Role of Compliance Flexibility Mechanisms

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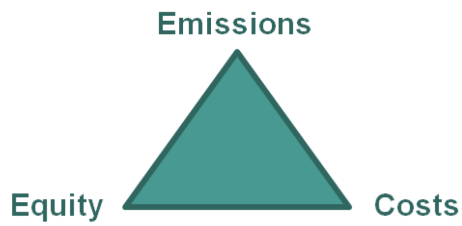
DEQ is a leader in restoring, maintaining and enhancing the quality of Oregon's air, land and water.

Overview

The Climate Protection Program will limit and reduce greenhouse gas emissions from some of the most significant sources in Oregon. DEQ aims to design a program that is anchored in significant reductions while promoting equitable outcomes and containing costs to businesses and consumers. DEQ does not believe these goals are mutually exclusive or zero-sum. While some program design decisions may address one goal more than others, DEQ is pursuing a program that balances these goals and maximizes opportunities for alignment across them.



Why provide compliance flexibility?

DEQ's current leaning is that flexibility or cost containment measures, if correctly designed, can play an important role in achieving these goals for the following reasons:

- Promoting benefits and alleviating burdens for EJ and impacted communities
  - Climate change is already affecting Oregon's air, water, land, economy, and our most vulnerable communities. The same communities facing disproportionate pollution impacts are expected to disproportionately bear climate change burdens.
  - Some compliance flexibility options could help direct benefits to environmental justice and impacted communities, while others may also reduce co-pollutants that have disproportionately harmed the health of these communities.
- Achieving significant emissions reductions
  - The costs of inaction on climate change would likely be high. For Oregon to do its part to prevent the worst impacts and costs of climate change, DEQ is currently proposing to reduce emissions by 80 percent by 2050.
  - Achieving at least 80 percent reductions by 2050 will require using a variety of technologies, approaches and tools. DEQ believes that flexibility mechanisms can be designed to help achieve significant reductions, support equitable outcomes, lower potential cost increases and drive investments within Oregon.
- Containing costs
  - Without enough compliance flexibility, costs could go up for Oregon businesses and consumers, which is of particular concern as DEQ looks for ways to address potential cost increases for low-income households.
  - There is also is a greater risk of leakage, meaning businesses and emissions move outside of Oregon, potentially negatively impacting the economy without achieving the objective of reducing greenhouse gas emissions.

The following paper looks at four flexibility options: banking, trading, alternative compliance, and multi-year compliance periods. These do not represent all potential flexibility options, but are several potentially important compliance flexibility mechanisms toward which DEQ is leaning. It explains the thinking behind DEQ's current program leanings and describes how these design choices interact with the program's goals. DEQ leanings are still open for discussion and may change during the rulemaking process, based on public and advisory committee feedback and staff analysis.

Banking

Allowing banking in the Climate Protection Program would mean that if regulated entities don't use all the compliance instruments they receive from DEQ in a given period, they could save them for use in the future.

Banking does not change the total number of compliance instruments that DEQ distributes over the course of the program, meaning it does not allow for additional emissions. In fact, banking encourages early emission reductions by offering an incentive for entities to reduce early and know they can hold on to the value of the compliance instrument for later use.

For example, imagine a regulated entity with emissions of 105,000 metric tons of carbon dioxide equivalent (MT CO_2e) the year before the program starts. Depending on how distribution is calculated, DEQ could issue 100,000 compliance instruments to this entity in the first year of the program. The regulated entity can reduce its emissions to 100,000 to comply with the program. However, because the entity is able to hold on to surplus compliance instruments, it chooses to reduce emissions further than to 100,000. It reduces its emissions to 95,000 MT CO_2e, then it would have 5,000 compliance instruments remaining. Those compliance instruments could be banked and saved for use in later years.

Enabling greater emissions reductions

Banking creates an incentive to reduce emissions early. Regulated entities that reduce emissions early can save their compliance instruments for future years, when there are fewer compliance instruments available as the allowable amount, or cap, decreases over time. Therefore, DEQ anticipates that banking will help to accelerate reductions. DEQ is considering allowing for unlimited banking of compliance instruments without expiration, as this would weaken the incentives for early reductions by decreasing the value of banked compliance instruments.

Promoting equity

To the extent that banking encourages earlier greenhouse gas emissions reductions, this may also hasten reduction of co-pollutants for communities near emissions sources such as transportation corridors.

Containing costs

Banking can protect regulated businesses and their consumers against certain risks, such as weather variability or economic changes, which can influence emissions from one year to the next. Banked compliance instruments can help businesses handle these external events and moderate cost spikes for businesses and consumers.

DEQ leaning

DEQ's current leaning is to include unlimited banking of compliance instruments.

Trading

The Climate Protection Program could allow regulated entities to buy and sell compliance instruments through direct agreements between each other. Over time, DEQ will distribute fewer compliance instruments to each regulated entity. These entities can reduce their emissions and comply using those limited compliance instruments. However, if some cannot reduce emissions at this pace, trading allows them to purchase more compliance instruments from regulated entities who can reduce their emissions more quickly. Trades would be reported to DEQ, and the agency would track holders of compliance instruments.

For example, imagine regulated entities A and B both have emissions of 105,000 MT CO_2e the year before the program starts. Depending on how distribution is calculated, DEQ could issue 100,000 compliance instruments to each entity in the first year of the program. Entity A is able to more easily reduce more emissions than entity B, due to differences in their businesses and operations. Motivated by the ability to sell compliance instruments, entity A reduces its emissions to 99,000 MT CO_2e. Entity B reduces its emissions to 101,000 MT CO_2e and purchases the 1,000 compliance instruments from entity A. As a result, both can flexibly meet the requirements of the program at lower total cost.

Enabling greater emissions reductions

Trading flexibility can support a more ambitious overall decline in the cap on emissions.

Once caps are set, trading doesn't change overall emissions reductions, but may allow some regulated entities to reduce emissions more slowly by purchasing instruments from entities that reduce emissions more quickly.

Promoting equity

Trading can support a more ambitious overall decline in the cap on emissions, which may also hasten reduction of co-pollutants for communities near emissions sources, such as busy roadways. Additionally, as DEQ distributes fewer compliance instruments to regulated entities over time, even regulated entities who buy compliance instruments will face pressure to decrease emissions as the available supply of compliance instruments decreases.

The pace of reductions will vary from entity to entity though, raising potential concerns that co-pollutant reductions could lag in certain communities near emissions sources that are buying compliance instruments. However, most emissions covered under the program will likely be regulated at fuel suppliers and natural gas utilities. These entities report statewide emissions and would have statewide compliance obligations. This means that allowing trading among these sources would mostly not have direct implications for where co-pollutants are reduced. Allowing trading between these entities could allow for a more ambitious cap decline and would likely achieve greater reductions from fuels such as transportation fuels. As emissions decline throughout the state, DEQ would look to other program elements to help ensure that the benefits of these reductions are distributed across the state.

Containing costs

Some entities will always face higher costs in reductions due to technical limitations within their particular businesses. Trading is one tool that can make it more feasible for entities to collectively meet significant reductions and with more balanced costs. It allows regulated entities to collectively find the least-cost reduction opportunities, thereby helping to reduce potential cost increases for customers.

DEQ leaning

DEQ's leaning is to allow for broad trading flexibility across different regulated sectors in the program.

Alternative compliance

The program could include a compliance option that allows regulated entities to invest in reductions that are the most beneficial and important to the communities in Oregon most impacted by pollution and climate change. DEQ could designate certain types of projects that reduce greenhouse gas emissions or sequester greenhouse gases as eligible to generate alternative compliance instruments. DEQ could develop or authorize types of projects that reduce greenhouse gases while directly benefitting Oregon communities, with a focus on environmental justice and impacted communities. Then, regulated entities could provide investments for these types of projects as an additional compliance option.

For example, imagine a regulated entity with emissions of 105,000 MT CO_2e the year before the program starts. Depending on how distribution is calculated, DEQ could issue 100,000 compliance instruments to the entity in the first year of the program. The entity is able to reduce its emissions to 102,000 MT CO_2e, but further reductions at this time are technically challenging or costly. In order to have enough instruments to meet the requirements of the program, the regulated entity chooses to separately fund an approved emissions reduction project to receive 2,000 alternative compliance instruments to meet their compliance obligation.

Enabling greater emissions reductions

Alternative compliance options would likely make it more feasible to achieve the significant reduction targets of the program. While regulated entities would use alternative compliance options to achieve those reductions, there are still overall reductions in greenhouse gas emissions. Further, by defining which types of reduction investments are eligible, DEQ could assure that reductions achieved as a consequence of this element of the program are done in ways that are of most importance and benefit to environmental justice and impacted communities.

DEQ could develop or authorize Oregon-specific alternative compliance options. An example could be investments in electric infrastructure, such as electric vehicle charging stations, or helping to purchase cleaner vehicles. These energy transition projects could result in emissions reductions that might overlap with emissions already within the scope of the program. For example, reducing emissions from transportation would reduce emissions from fuels, which are already regulated directly by the program. However, these projects could support other program goals and may help accelerate installation of infrastructure that makes future reductions more feasible and help benefit communities.

Promoting equity

If DEQ develops or authorizes Oregon-specific alternative compliance options, these could be focused on providing benefits to Oregon communities, with a particular focus on environmental justice and impacted communities. For example, these could drive investments that fund assistance to transit districts updating to cleaner fleets, or the installation of more efficient home heating systems. Electrifying public transportation would not only reduce emissions, but also vehicle co-pollutants, which have disproportionately affected the health of environmental justice and impacted communities.

DEQ believes the Climate Protection Program presents an opportunity to drive investments toward communities that may not otherwise see direct investment or emissions reductions.

However, if DEQ allows the use of existing offset protocols and registries, DEQ would likely have less ability to focus alternative compliance options on driving benefits toward communities in Oregon.

Containing costs

Alternative compliance would likely reduce the cost of participating in the program by adding additional compliance pathways and flexibility measures available to regulated entities. Depending on how alternative compliance is structured, it could also drive investment within Oregon communities.

DEQ leaning

DEQ's leaning is to allow for alternative compliance options in the Climate Protection Program. However, DEQ does not currently have a leaning on establishing the allowable percentage, or if that allowance percentage could change depending on program conditions.

DEQ is interested in finding ways for designing alternative compliance options to expressly drive investments in emissions reducing measures that are of most importance and benefit to Oregon communities, with a particular focus on environmental justice and impacted communities.

Multi-year compliance periods

If the program allows for multi-year compliance periods, this means regulated entities would have more time to demonstrate that their emissions are allowable under the program. A multi-year compliance period does not change the emissions cap levels or total number of compliance instruments distributed by DEQ and does not change the permissible amount of emissions or the emission reductions achieved by the program.

The example below shows how this might look for a regulated entity with emissions of 105,000 MT CO_2e the year before the program starts.

Illustrative Example: 2-year compliance period

	Compliance Instruments Received from DEQ	**Actual Emissions (MT CO2e)**	**Compliance Instruments Used to Demonstrate Compliance***
Year 1	100,000	102,000	0
Year 2	90,000	88,000	190,000
Total Compliance Instruments/ Allowable Emissions	**190,000**	**190,000**	**190,000**

Enabling greater emissions reductions

Multi-year compliance periods allow for flexibility, especially in relation to annual variability in emissions from factors outside the control of regulated entities, such as weather conditions. Allowing regulated entities a greater period of time to demonstrate compliance does not change the overall reductions requirement. However, it would make it more feasible over time to implement the significant reduction targets.

Promoting equity

To the extent that a multi-year compliance period allows the program to have stronger reduction targets, this can reduce the impacts of co-pollutants on communities near emissions sources and transportation corridors. Additionally, by reducing uncertainty and providing more time to achieve compliance, a multi-year compliance period could reduce the risk of unexpected cost impacts to consumers.

Containing costs

Regulated entities need time to install new technologies or adjust business practices to reduce emissions. A multi-year compliance period will allow regulated entities some flexibility to demonstrate that they have met these reductions. If the program is adopted by the EQC at the end of 2021 with a first compliance period beginning in January 2022, this means regulated entities would need to very quickly begin reducing emissions to comply with an annual 2022 program cap. Thus, a multiple-year compliance period may be beneficial.

Additionally, regulated entities may experience uncertainty about the overall process and availability of other flexibility mechanisms (such as supply of compliance instruments through trading), especially in the early years of the program with little data. A multi-year compliance period would help reduce uncertainty and reduce costs associated with purchasing compliance instruments or funding alternative compliance projects.

DEQ Leaning

DEQ’s leaning is to provide flexibility to regulated entities with 3-year compliance periods, especially during early program implementation.

Alternative formats

DEQ can provide documents in an alternate format or in a language other than English upon request. Call DEQ at 800-452-4011 or email deqinfo@deq.state.or.us.