OREGON OFFICE OF CARBON POLICY
MAY 6 2019

Overview of Linkage Opportunities with the Western Climate Initiative

Origin and Structure of WCI:
The Western Climate Initiative (WCI), Inc. is a nonprofit corporation that provides the administrative, technical, and financial services to operate the greenhouse gas cap-and-trade markets of member jurisdictions. Current member jurisdictions include Quebec, Nova Scotia, and California. California and Quebec operate their carbon markets on the WCI platform as linked programs. Nova Scotia will operate its carbon market on the WCI platform independently of Quebec and California. The WCI is governed by a board of representatives from the member jurisdictions and has six full time staff.

The decision for Oregon to pursue membership in WCI, Inc. is independent of the decision to formally link its carbon market with those of other jurisdictions. Members may operate independently on the WCI platform. HB 2020 -84 (Section 37) states that it is the intent of the Legislature for Oregon to pursue membership in the WCI, assume board representation, and utilize WCI's administrative, technical, and financial services. Those services include:

- **Access to an auction platform**: this is the online portal that registered entities can submit bids during a prescribed bidding window. This platform is designed to auction allowances jointly from multiple jurisdictions. The platform provides a variety of features that can respond to policies in the jurisdictions, such as bidding limitations (e.g. minimum price and purchase/holding limits), handles exchange rates, and produces auction results.
- **Allowance tracking system**: this is a software program that manages and tracks compliance instruments issued by a jurisdiction. This begins with the registration of regulated emitters and voluntary market participants. Compliance instrument tracking begins with issuance of the instruments - either allowances in a new annual allowance budget or issuance of offset credits. Once these instruments are created by a jurisdiction, the program allows for them to be transferred to a range of different accounts, originating at the jurisdiction but subsequently being transferred, either via successful bids at auction or direct issuance, to registered entities. Subsequent transfers (e.g. sale from one entity to another) are tracked, as are the ultimate retirement of the compliance instruments for compliance.
- **Market monitoring service**: This is an independent contractor that monitors real time auction performance (bids & results), relevant activities such as holdings and transactions in CITSS (the official allowance tracking system), the secondary, derivative and associated markets, participant corporate structure (ownership and affiliations), and inappropriate market activity such as fraud, manipulation, collusion or anti-competitive behavior subject to laws and regulations in participating jurisdictions.

Oregon's Options for Market Linkage:

There are several potential pathways for Oregon to explore with WCI member jurisdictions.

1. <u>No linkage:</u> Oregon operates its carbon market independently. This means that regulated entities in Oregon can only use Oregon issued allowances and Oregon approved offsets to satisfy compliance obligations. Oregon can determine its own floor and ceiling prices, timing of auction, and other factors related to the operation of the carbon market independent of the actions of other jurisdictions. (HB 2020 does direct the implementing agency to consider floor and ceiling prices in nearby jurisdictions as it determines its own price ceiling and floor). Within the range of trading between the price ceiling and price floor, the price of allowances will be determined by supply and demand across Oregon's regulated entities. Allowances will be sold at the clearing price in the auction. There may also be secondary market trading for allowances issued in Oregon. The price of an Oregon issued allowance should reflect the marginal cost of emissions reduction across regulated sectors in Oregon.

2. <u>Bilateral Linkage:</u> This characterizes the current linkage agreement between California and Quebec. Allowances and offsets issued and approved in California and Quebec are fully fungible across the programs. This type of full linkage requires identical auction, offset, market, and compliance event rules. Bilateral

linkage does not change the sovereignty of a jurisdiction to adopt its own rules. Prior to linkage with any new partners, California and Quebec will need to work with the interested jurisdiction to ensure compatibility with the linked program and consistency with statutory pre-requisite requirements. Trading amongst participants in the various jurisdictions equalizes the marginal cost of emissions reduction across sectors and across jurisdictions.

3. Unilateral linkage: This is a type of agreement where a jurisdiction may allow its compliance instruments, when sold on the secondary market, to be used by regulated entities in another jurisdiction to meet their compliance needs. This increases demand for allowances in the secondary market for jurisdictions that allow their allowances to be used for compliance elsewhere, without changing its underlying supply. But it gives entities in the other jurisdiction access to more compliance instruments, if needed, to deter market manipulation and provide cost containment.

   This type of agreement is easier to negotiate as it does not require shared market rules. Each jurisdiction would determine the set of market conditions (prices, volumes) that would trigger the conditions for unilateral sales of allowances to occur.

Likely Path for Oregon Linkage:

HB 2020 directs the regulating agency to explore potential linkage with other jurisdictions. Linkage will require findings on the part of the Governor, before the Agency is able to finalize an agreement. Other WCI jurisdictions require a similar process, where they will be required to make findings about Oregon's program prior to a formal decision. We cannot assume that bilateral linkage would be agreed to by other jurisdictional governments. As these processes take time and careful discussion, and cannot even begin until Oregon finalizes its program rules, we should assume that Oregon will begin its cap-and-trade program independent of other jurisdictions, while utilizing the WCI, Inc. platform as a full WCI, Inc. board member. Oregon will pursue unilateral market opportunities with California and Quebec as appropriate, with the goal of exploring bilateral linkage opportunities in the near future.