

# Agenda Item B

## Buying and Selling Credits

### October 7, 2010



The purpose of this document is to outline a proposed mechanism for regulated parties and opt-in parties to buy and sell low carbon fuel credits. The general structure and calculation of low carbon fuel credits and deficits was discussed at the January 27, 2010 low carbon fuel advisory committee meeting. A discussion paper and meeting notes capturing advisory committee input can be found on the low carbon fuel advisory committee website:

- Low Carbon Fuel Credits and Deficits discussion paper: <http://www.deq.state.or.us/aq/committees/docs/janLCF/itemB.pdf>
- Supporting Documentation for Calculating Credits and Deficits: <http://www.deq.state.or.us/aq/committees/docs/janLCF/itemBsummary.pdf>
- January 27, 2010 meeting notes (pages 2-6): <http://www.deq.state.or.us/aq/committees/docs/janLCF/janMeetingNotes.pdf>

Other related discussion papers include:

- Low Carbon Fuel Reporting: <http://www.deq.state.or.us/aq/committees/docs/feb10/itemG.pdf>

## 1. Background on compliance demonstrations (i.e. reconciling credits and deficits), and reporting

Compliance with a Low Carbon Fuel Standard (LCFS) would be demonstrated through the calculation of carbon intensity credits. DEQ proposes that a fuel sold in Oregon by regulated or opt-in parties with a carbon intensity that is less (lower) than the required low carbon fuel standard would generate low carbon fuel credits<sup>1</sup>. A fuel sold in Oregon with a carbon intensity that is higher than the low carbon fuel standard would generate deficits. At the end of the year, a regulated party would reconcile credits and deficits to demonstrate compliance with the LCFS. If a company generates more credits than deficits in a year, their compliance demonstration will show a net credit, which they can bank and use later, or sell. If a company generates more deficits than credits, then they will have a net deficit, which must be made up, potentially through the purchase of LCFS credits.

At the January 27<sup>th</sup>, 2010 low carbon fuel advisory committee, the advisory committee discussed the reporting that would be required under a low carbon fuel standard. DEQ envisions three main categories of reporting that would be required under the LCFS.

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<sup>1</sup> For DEQ's proposal and examples of how low carbon fuel credits are calculated, please refer to the discussion paper available at: <http://www.deq.state.or.us/aq/committees/docs/janLCF/itemB.pdf> and the Supporting Documentation for Calculating Credits and Deficits available at: <http://www.deq.state.or.us/aq/committees/docs/janLCF/itemBsummary.pdf>

1. Initial physical pathway: Regulated parties and opt-in parties would be required to demonstrate a physical pathway or pathways for the fuel they sell, and DEQ would need to review the documentation and approve the carbon intensity of a producer's fuel.
2. Quarterly Recordkeeping or Reports: DEQ also proposed that regulated and opt-in parties would submit quarterly reports that would not be used to determine a regulated party's compliance with the low carbon fuel standard. These quarterly reports would contain information about the volume and carbon intensity of fuel sold, and any low carbon fuel credits that were bought or sold. Alternatively, DEQ could require quarterly recordkeeping by regulated parties and opt-in parties who have opted in, but not submission of the reports to DEQ.
3. Annual Compliance Report: DEQ has proposed that regulated and opt-in parties submit an annual compliance report at the end of the compliance year, to provide information such as the volume and carbon intensity of fuel sold, and the calculation of credits and deficits earned. If credits were sold or bought during the compliance year, the credit buyer would need to report who sold them the credit, and the seller of the credit would need to report who they sold the credit to. At the end of the annual compliance period, DEQ would review the volume of fuel sold, the carbon intensity of the fuel sold, and check the calculations for credits and deficits. DEQ could also choose to review invoices and other documents to verify the volume of fuel or carbon intensity of the fuel.

For each regulated and opt-in party, the compliance verification process at the end of each year verify how many deficits must be made up to meet the standard in that year, and how many credits were available to use or sell. Each year, this process verifies the extent to which credits were needed by regulated parties and the availability of credits across the market to fill that need.

There are various models that the LCFS program could use to structure the buying and selling of LCFS credits. The "Description of Options" section on page 3 describes options for how DEQ could structure credit buying and selling, ranging from simply comparing regulated or opt-in party reports on the number of credits bought and sold to facilitating credit sales.

## 2. Buying and Selling LCFS Credits

**Advisory Committee Objective:** Discuss possible options for managing the purchase and sale of low carbon fuel credits. DEQ envisions five possible options, each with different levels of DEQ involvement. These options are described on the following pages.

- Option 1: Minimal DEQ involvement (see page 3)
- Option 2: Voluntary verification of credits prior to sale (see page 3)
- Option 3: Mandatory verification of credits prior to sale (see page 4)
- Option 4: DEQ Clearinghouse (see page 4)
- Option 5: DEQ Facilitates Trades (see page 4)

## Description of Options

Please consider the following options carefully for discussion at the October 7<sup>th</sup> low carbon fuel advisory committee.

**Option 1: Minimal DEQ Involvement.** As described above, regulated and opt-in parties would report low carbon fuel credits generated in their annual compliance report, as well as the source and number of any credits bought or sold during the compliance period. At the end of the compliance year, DEQ could compare credits bought with credits sold based on those annual compliance reports. For example, if Company A reported to DEQ that they purchased 10 credits from Company B, and Company B reported to DEQ that they sold 10 credits to Company A, DEQ would compare the two reports and verify that the number of credits claimed and sold, were a match. This could be the simplest way for DEQ to track and account for the use of credits in the market.

Under Option 1, credits would not be verified by DEQ prior to sale. The company purchasing credits would need to rely on the company selling the credits to ensure that the carbon value of those credits had been calculated accurately.

Considerations with this approach include:

- a. This option has the least amount of administrative burden on both regulated and opt-in parties, and DEQ. It is the least complex of the options, and the easiest to implement.
- b. There would be fewer barriers to buying and selling credits, and therefore this option could decrease compliance cost.
- c. Under this option, there is less transparency in the credit market than other options. The lack of this transparency could impede credit transactions because the regulated and opt-in parties would have less information on current low carbon fuel credit prices and parties with available credits for sale.
- d. Avoids the potential for revealing confidential business information

**Option 2: Voluntary verification of credits prior to sale.** This option is the same as Option 1, except a regulated or opt-in party could request DEQ verification of credits prior to sale, instead of at the end of the compliance period. Verification of credits prior to sale would not be required.

Considerations with this approach include:

- a. This option increases the administrative burden on DEQ. Regulated and opt-in parties could choose whether or not the administrative burden is worth having credits approved prior to sale.
- b. Verification of credits prior to sale could be time consuming and hinder the fast sale of credits.
- c. This option provides more certainty to a buyer of a credit that the credit is calculated accurately.

**Option 3: Mandatory verification of credits prior to sale.** This option is the same as Option 1, except that credits would be required to be verified by DEQ prior to sale.

Considerations with this approach include:

- d. This option increases the administrative burden on both regulated and opt-in parties, and DEQ.
- e. Verification of credits prior to sale could be time consuming and hinder the sale of credits.
- f. This option provides more certainty to a credit buyer that the credit is calculated accurately.

**Option 4: DEQ Clearinghouse.** Under this option, DEQ would perform all of the roles listed in the first “Minimal DEQ involvement” option, but would also maintain additional publicly available information on low carbon fuel buying and selling. This information could include identification of regulated and opt-in parties that have credits available for purchase, the amount of credits available, the average price paid for a credit, and aggregate deficits and credits generated during the compliance period.

Considerations with this approach include:

- a. This option has more administrative burden on both regulated and opt-in parties, and DEQ. This includes managing concerns that credit information should be kept confidential under Oregon’s trade secrets law. DEQ would also require resources to develop a web-based tool to provide credit information to businesses and the public.
- b. Under this option, there is more transparency in the credit market than in Option 1, 2, or 3.

**Option 5: DEQ Facilitates Trade.** In this option, DEQ would serve as an intermediary between a credit seller and buyer. DEQ would maintain information on who needs credits and who has credits available.

Considerations with this approach include:

- a. This option has more administrative burden on DEQ.
- b. This option could reduce transaction costs for regulated parties, because DEQ would be a known entity that could connect sellers with buyers.
- c. DEQ may not be able to get buyers and seller together as quickly or effectively as the agent of a regulated party or similar entity.

## Other Considerations

- Any information that DEQ collects is considered public information, unless it constitutes a trade secret as defined in ORS 192.410-505. We are exploring with the Department of Justice to what extent information used in the LCFS credit program could be considered a “trade secret” if requested by a regulated or opt-in party.
- Transparency in the number of credits needed and available could make business planning easier for regulated and opt-in parties. Providing information during the compliance period, such as the aggregate number of credits, net deficits, and deficits generated would help in this regard. There are three ways that DEQ could address the transparency issue:
  - a) DEQ could require regulated parties and opt-in parties who have opted in to calculate credits and deficits quarterly. As described above, these would not be used for compliance purposes, but could be used by regulated and opt-in parties to keep track of credits and deficits throughout the year. Requiring quarterly recordkeeping could encourage regulated parties to address compliance issues throughout the year, instead of waiting until the end.
  - b) DEQ could require regulated and opt-in parties who have opted in to submit quarterly reports on the number of credits and deficits generated. It could be beneficial for DEQ to periodically track the creation of deficits and credits, and make this information available publically so that regulated parties can take any corrective actions needed at key junctures throughout the year. Tracking and making information available on the need for credits and credit availability quarterly could help keep credits moving routinely through the market, rather than wait for a end of year rush on credits.
  - c) As stated above, DEQ has not proposed that the quarterly reports be used for compliance purposes, and that a regulated party only needs to comply with the low carbon fuel standard on an annual basis. However, another option is to require regulated parties to meet the low carbon fuel standard each quarter, or for regulated parties to be within a certain percent of the low carbon fuel standard each quarter. This would provide transparency, and also would keep credits moving routinely through the market.
- DEQ’s LCFS program will not be at the same large scale as the federal Renewable Fuel Standard Program. Therefore, having a government or third party broker or exchange for low carbon fuel credits might be unnecessary.
- DEQ could investigate the possibility of starting a listserv for regulated and opt-in parties to communicate regarding buying and selling credits. Such a service could also be provided by a third-party.

At this point, DEQ proposes (for advisory committee discussion) that the LCFS use **Option 1: Minimal DEQ Involvement** for the following reasons.

- A. Least amount of administrative burden for regulated parties and DEQ
- B. Simplicity
- C. Fewer barriers to credit buying

- D. Minimization of transaction, and therefore compliance cost
- E. Avoids possibly revealing trade secrets

## **Advisory Committee Questions:**

1. Which option would you recommend DEQ implement for the low carbon fuel standard, and why?
2. Are there any unintended consequences of each option?
3. Are there any changes we need to make, given the “Other Considerations” listed above?