon's anthropogenic GHG emissions are produced through the combustion of fossil fuels such as natural gas and petroleum products. A portion of these emissions is produced by large stationary sources, such as industrial facilities. Another portion is produced at

¹ Green Energy Institute Comments on Cap and Reduce Technical Workshop 3: Alternative Compliance Options, Sept. 10, 2020; Green Energy Institute Comments on Cap and Reduce Technical Workshop 5: Cost Containment, Oct. 2, 2020.

decentralized locations, such as residential and commercial buildings that combust natural gas for heat and cooking, and another portion is produced by mobile sources like cars and trucks. While many state and federal air pollution programs regulate emissions from large stationary sources, it would be challenging from an administrative standpoint to impose emissions caps on decentralized sources, such as individual buildings and vehicles. Instead, it makes more sense to regulate the fuel suppliers and distributors that are indirectly responsible for the emissions produced from the fuels they sell to consumers. However, because these fuel suppliers do not have direct control over the actions of their consumers, regulatory mechanisms designed to control direct stationary source emissions may not have the same effect on indirect emissions from regulated fuel suppliers.

We encourage DEQ to compare and consider how various program design elements could influence the compliance activities of fuel suppliers in comparison to stationary sources. For example, illustrative scenario 3 restricts compliance instrument trading and does not include alternative compliance options as a means of achieving on-site emissions reductions. A large stationary source could presumably meet its compliance obligations under this scenario by installing new equipment or altering its operating practices to reduce its emissions. A natural gas provider, however, would have few compliance options available under this program, and would likely need to increase its rates to encourage its customers to reduce their gas consumption. DEQ recognized that scenario 3 could drive up costs and impose burdens on low-income gas customers and proposed mitigating these impacts through an exemption or financial assistance programs.² However, DEQ could potentially achieve the same objective (*i.e.*, reducing direct stationary source emissions) and mitigate cost increases by varying the program's design elements for the different types of regulated sources. For example, DEQ could make alternative compliance options available for fuel suppliers, but not for regulated stationary sources. The agency does not need to follow a one-size-fits-all approach to effectively cap and reduce GHG emissions in Oregon, and could potentially achieve the program's goals more quickly and more efficiently if it creates adaptable design mechanisms that reflect available compliance pathways for different types of entities.

B. Distribution of Compliance Instruments

DEQ is developing Oregon's cap and reduce program during a period of unprecedented uncertainty. The COVID-19 pandemic and associated efforts to control the virus' spread have had dramatic impacts on consumer behavior and economic performance. Many businesses and industries experienced a drop in GHG emissions in 2020 due to COVID-related shut downs and the shift to working from home, but these reductions are generally assumed to be temporary. While 2020 is almost certainly an outlier in terms of emissions trends and trajectories on an economy-wide basis, certain industries or sectors could experience a permanent shift in their pre-2020 and post-2020 emissions rates. If DEQ initially distributes compliance instruments based on pre-2020 emissions, some sources or sectors could receive an over-allocation of compliance instruments. If the source or sector is able to bank and/or trade these excess allowances, it could undermine the integrity of the cap in future compliance periods.³

² OREGON DEPT. OF ENVTL. QUALITY, PROGRAM DEVELOPMENT TO REDUCE GREENHOUSE GAS EMISSIONS: ILLUSTRATIVE SCENARIOS 7 (Dec. 2, 2020).

³ For the purposes of these comments, the term "allowance" refers to a cap and reduce compliance instrument.

To preserve the integrity of the cap, DEQ should consider incorporating safeguard mechanisms into the program to prevent or mitigate potential over-allocations of compliance instruments in the initial compliance period. These safeguards could take any number of forms. For example, DEQ could intentionally withhold a larger percentage of allowances in an initial compliance instrument reserve to reduce the number of compliance instruments available for distribution. The agency could then establish temporary conditions for withdrawing instruments from the reserve that only apply in early compliance periods. Or DEQ could initially distribute compliance instruments based on pre-2020 emissions and establish a mechanism to automatically adjust this distribution if a source or sector banks and/or trades a threshold number of compliance instruments in the early years of the program. If any regulated source or sector receives an over-allocation of compliance instruments in any compliance period as a result of unanticipated market dynamics, DEQ should withhold at least an equal number of compliance instruments from the source or sector in the subsequent compliance period.

C. Redistributing Compliance Instruments

As we discussed in section I.B, DEQ should retain authority to adjust the distribution of compliance instruments to reflect changes in source or sector emissions profiles resulting from shifting market dynamics or other circumstances. However, there are some potential tensions between the need to account for changes in emissions rates resulting from market forces and changes resulting from intentional emissions reduction activities and investments. Redistribution protocols should be designed to avoid penalizing regulated entities that reduce emissions through investments and operational changes undertaken for compliance purposes. To achieve increasingly stringent compliance obligations, many regulated entities will presumably need to choose between investing in new technologies to reduce emissions or purchasing excess compliance instruments from other regulated sources. New technologies are typically capital-intensive, and regulated entities are more likely to make these investments if they can recoup their capital costs over time. The ability to sell compliance instruments provides one potential pathway for recouping these costs, so redistribution protocols should ensure that sources willing to make investments in emissions reduction technologies maintain some ability to generate and trade excess compliance instruments. Redistribution protocols should ideally aim to prevent over-allocation windfalls for regulated entities that reduce emissions due to market pressures, while still incentivizing regulated entities to invest in technologies, systems and practices that reduce emissions in the near-term.

D. Trading Compliance Instruments

The effectiveness of compliance instrument trading in achieving the program's goals will largely depend on the accuracy of DEQ's compliance instrument distributions. If every regulated entity and/or sector initially receives compliance instruments that under-reflect the sources' or sectors' business-as-usual emissions in a post-pandemic economy, an unrestrictive trading mechanism would theoretically encourage investments in cost-effective emissions reductions and establish a market price that accurately reflects the economic (if not social or environmental) cost associated with those emissions reductions. If, however, DEQ over-allocates compliance instruments to any sources or sectors, it could lead to an over-supply of allowances on the market that would drive

down costs and deter other sources or sectors from investing in on-site emissions reductions. Restrictions on trading would help mitigate the impacts of over-allocation by helping reduce the supply of available allowances and incentivize investments in emissions reductions. If compliance instruments are under-allocated, however, restrictions on selling excess compliance instruments could potentially deter entities from investing in projects or processes that maximize emissions reductions in the near-term. To address these tensions, DEQ could consider establishing restrictive trading mechanisms that are automatically triggered if the available supply of unused compliance instruments exceeds a certain threshold.

E. Banking Compliance Instruments

The allocation of compliance instruments has similar implications for the banking of excess compliance instruments as it does for trading. If DEQ over-allocates compliance instruments to any sources or sectors, and those sources or sectors are permitted to bank their excess allowances indefinitely, it could result in an over-supply of allowances at any point in the future. If DEQ over-allocates allowances to multiple sources or sectors in its initial distribution of compliance instruments, a flood of banked allowances could completely undermine the program's emissions reductions in later compliance periods. At the same time, however, the ability to bank excess compliance instruments could incentivize regulated entities to invest in early emissions reductions that would provide a greater benefit to Oregon than later reductions. Similarly to the trading issues described in the previous subsection, DEQ could potentially address these banking tensions by developing a mechanism that automatically triggers banking restrictions (such as a limit on the number or percentage of compliance instruments sources can bank at a time, or expiration dates on banked compliance instruments) if certain conditions occur.

F. Strategies to Promote Equitable Benefits and Outcomes

We agree with DEQ that equity must be a key priority under the cap and reduce program, and support the agency's objectives to develop mechanisms to promote community benefits and alleviate community burdens, particularly in environmental justice (EJ) and impacted communities. We believe the alternative compliance framework described in Scenario 2 offers the strongest opportunity to achieve some of these objectives within the existing legal confines by creating an avenue to invest in projects that benefit impacted communities. Projects that reduce GHG emissions while helping EJ and impacted communities transition to zero-emissions technologies will provide meaningful immediate benefits while also protecting communities from future fossil fuel cost volatility.

However, investments in zero-emissions technologies alone will not effectively mitigate the long-term threats that climate change presents for Oregon's frontline communities. To mitigate these risks to the greatest extent possible through state-level action, DEQ must develop a program that effectively and meaningfully reduces GHG emissions quickly and permanently. This is unlikely to occur if DEQ allows economic concerns to outweigh climate benefits in the design and implementation of the cap and reduce program.

Oregon's persistent and widespread equity challenges largely stem from and continue to be driven by inequitable policies that are directly or indirectly designed to protect entrenched

economic interests rather than community health and wellbeing. These policies generally were not adopted with malicious intent; instead, they were crafted in response to stakeholder input. The underlying problem is that powerful economic interests typically have the capacity and resources to influence decision-making to a much greater extent than individual citizens or communities. DEQ has made a concerted effort to address some of these imbalances through the cap and reduce stakeholder process, but these efforts may not be sufficient to override decades of ingrained institutional culture and practice. There remains a concerted risk that well-resourced commercial interests will constrain the program's ambition and ability to achieve its goals, or encourage the agency to weaken the program's emissions reduction potential at some time in the future. The burdens of either of these outcomes would fall disproportionately onto Oregon's most vulnerable communities.

To mitigate these risks, DEQ should consider incorporating precautionary response measures into the program that would automatically trigger additional requirements or restrictions if programmatic emissions reduction thresholds or other pre-determined conditions are not met. For example, if the state's total reported emissions do not drop from one compliance period to the next, it could automatically trigger restrictions on banking and trading of compliance instruments. DEQ could also develop sector-specific response measures. For example, if fuel prices rise above a certain threshold, fuel suppliers could be required to submit a certain number of alternative compliance instruments from projects that mitigate cost burdens for low-income customers. These types of mechanisms could help ensure that the program stays on track to achieve its goals and address some of the influence-related imbalances that have the potential to stymie progress.

DEQ should also work with other agencies, municipalities, and community groups to identify other opportunities to further mitigate potential burdens on EJ and impacted communities through policies and program beyond the scope of the cap and reduce program. For example, DEQ could work with the Public Utility Commission to develop strategies to mitigate impacts to low-income electricity and gas ratepayers, and the agency could work with the Oregon Department of Energy, the Oregon Department of Transportation, and local governments to identify strategies to mitigate transportation-related burdens.

III. Conclusion

We want to thank DEQ for continuing to engage with stakeholders on technical design options and policy considerations for the cap and reduce program. Achieving the program's climate, equity, and economic goals requires careful deliberation at the design stage to determine how available regulatory mechanisms could impact outcomes under varying conditions. We appreciate the opportunity to provide input on the implications of certain design options and offer suggestions for addressing the tensions and trade-offs that could influence the program's outcomes. Thank you for considering our comments.

Sincerely,

Amelia Schlusser

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