

Submitted to:

Beth Reily, Legislative Coordinator, Joint Committee on Carbon Reduction

**INTERNATIONAL EMISSIONS TRADING ASSOCIATION (IETA)
COMMENTS ON OREGON HOUSE BILL 2020**

For two decades, IETA has been the premier international business voice on carbon pricing and climate finance, including the design and implementation of greenhouse gas markets and offset systems. Our global multi-sector non-profit organization represents 150 companies, many with assets and investments across Oregon and the Western Climate Initiative. IETA's experience and expertise is regularly called-upon to inform climate change policies that achieve real, quantifiable, and verifiable greenhouse gas reductions, while balancing economic efficiencies with environmental integrity and social equity.

IETA's comments on House Bill 2020 (HB 2020) are structured as follows:

	IETA's Comments on Oregon's House Bill 2020
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1. SUPPORT FOR LINKING

IETA supports all proposed provisions, contained in HB 2020, allowing for agreements to link Oregon's cap-and-trade program with programs in other jurisdictions. The benefits of market linking and cross-border partnerships are clear: the bigger and broader the market, the wider the range of abatement opportunities and improved efficiencies, driving down program costs. There are also significant administrative benefits from sharing market infrastructure and political benefits from showing a unified response to climate change (Burtraw et al, 2013).

IETA encourages continued discussions with potential linkage partners, especially California and Québec. Aligning essential program design rules, standards, and joint market infrastructure with potential linking partners are foundational steps towards building a broad, linked market. There are a limited number of elements that must be aligned, from technical and economic perspectives, before establishing



a formal link with fungible credits. However, much of the work lies in determining, from political and policy perspectives, which aspects are essential for alignment (and which are not) through careful and consistent conversations between regulators and affected stakeholders.

2. CAP-SETTING AND SCHEDULE

IETA supports legislative efforts to establish a clearly-defined, predictable, and transparent market framework over the long-term. Regulators must allow cap-and-trade to behave like other commodity markets – where price shifts are driven by market supply and demand fundamentals. This can be achieved by establishing clear, stable and predictable rules upon which participants can make long-term business and investment decisions.

Setting and clearly-communicating annual cap levels to the market is a fundamental step toward reducing cumulative emissions cost-effectively and quickly. IETA therefore endorses Section 9(A), as it directs the regulator to set annual allowance budgets over a long-term timeframe from 2021 to 2050. This section could be further enhanced by clarifying that the regulator shall publish a complete cap schedule (i.e., annual allowance budgets for each year from 2021 to 2050) as early as possible and practical. The long-term market signal created by such a cap schedule would facilitate additional investments from compliance entities in lower-emitting technologies (thereby lowering costs) and encourage earlier action (thereby reducing cumulative emissions earlier rather than later).

IETA advises against regulators introducing unanticipated policy or market design changes that affect price and result in uncertainty. Unexpected program design or supply changes can have significant, typically adverse, effects on market growth, confidence, and ultimately achieving the intended policy goal of driving least-cost reductions. As Oregon moves forward, the need for program evaluations and modifications to core design elements will arise. Both before and during this process, the need for “market certainty” is imperative. In the context of cap-setting, IETA requests additional language be added to the bill to elaborate on how changes to cap levels would be addressed, including clearly-defined rational mechanisms and timetables for reviewing, proposing, and implementing cap adjustments in a manner that preserves confidence of market participants overtime.

Finally, IETA shares some guiding questions on cap-setting that we pose to regulators in all jurisdictions. These are a selection of questions that are useful in helping regulators think through the design of their caps. We would be more than happy to discuss or elaborate upon these questions in future discussions.

- Does the cap design drive a meaningful price signal based on demand and supply balances?
- Will the pace of graduated cap-tightening produce a balanced market over a reasonable time?
- Would the cap imposed by Oregon make an overall linked market more vibrant and robust?



3. PENALTIES FOR NON-COMPLIANCE

Strong penalties for non-compliance are an essential aspect of a successful cap-and-trade program. Section 9(4)(c) states that the regulator shall require a covered entity that fails to timely surrender a sufficient quantity of compliance instruments to meet an obligation to surrender a number of compliance instruments *in addition* to the entity’s obligation. Typically, non-compliance penalties require surrender of a number of compliance entities equal to a multiple of an entity’s shortfall, which is the difference between its compliance obligation and retired allowances. IETA recommends adopting similar language because it is more precise and likely a stronger deterrent for non-compliance.

4. HOLDING LIMITS

Holding limits operate as artificial market constraints that impede, rather than enhance, market liquidity and performance. Holding limits can force large compliance entities to buy allowances at a premium on the secondary market. Holding limits can also limit the participation of third-party liquidity providers, which provide certain exchange-cleared transactions that enable covered entities to take advantage of lower capital and borrowing costs from the market, thereby lowering carbon inventory financing costs. The overall consequence of holding limits is higher costs of capital for covered entities and increased indirect costs for consumers. IETA therefore recommends eliminating holding limits and encourages the consideration of alternatives that more effectively address market power concerns, including vigorous market monitoring or increased auction frequency (Schatzki and Stavins, 2013). To the extent holding limits are adopted, they should apply equally to all market participants, regardless of a participant’s compliance obligation, to ensure trading parity.

5. TREATMENT OF TRANSPORTATION SECTOR

IETA supports as broad a sectoral coverage as economically and politically practical. Wider coverage maximizes cost savings and enhances efficiencies across the market, while allowing regulators to more effectively use the cap to drive down economy-wide emissions. IETA therefore supports the inclusion of the transportation sector under Oregon’s cap-and-trade program.

IETA encourages Oregon to use cap-and-trade as the workhorse for carbon reductions in the transportation sector. It is critical to recognize that a primary driver of low allowance prices is the aggressive use of complementary or overlapping policies in parallel with cap-and-trade programs. A more cost-effective strategy to achieve statewide climate goals would be to de-emphasize the role of these supplementary, more prescriptive and costlier, policies in favor of emphasizing the role, and intended power, of the cap-and-trade program (LAO, 2018). In other words, cap-and-trade should be recognized and enabled as the “workhorse” policy measure, rather than the “backstop” policy measure, to cost-effectively achieve Oregon’s statewide climate goals.



6. TREATMENT OF ELECTRICITY SECTOR

IETA supports the use of a small consignment auction in the electricity sector. History and practical experience show that consignment auctions offer a way to increase fairness, transparency, and liquidity in allowance markets. While IETA understands that a full consignment auction is an unlikely design feature for Oregon’s cap-and-trade program, we offer an additional insight: only a small portion of allowances needs to be consigned to achieve a significant positive impact. For example, the first allowance market, the US Acid Rain Program, required a 3 percent consignment auction that led to impactful price discovery (Burtraw and McCormack, 2017). If even a limited consignment auction cannot be designed, IETA would further underline the importance of linking Oregon’s cap-and-trade program with the Western Climate Initiative to ensure a vibrant market for allowances.

IETA encourages careful projections of carbon emissions in the electricity sector. To the extent that free allocations to utilities are based on projections included in integrated resource plans developed by utilities, as contemplated in Section 15(1), such projections must be adjusted to recognize the prospective cost of carbon, increasing Renewable Portfolio Standard (RPS) requirements, expected changes in technology, and similar adjustments. This approach will ensure that utilities can accurately calculate their respective carbon emissions projections.

IETA suggests additional provisions on use of allowance revenue. Amendments are required to ensure that allowance value is not used in a manner that diminishes competition in the wholesale or retail electricity markets. In addition, allowance value should only be used for the benefit of Oregon customers of investor-owned utilities and should not be used in a way that discriminates against customers of electric service suppliers.

IETA recommends striking language that exempts certain electricity exports. Specifically, we recommend striking Section (10)(2)(c) including subsections (2)(b)(A) and (B). These provisions would apply to one-half of a single existing Hermiston power plant that is co-owned by PacifiCorp and Perennial Power. PacifiCorp is already receiving free allowances for that portion of power generated by its share of the plant used for Oregon ratepayers. There is no legal basis to exempt Oregon emissions from this plant that are delivered into states that do not have a price on carbon.

7. PRICE REDUCTION UNITS

IETA recommends the use of price reduction units at the hard price ceiling. Current provisions outlined in Section 25(5)(c) set a hard price ceiling and directs the regulator to adopt rules making an unlimited amount of allowances available for auction upon exceedance of the hard price ceiling. IETA suggests considering using the revenue collected from a breach of the hard price ceiling, at least in part, toward the purchase of carbon offsets. This provision would at least ensure (and potentially enhance) the environmental integrity of the cap.



8. THIRD-PARTY VERIFICATION

IETA supports third-party verification of emissions reports and output/product data from covered entities. Accurate emissions reports form the backbone of a successful cap-and-trade program and accurate output/product data are needed to ensure proper allocation of allowances. The Western Climate Initiative (WCI) design documents required third-party verification of GHG emissions and all operating economy-wide greenhouse gas reduction programs in North America require third-party verification. These programs specifically include California and Quebec’s cap-and-trade programs. More generally, having emissions reports and outputs/products verified by third-parties is considered best practice for carbon reduction programs around the world.

9. CARBON OFFSETS

IETA’s comments regarding carbon offsets are structured around four subsections: 1) quantitative usage limits; 2) direct environmental benefits; 3) additional offset protocols; and 4) invalidation procedures.

(1) Quantitative Usage Limits

IETA strongly supports the maintenance of an 8 percent offset usage limit described in Section 19(2)(a). Offsets provide a key source of cost containment for compliance entities. While a higher usage limit would be preferable, the 8 percent usage limit ensures a minimum level of cost containment while creating revenue-earning opportunities for sectors not subject to the cap. This is also the limit currently used in California and Quebec.

IETA seeks clarification on Section 19(2)(b) that gives the regulator discretion to impose additional quantitative usage limits on certain emissions sources. The provisions in this section introduce ambiguity as to the number of credits that can be used by certain compliance entities. Such ambiguity may create difficulties with compliance and will create substantial uncertainty in the market that discourages investments in reductions. Therefore, IETA suggests more specific language regarding how individual entities’ offset usage limit may be reduced or, at the very least, include in the text a range of potential outcomes that is as narrow as possible.

(2) Direct Environmental Benefits

IETA does not support the 4 percent carve-out for direct environmental benefits. As greenhouse gases are global pollutants, the climate benefit to Oregonians is the same regardless of where mitigation takes place. Imposing an in-state quota will simply saddle Oregon consumers with higher costs. Oregonians should be free to access the least-cost emissions reductions, irrespective of state boundaries.



Insofar as direct environmental benefits remain, IETA proposes modifications. Specifically, out-of-state offset projects that provide direct environmental benefits to the state should qualify. In addition, projects that reduce fluorinated gases in-state should also qualify.

(3) Additional Offset Protocols

IETA encourages Oregon to introduce additional offset protocols. Oregon has a clear and discrete opportunity to draw upon protocols already used in the Western Climate Initiative. There is also a broader opportunity to create additional offset protocols tailored to leverage Oregon's unique strengths. For example, IETA supports the inclusion of language, Sections 19(3)(A)-(B), that calls for the use of aggregation. Enabling aggregation will improve the economic viability of projects and increase participation from smaller participants (EPRI, 2012). A streamlined framework for introducing and approving additional offset protocols would facilitate a robust market for carbon offsets.

IETA encourages Oregon to pursue opportunities to sell offset credits. Oregonians have already sold an estimated 12 million offset credits to other jurisdictions, primarily California, (Burtraw et al. 2019). These sales have not only profited participating farmers and landowners but allowed these stakeholders to be engaged in smart climate solutions. A robust stable of eligible protocols could also facilitate potential sales into international markets, including the emerging Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) and Article 6 market opportunities of the Paris Agreement under the United Framework Convention on Climate Change (UNFCCC). Oregon stands well-positioned to capitalize on these forthcoming sources of demand – and clean investment in-flows – for high quality offsets, and IETA remains dedicated to facilitating the export of Oregonian offsets.

IETA supports a 10-year review of the implementation and operation of Section 19 of HB 2020. As a nascent market, we feel strongly that the bill must provide certainty to key offset regulation concepts, such as the usage limit, direct environmental benefits, and invalidation during the initial 10 years of the program. We are, however, concerned that Section 75(2), as introduced, prevents the ability of CPO to adjust and/or adopt new protocols prior to the issuance of the report. While providing certainty in offset protocol requirements is something we support, it is important to also provide the CPO with the flexibility to manage protocol updates. In our experience, new offset protocols are revised following the implementation and initial verification as the actual piloting of these protocols helps to identify best practices. Additionally, it is important to be able to incorporate new science into protocols such as any updates in Global Warming Potentials (GWPs) as determined by the Intergovernmental Panel on Climate Change (IPCC).

(4) Invalidation Procedures

IETA supports withholding 3 percent of offset credits issued from each project and depositing them in an Environmental Integrity Account. We are opposed, however, to referring the adoption of these



provisions to a rulemaking, rather than a legislative, process because of the uncertainty this creates for early adopters of potential offset projects. There is also a risk that these rules would hamper the use of aggregation, as outlined in Section 19.3(A), which underlines the importance of fleshing out the specifics via a legislative process.

CONCLUDING REMARKS

IETA applauds Oregon’s climate leadership and we look forward to future engagement with the legislature as it moves forward with HB 2020.

If you have questions or follow-up related to our submission, contact Clayton Munnings, IETA West Coast Representative, at munnings@ieta.org.

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