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October 2, 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 Technical Workshop 5—Cost Containment

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 Technical Workshop on Cost Containment.

Our comments respond to the overarching question presented at DEQ's fifth technical workshop: *how much flexibility should DEQ and EQC offer regulated entities in complying with a greenhouse gas emissions cap and reduce program?* In response, we believe that all elements of this program must be designed with an eye toward measurably and permanently reducing anthropogenic emissions in Oregon. Any goal of lowering costs and increasing flexibility for regulated entities must cede to a pathway that achieves the statewide GHG reduction targets established through Governor Brown's Executive Order 20-04.

Due to the piecemeal approach of these workshops, there is a significant risk of losing sight of this program's mission and of creating unnecessary confusion. As a result, in light of so many unknowns about what the program will end up looking like, the recommendations contained in these comments anticipate a program otherwise designed to maximize GHG emissions reductions. Part I of these comments urges DEQ and the EQC to consider potential economic benefits while evaluating compliance costs, as well as potential impacts from insufficient action. Part II urges the agencies to distribute compliance instruments and set compliance periods to maximize emissions reductions. Part III encourages DEQ and the EQC to allow community emissions reduction credit banks to certify, manage, and distribute credits used for alternative compliance under the program and provides additional guiding principles to create market

certainty. Part IV urges strong oversight of trading under the program. Part V identifies concerns with compliance instrument reserves. Finally, Part VI underscores the need for socially beneficial and equitable emissions reduction projects that do not include biogenic carbon offsets as eligible Alternative Compliance Options.

I. Balance Costs and Benefits and Prioritize Meaningful and Measurable GHG Reductions over Cost Containment

In designing the tools DEQ believes will achieve lower costs and flexibility—like multi-year compliance periods, banking, trading, and alternative compliance options—DEQ should consider the possibility that cost containment mechanisms ultimately may not be necessary under the program. In fact, DEQ should prepare for the opposite outcome to occur—that costs might actually decrease under the program—and avoid creating mechanisms that diminish the program’s effectiveness in an effort to contain costs that may fail to materialize. For example, the states involved in the Regional Greenhouse Gas Initiative (RGGI) reduced emissions faster and at a lower cost than anticipated; in 2016, RGGI state emissions fell 8.4% below the RGGI cap, and average electricity prices decreased by 6.4%, while electricity prices in other states increased by 6.2%.¹ While it is imperative that the program include safety mechanisms to protect impacted communities and businesses from burdensome costs, DEQ and the EQC should not assume that the program will create unmanageable costs for all regulated sectors.

While assessing mechanisms to contain costs under the program, DEQ should also consider the potential economic benefits that may arise as a result of the program. Existing GHG reduction programs have shown that it is possible to meaningfully reduce carbon emissions while achieving economic growth. California, for example, has successfully reduced GHG emissions while its economy has grown and generated jobs.² The RGGI states similarly experienced economic growth exceeding that of non-RGGI states by 4.3%.³ Ambitious GHG reduction targets could help attract new industries to Oregon and expand the market for emissions-free technologies that are currently designed and produced in the state. As Oregon adopts cleaner technologies and deploys new infrastructure to support a growing low-carbon economy, new jobs will be created to enable and accelerate the transition.

As the Ninth Circuit Court of Appeals established in a case more than a decade ago, it is arbitrary and capricious action to avoid assessing some value to the benefit of carbon emissions reductions when engaging in a cost-benefit analysis.⁴ For that reason, we encourage DEQ to evaluate the potential economic and employment impacts and benefits from the program under a

¹ ACADIA CENTER, *OUTPACING THE NATION: RGGI’S ENVIRONMENTAL AND ECONOMIC SUCCESS*, 3 (2017), available at https://acadiacenter.org/wp-content/uploads/2017/09/Acadia-Center_RGGI-Report_Outpacing-the-Nation.pdf.

² “From 2000 to 2017, the carbon intensity of California’s economy has decreased by 41 percent from 2001 peak emissions while simultaneously increasing GDP by 52 percent. In 2017, GDP grew 3.6 percent while the emissions per GDP declined by 4.5 percent compared to 2016.” CAL. AIR RESOURCES BD., *CALIFORNIA GREENHOUSE GAS INVENTORY FOR 2000 TO 2017*, 3–4 (2019), available at https://ww3.arb.ca.gov/cc/inventory/pubs/reports/2000_2016/ghg_inventory_trends_00-16.pdf.

³ *OUTPACING THE NATION*, *supra* note 1, at 6.

⁴ *Center for Biological Diversity v. Nat’l Highway Transp. Safety Act*, 538 F.3d 1172, 1203 (9th Cir. 2008).

series of scenarios that incorporate varying assumptions on market dynamics and technology deployment. We recognize that it can be challenging to model uncertain costs, but uncertainty or complexity cannot justify declining to conduct an array of economic analyses to help determine what types of emissions reductions trajectories are economically feasible.

Moreover, DEQ and the EQC must not forget the overwhelming and growing costs of climate change when assessing the costs of implementing the cap and reduce program. DEQ recognizes the existence of these costs in the increasing average temperatures, severity of storms, rising sea levels, ocean acidification,⁵ not to mention increased risk and extent of wildfires. DEQ and the EQC should prioritize achieving meaningful and measurable GHG emissions reductions over containing costs for large emitters.

II. Incentivize Technological Transformation in the Distribution of Compliance Instruments and in Setting a Compliance Period

We urge DEQ and the EQC to establish compliance instrument distribution protocols and compliance periods that maximize emissions reductions as quickly as possible. While we are wary of assigning indefinite compliance benefits in exchange for early action, particularly for emissions reductions resulting from investments in “low hanging fruit,” we also recognize the urgent need to maximize GHG reductions as rapidly as possible. We encourage DEQ to conduct a thorough evaluation of the potential benefits and implications of incorporating early action incentives into the program. Through this assessment, DEQ should consider whether early action incentives are actually necessary to compel near-term investments, or whether these kinds of mechanisms would simply reward emitters for actions they should or would have previously taken. If DEQ and the EQC determine that early action incentives are necessary to achieve the state’s GHG reduction goals, they should only make these incentives available for actions that result in meaningful and additional emissions reductions and they should ensure that early action incentives will not deter further emissions reductions in the future. Compliance instrument distribution protocols should also incentivize early adoption and deployment of non-emitting technologies and associated infrastructure.

In terms of setting a compliance period, we recognize the value of aligning with other jurisdictions’ timelines for purposes of harmonizing multiple reporting and compliance demands. However, any compliance period under Oregon’s cap and reduce program should be no longer than three years. Emissions reductions must happen as quickly as possible and shorter compliance periods can drive early reductions. The Kyoto Protocol’s five-year commitment period is a good example of a compliance period that is simply too long. Compliance periods should be short enough to incentivize early GHG reductions while facilitating swift correction of noncompliance.

⁵ OREGON DEPT. OF ENV’T L QUALITY, PROGRAM OPTIONS TO CAP AND REDUCE GREENHOUSE GAS EMISSIONS, FINAL REPORT 6 (June 2020).

III. Establish Stringent Banking Protocols to Preserve the Integrity of the Cap

Before creating a new system for certifying, banking, and distributing alternative compliance instruments under the cap and reduce program, DEQ and the EQC should consider expanding the use of community emissions reduction credit banks authorized under ORS § 468A.820. As we noted in our previous comments on alternative compliance options, community emissions reduction credit banks would help ensure that emissions reduction credits (ERCs) are issued for projects that measurably reduce anthropogenic emissions and provide meaningful benefits to local communities. Community ERC banks could also help prioritize projects that reduce emissions in impacted communities. In addition, community ERC banks could potentially collect revenues from ERC transactions, which could then be used to fund projects that reduce GHG emissions in a just and equitable manner.

Additionally, we encourage DEQ and EQC to apply the following principles in any banking protocols the agency develops for the cap and reduce program: incentivize innovation, effectuate equitable outcomes, reward proactive responsibility, and reduce uncertainty. These guiding principles would help maintain the integrity of the program cap while supporting a just and equitable transition to a decarbonized society.

Because the cap and reduce program must operate within the parameters of the agency's existing regulatory authorities, DEQ must presumably freely allocate compliance instruments to covered sources.⁶ To protect the integrity of the program cap, any source receiving freely allocated compliance instruments should not be permitted to bank those instruments unless the source can demonstrate that it has implemented process or technological changes that permanently and additionally reduce GHG emissions. Initial allowance allocation and cap-setting decisions, based on good data, will avoid overallocation of instruments; however, should overallocation occur at the outset, sources should not be permitted to bank those instruments. Rather than perpetuate a benefit to one source for having done nothing but accept a compliance instrument from the agency, banking rules should encourage reductions in emissions through additional actions, such as efficiency improvements. Sources should not be entitled to bank excess compliance instruments for emissions reductions resulting from external factors outside sources' control, such as a pandemic or an economic downturn. If a source *earns* its emissions reductions through affirmative and proactive actions or investments, it should be permitted to bank the corresponding compliance instruments as a reward for its responsible behavior. However, sources should be prohibited from banking compliance instruments for emissions reductions resulting from actions that predate the cap and reduce program.

In addition to imposing restrictions on the types of emissions reductions that can create bankable compliance instruments, DEQ and the EQC should impose strict limitations on the duration of banking. Unlimited banking creates market uncertainty and undermines the motivation to invest and innovate. The beauty of a declining cap is that everyone knows what the cap is, it leads to emissions reductions, and it creates certainty in the market. A flood of offsets or banked

⁶ As DEQ has acknowledged in its issue briefs and technical workshops, Oregon's air quality laws restrict the agency's authority to exact fees from regulated sources that exceed those necessary to cover administrative costs. As a result, DEQ and the EQC do not appear to have authority to establish a pay-to-pollute system for allocating compliance instruments, and instead must allocate instruments through existing permit mechanisms.

allowances would inject uncertainty into the market. To reduce uncertainty and the potential for banked credits to distort the market, DEQ and the EQC should establish strict limits on the number of years sources may bank allowances under the program. To prevent banked allowances from negating the need for actual emissions reductions in a given compliance period, the agency should also impose strict limits on the quantity of allowances a source may bank or surrender during a compliance period. Finally, EQC rules should clearly specify that allowances are not property rights. This would prevent regulated entities from bringing takings challenges against the agency if the allowance banking rules are changed in the future.

IV. Establish Trading Oversight Protocols for Secondary Market Transactions

As DEQ itself recognizes, it will be critical for DEQ and the EQC to monitor and account for trading on a secondary market. Trading should only be allowed if the EQC adopts rules requiring reporting of secondary market transactions. DEQ and the EQC should also prohibit trading on any secondary markets that would enable regulated entities to purchase credits for biogenic carbon offsets and use the credits to meet cap and reduce compliance obligations. While trading between regulated entities could potentially encourage economical emissions reductions and near-term action, trades conducted through interstate or international secondary markets could erode the integrity of the program if regulated entities are able to purchase low-cost offsets to reduce their in-state compliance obligations.

V. Fully Evaluate the Risks and Implications of Compliance Instrument Reserves

We have several concerns about the prospect of establishing compliance instrument reserve under the cap and reduce program. As DEQ recognizes, under the agency's existing legal authority, any releases of additional compliance instruments would necessarily be freely allocated to regulated entities. A compliance instrument reserve could therefore undermine the incentive to invest in emissions reductions and encourage regulated sources to adopt a wait-and-see approach to compliance. Compliance instrument reserves that are designed to respond to external economic circumstances could create opportunities for market manipulation and regulatory capture. Compliance instrument reserves would also inject additional uncertainty into secondary markets and potentially expose markets to gaming or manipulation.

While we recognize the value of developing precautionary response mechanisms that would enable the program to adapt to unforeseen circumstances, it is imperative that DEQ and the EQC preserve the integrity of the program's declining emissions cap. Under no circumstances should a compliance instrument reserve allow GHG emissions to exceed the statewide cap in any given compliance period. If a compliance instrument reserve is created under the program, it must only contain instruments that would otherwise be allocated to regulated entities under the cap. Reserved instruments should also be retired at the end of each compliance period to reduce market uncertainty and preserve the integrity of the cap.

If DEQ and the EQC ultimately conclude that compliance instrument reserves are a necessary tool under the program, the agency should establish stringent standards and criteria to justify any

releases from the reserves. DEQ and the EQC should require a showing of sustained and substantial economic hardship on Oregonians (as opposed to industry) before releasing additional compliance instruments.

The program should also clearly specify which entities may receive compliance instruments from a reserve. Only existing entities that are subject to regulation under the program should be eligible to receive reserved compliance instruments. New emitters should not be eligible to receive compliance instruments from the reserve or use reserved compliance instruments. If a new emitter wishes to enter the market, it should be required to purchase compliance instruments from existing regulated entities.

Finally, while the prospect of allocating compliance instruments based on 2020 emissions levels and reserving the remaining compliance instruments to respond to an economic rebound could potentially help prevent emissions from returning to pre-COVID levels, we are concerned that this approach could incentivize some regulated entities to maximize output or sales rather than invest in permanent changes to reduce emissions. If DEQ and the EQC decide to pursue this approach, the agency should establish clear thresholds for triggering releases from the reserve and stringent criteria for determining which sources are entitled to compliance instruments from the reserve and what conditions must be met before a source is eligible for a distribution from the reserve.

VI. Carefully Design and Evaluate Alternative Compliance Options

With stringent parameters to guide their use, alternative compliance options have the potential to accelerate a just and equitable transition to a decarbonized economy. However, loosely regulated alternative compliance options risk undermining the integrity of the program by creating a disincentive to reduce anthropogenic emissions in Oregon. Because alternative compliance options have significant implications for the ultimate success of the program, we want to reiterate some of the points we raised in our previous comments on alternative compliance options. DEQ and the EQC should develop parameters to ensure that alternative compliance projects 1) help impacted communities in the state of Oregon transition away from fossil fuel-dependent technologies, 2) require large stationary sources to maximize on-site emissions reductions before they are eligible to use alternative compliance options, 3) require regulated stationary sources to procure emissions reduction credits from projects that reduce emissions within communities in the vicinity of the facility, and 4) measurably reduce or prevent *anthropogenic* GHG emissions.

We want to emphasize the importance of limiting alternative compliance options to projects that reduce anthropogenic emissions and prohibit regulated sources from using biogenic carbon offsets to demonstrate compliance with their emissions caps. Biogenic carbon offsets, and forest carbon offsets in particular, should not be permissible alternative compliance instruments under the program due to significant uncertainty over the permanence, additionality, and measurability of their carbon reductions. Allowing forest offsets would weaken our emissions reductions program, would fail to drive investments in technology that are necessary to facilitate the

elimination of fossil fuels, and are not sufficiently measurable or permanent to be reliable in a program with a limited cap.

First, the climate crisis is the direct consequence of anthropogenic fossil fuel combustion, and we can only effectively address Oregon's contribution to climate change by reducing anthropogenic emissions moving forward. Indeed, every biogenic carbon offset takes pressure off of the need to reduce and ultimately eliminate fossil fuel consumption in Oregon. Experience with cap-and-trade programs that authorize biogenic offsets demonstrates these offsets delay fossil fuel reductions, often at some of the biggest emitting facilities.⁷ This, in turn, delays the rate of clean energy innovation and deployment that can make technologies less expensive and more deployable.

Second, one of the biggest challenges with reducing emissions from the transportation and gas sectors is the fact that we have equipment and infrastructure that, if it is not replaced, will lock in reliance on fossil fuels and threatens to strand lower-income users with fossil fuel equipment as prices increase. An emissions cap on its own will not directly result in infrastructure changes. For that reason, we support alternative compliance options that allow sources to meet a certain amount of their compliance obligations by surrendering emissions reduction credits from projects that replace fossil fuel equipment with new zero-emitting equipment, such as replacing a diesel truck with an electric truck or a natural gas furnace with an efficient electric heat pump. In contrast, biogenic offsets do nothing to support the substantial challenges of infrastructure lock-in, and they may actually delay it.

Finally, forest and land use offsets are notoriously difficult to quantify and, as wildfires increase in intensity, protect.⁸ The recent wildfires that raged across the state provide a real-world example of the risks associated with biogenic offsets. Before the 2020 fire season, California issued the Confederated Tribes of Warm Springs more than 2.6 million carbon offset credits in exchange for the Tribes' commitment to sequester carbon in their forest.⁹ That forest was recently engulfed by the Lionshead Fire.

We recognize that forest and land use offset programs can provide some unquantifiable climate benefits and therefore should be included in the broader climate action toolbox. However, the cap and reduce program is based around and driven by numerical data, and biogenic offsets should not be included within the program.

⁷ Lara Cushing, et al., *Carbon Trading, Co-Pollutants, and Environmental Equity: Evidence from California's Cap-and-Trade Program (2011-2015)*, PLOS Medicine (July 10, 2018), <https://journals.plos.org/plosmedicine/article?id=10.1371/journal.pmed.1002604>.

⁸ Lisa Song, *An Even More Inconvenient Truth: Why Carbon Credits for Forest Preservation May be Worse than Nothing*, PROPUBLICA (May 22, 2019), <https://features.propublica.org/brazil-carbon-offsets/inconvenient-truth-carbon-credits-dont-work-deforestation-redd-acre-cambodia/>; James Temple, *Whoops! California's Carbon Offsets Program Could Extend the Life of Coal Mines*, MIT TECHNOLOGY REVIEW (August 26, 2019), <https://www.technologyreview.com/2019/08/26/133261/whoops-californias-carbon-offsets-program-could-extend-the-life-of-coal-mines/>.

⁹ Emily Pontecorvo & Shannon Osaka, *This Oregon Forest was Supposed to Store Carbon for 100 Years. Now it's on Fire*, GRIST.ORG (Sept. 18, 2020), <https://grist.org/climate/this-oregon-forest-was-supposed-to-store-carbon-for-100-years-now-its-on-fire/>.

In sum, due to the substantial uncertainty surrounding the integrity and longevity of land use and forestry-based carbon offset projects, we strongly urge DEQ and the EQC to exclude biogenic carbon offsets as a means of compliance under the cap and reduce program.

VII. Conclusion

While the cap and reduce program should be designed to minimize negative economic impacts to Oregon citizens and mitigate costs that disproportionately burden impacted communities, DEQ and the EQC should not prioritize cost containment at the expense of program effectiveness. Many Oregon communities are already bearing tremendous burdens from the impacts of climate change, and swift and ambitious action is necessary to reduce emissions before the economic, social, and environmental costs of climate change outpace our capacity to pay them.

We strongly encourage DEQ and the EQC to carefully evaluate the potential costs *and* benefits of carbon regulation and include stringent banking and trading protocols into the program to preserve the integrity of the emissions cap. We appreciate your consideration of our comments.

Sincerely,

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