

The Risks of Unlimited Banked Allowances in a Cap-and-Trade Program

The Oregon Legislature is proposing to create a cap-and-trade program for emissions of greenhouse gases from the state's largest emitters. Under a cap-and-trade program, lawmakers establish an overall cap on allowable emissions from the covered sources. The cap will decline over time, so that covered sources' emissions will decline by 45% below 1990 levels by 2035 and by 80% below 1990 levels by 2050. Although these reductions seem (and could be) deep, the Legislature's proposal includes several design elements that could weaken the bill's goal and potentially undermine the ability of the Legislature or regulators to strengthen the greenhouse gas reductions goals in the future. One of these design elements is unlimited banking of allowances.

Each covered source must meet its own individual emissions cap. To demonstrate compliance, each covered source must obtain, and then surrender, one allowance (equivalent to 1 metric ton of carbon dioxide equivalent, or tCO₂e) for each ton of greenhouse gases the source emits during the compliance period. If the source emits more than its cap allows, the source may purchase allowances from other sources. If the source emits less than its cap allows, the source may sell or "bank" its excess allowances to use in the future.

Oregon's proposed law does not limit the extent to which sources may bank emissions or set an expiration date on banked allowances. This is dangerous, because it could allow covered sources to accumulate excess allowances when emissions caps are relatively high in comparison to actual emissions and apply those banked allowances in the future, when emission caps will be lower. While banking could be seen as a way to ease compliance, it often allows companies to benefit from windfalls associated with poor program design. Based on past experience with other emissions trading programs, the integrity of Oregon's program is at risk due to emissions banking. For example:

- Under the proposed law, investor-owned electric utilities will receive 100% of the allowances they need to cover their emissions through 2030. Their emissions allowances will not be based on the cap. Instead, their emissions allowances will be based on emissions forecasts included in the utilities' integrated resource plans (IRPs) developed before 2020. Under Oregon law, utilities develop their own IRPs, and the Oregon Public Utility Commission (PUC) has responsibility for reviewing the IRPs. If the utilities' acknowledged IRPs propose resource mixes with substantial amounts of fossil fuel-based electricity (which is likely), the utilities will receive, for free, allowances based on those fossil fuel-intensive plans. Even if the utilities retire or divest from some fossil fuel-fired plants before 2030, they will still receive the same number of allowances based on their forecasted emissions. This creates an incentive for the utilities to overstate their emissions forecasts in their IRPs, because they will be able to accumulate and then bank the emissions for future compliance years, when the utilities will finally be exposed to the caps. If the utilities are

able to bank their allowances indefinitely, this will delay their investments in zero-carbon electricity sources.

- Under the proposed law, most large stationary sources in the state will be treated as “trade-exposed” businesses that are eligible for free allowances based on their emissions caps. If a source is allowed to emit, for example, 30,000 tons of carbon dioxide in a year, it will receive 30,000 allowances. If the source actually emits 25,000 tons, it will be allowed to bank its excess allowances for future use or sale. This creates a potential windfall to the source, which will now be able to profit from selling allowances it received for free. It may also delay the source’s investment in zero-carbon energy or emissions-free technologies, if the source is able to accrue substantial amounts of banked allowances.
- The proposed law does not include mechanisms to limit banking during economic slumps, when emissions are likely to drop. This could result in an excess of banked allowances that could be used in the future, delaying decarbonization efforts. Under other existing emissions trading programs, including the European Union Emissions Trading System and the Regional Greenhouse Gas Initiative, economic slumps coincided with deep reductions in emissions and extensive banking. These programs then had to reset their rules to prevent banked emissions from flooding their systems. In California, market watchers estimated that the system would create between 100 million and 300 million banked allowances. While California regulators and the market watchers dispute how these banked allowances will affect future compliance with California’s cap, they agree that the program has resulted in substantial banked allowances that will likely delay emissions reductions in the state. Oregon’s proposed law should be designed to minimize the risks of an oversupply of banked emissions allowances.
- The proposed law does not include any mechanism that would require a covered source to immediately surrender all of its allowances when it closes or ceases operation. A source could therefore accumulate banked allowances during its time of operation and, when it decides to close, sell its banked allowances to other covered entities. This creates a windfall to the closing source (particularly if it received emissions allowances for free) and runs the risk of flooding the market with banked allowances.

To minimize these risks, Oregon lawmakers should:

- Stipulate that allowances have a lifespan of no more than 3 years. This will give covered sources some flexibility, but it will also help prevent banking from delaying investment in technologies and strategies to reduce emissions.
- Limit the amount of banked allowances that can be used for compliance by each source and by all sources collectively during each compliance period. This will ensure that covered sources have continued obligations and incentives to reduce their emissions on an ongoing basis.
- Limit or prohibit the banking of allowances that covered entities receive through free allocations. Covered sources are already receiving a windfall from the state



by receiving the right to emit for free. Moreover, these sources are allowed to sell for a profit the allowances they receive for free from the state. Oregon should not create additional windfalls for covered entities that have already benefitted from decades of externalizing their pollution onto the rest of society.

ABOUT US

The Green Energy Institute is a renewable energy policy organization within Lewis & Clark Law School's Environmental, Natural Resources, and Energy Law Program. The Green Energy Institute develops strategies and advocates for a transition to a renewable energy grid.

For more information on the Green Energy Institute, please visit our website at: https://law.lclark.edu/centers/green_energy_institute/

CONTACT INFORMATION

Green Energy Institute
Lewis & Clark Law School
10015 SW Terwilliger Blvd.
Portland, OR 97219

Melissa Powers
Director
powers@lclark.edu
503.768.6727

Amelia Schlusser
Staff attorney
ars@lclark.edu
503.768.6741

Licia Sahagun
Deputy Director
lsahagun@lclark.edu
503.768.6785