EPA Technical Comments on ACUS Marketable Permits Proposed Recommendation (April 11, 2017)

Preamble

- Page 1, line 9-10: Suggest deleting or moving sentence beginning with "Alternatively" to the following paragraph. As worded, this sentence seems to conflate a rate-based form of limitation with a total cap approach. We are unclear what kind of program this is describing and would recommend against that kind of formulation. Generally in EPA's experience, a "cap" refers to a mass limitation, and it would not make sense to speak of a rate-based program in terms of a "cap" since no absolute outcome can be ensured.
- Page 1, line 12: Delete "(a form of grandfathering)." We would not use the term grandfathering in the context of allocations because it conflates too closely with compliance. Grandfathering in the ordinary sense refers to allowing an entity to continue an activity that has been prohibited to others going forward. This is not the same as historical-data based allocation. Further, allocations can be done based on a variety of approaches, not just historical activity.
- Page 1, line 12-13: Change "may be allowed to further" to "are generally free to…." The defining characteristic of the marketable permit is that it is freely tradable.
- Page 1, line 15: Change "new entrant" to "covered entity."
- Page 2, line 26: Rather than "traditional regulation," we suggest "regulation that mandates the use of a particular technology." For instance, under what might be considered "traditional" CAA programs, standards are typically set at a level reflecting the *performance* of a particular technology, but EPA does not mandate the use of that specific technology, thus allowing for further innovation.
- Page 2, line 31-32: Suggest including a citation for the sentence about the Acid Rain Program.
- Page 3, line 37: Suggest rewording "indicating that agencies have" to "reflecting that agencies may have..."

Recommendations: Establishment of Marketable Permitting Programs

- Recommendation 1: Consider adding as a threshold factor for agencies to consider in deciding whether to adopt a marketable permitting system: "whether marketable permits would be consistent with and effective at achieving the statutory objective." This gets closer to the core of the question of authority than the explicit versus implicit authority distinction.
- Recommendation 1.c: The first sentence asserts a scenario that a regulator may not be willing to admit. Suggest rewording to "There are informational challenges in setting facility-specific compliance obligations or in valuing the resource or activity to be allocated."
    - In addition, it is not necessarily the case that a marketable permit program is more suited to "heterogeneous" sources and "small sources." This doesn't seem like a characterization that can be generalized across all types of marketable permit programs.
    - The design of trading programs can actually involve greater complexity and be more difficult when different categories of facilities are included under a single cap, particularly if the quantification of the cap is based in part, e.g., on information about the source's compliance costs. It could in such circumstances be easier to develop an appropriate cap when dealing with homogenous and larger sources.

    - The question may also turn on the statutory objective to be achieved and the degree to which shifting marketable permits between different classes of facilities can be done consistent with that purpose.
- Recommendation 1.d: Rather than "overall level of the activity," we suggest "overall impact of the activity to be regulated or controlled."
- Recommendation 3 (and recommendation 14): ACUS should better distinguish throughout the document between "market oversight" and the functions necessary to ensure program compliance and overall outcomes. In this sentence, an agency's legal authority to ensure program compliance (which could include "fraud" and "other abuses") is included with authority to prevent "manipulation" (presumably "market manipulation."). The sentence here too strongly insists on the need for the agency administering the marketable permit program to *itself* have market oversight authorities (which contrasts with Recommendation 14, where agencies are merely encouraged to use available tools—we would generally support the latter formulation).
    - ACUS could consider recommending that marketable permit programs consider mandatory monitoring and reporting obligations to aid with market oversight, where feasible.
    - In EPA's past experience, we have not found the need for market oversight to be as great as theorized at the time the Acid Rain Program was enacted. ACUS may want to consider how much prominence is necessary to give to this topic in its Recommendation versus monitoring, reporting, recordkeeping, and other elements of compliance needs.

<u>Recommendations: Desired Features of Marketable Permitting Programs</u>

- Consider adding a recommendation noting that an important consideration in program design is whether the entire universe of regulated entities can be covered by the program or not. ACUS should consider converting the "uncovered sources" discussion on page 53 of the report into a recommendation on this point. (This may also be worth including as a threshold consideration in recommendation 1 on whether a marketable permit program is appropriate to establish at all.)
- Recommendation 4, line 73: Add "or authorizations" after "rights."
- Recommendation 5: As re-worded, this recommendation now conflates the appropriateness/advantage of going through notice-and-comment on agency actions with the issue of whether a program has explicit or implicit statutory authority. These considerations are not necessarily related. In particular, it is unclear why this recommendation now suggests that guidance regarding implementation of an existing program should necessarily be subject to notice-and-comment processes as such guidance would not necessarily implicate legal authority for the initial establishment of a marketable permit program.
    - We would suggest rewriting by more closely following the original language of recommendation 11 from the prior draft, as follows: "Agencies should consider using rulemaking to establish marketable permit programs, in order to reduce uncertainty and inconsistent implementation. Where guidance or other less formal means may be used to establish a marketable permit program, agencies should go through public notice and comment as a best practice."
- Recommendation 6: We support the rewording of this recommendation to be more neutral. In addition, at line 83, this recommendation uses the term "cap" in a way that suggests it applies

to a rate-based approach. (See our first bullet above, and the bullet below on terminological distinctions between rate and total-cap programs.)

- Recommendation 7: Reword to be more general. Open access to market is not just about, or even primarily about, retiring permits based on social preferences. It is also valuable for price discovery and liquidity.
- Recommendation 7, line 85 (and recommendation 13): The recommendations at times use terminology related to rate-based versus total-cap programs interchangeably. Here, "credit" is apparently used to describe all types of tradable instruments, but this term has a connotation of being "earned," rather than distributed, and would likely not be the term used to describe instruments in a mass or total cap approach. ACUS may want to consider using distinct terminology for different types of programs. For instance:
    - Total Cap: "Allowance" refers to a marketable permit to conduct an absolute quantity of a given activity (e.g., to emit a ton of air pollution). Allowances are "created" by an agency up to a certain "budget" size, and then distributed, auctioned, or allocated in some fashion. Allowances can be placed into "set-aside" accounts for distribution to a particular sub-group or to further some purpose complementary to the overall program. EPA's emissions tracking system keeps track of every allowance in the system (i.e., the allowances never "leave" the system, and thus the integrity of each allowance is fairly well assured so long as the tracking system and related software maintain integrity).
    - "Credit" or "offset" refers to an instrument that is generated or earned through private-party action. Thus, where an agency is taking a total-cap approach, agencies should be wary of allowing credits to be generated that would expand the overall size of the cap in a way that would undermine the purpose or stringency of the program.
    - "Third Party Verifiers," as the term is used in the context of verifying the validity of the marketable permit itself, is a concept that is primarily significant in the context of "credit" or rate-based approaches where private activity generates the tradable instruments (e.g., Renewable Fuel Standard credits or ERCS in the Clean Power Plan rate-based approach), and thus may need to be independently verified. In those cases (or, in the special case of offsets or set-aside accounts in total-cap programs, where the allowance or offset can be "earned" by parties through certain activities or meeting certain qualifications), use of third-party verifiers can be important for ensuring program integrity and preventing fraud. Third-party verifiers may be less important in a basic total-cap approach (in which there are no set-asides of allowances, credits, or offsets that can be "earned"), particularly if the agency itself creates and retains administrative control over the entire universe of marketable permits for the entire period of their existence.
- Recommendation 8: Consider rewording to a more general point regarding market liquidity. "In considering the size of the 'budget' in a total-cap approach to marketable permits, agencies should evaluate the degree of need for market liquidity in light of the stringency of the cap, mechanisms for adjusting the cap, and the objectives of the program."
    - Agencies should consider other aspects of program design that assist with liquidity as well, such as by providing for open participation in the market (as referenced in pages 74 and 82 of the Report).

    - A related concern is ensuring that the program provides liquidity at the "right time." Thought must be given to making sure market actors have access to the marketable permits when they need them (e.g., if there is a true-up deadline).
- Recommendation 9: Auctions might be desirable from a certain perspective, but present their own set of challenges (e.g., what to do with the funds). Historical allocations are one method that might be appropriate in some circumstances. We recommend rewording more generally to encourage agencies to consider the pros and cons of any approach are weighed when making the decision, and emphasize that the choice is largely an equity concern and not a market efficiency concern.
- Recommendation 9, lines 89-90: The first sentence implies that agencies generally face a binary choice between auctions and "grandfathering." By grandfathering, we understand you to mean allocation based on historical level of activity. First, we would not use the term grandfathering in the context of allocations because it conflates too closely with compliance. Grandfathering in the ordinary sense refers to allowing an entity to continue an activity that has been prohibited to others going forward. This is not the same as historical-data based allocation. Further, allocations can be done based on a variety of approaches, not just historical activity (as reflected in the sentence referencing output approaches to allocation). To the extent ACUS retains the content of this sentence, consider "auctions over historical-data based allocation" or similar formulation, and drop the term "grandfathering" in this context.
- Recommendation 10: We suggest a more general wording, as the reasons an agency gives for using auctions would not necessarily control a court's analysis.
    - ACUS may also want to consider the potential for Congress to provide "retain and use" authority to an agency, which would be a means by which federal agencies, like several of their state counterparts are already doing, could use auction proceeds to make the marketable permitting program financially self-sufficient and/or support complementary programming to a marketable permits programs. Such a limited exception from 31 USC 3302 was provided in the Acid Rain Program at 42 USC 7651*o*(d)(3).
    - ACUS may be interested in an Office of Legal Counsel (OLC) opinion from 1989 regarding a stratospheric-ozone trading program under the 1977 version of the CAA. A copy of the opinion can be found in a rulemaking docket in regulations.gov (Doc. ID EPA-HQ-OAR-2015-0199-0238). This contains some discussion of why auctions are generally not viewed as "taxes."
- Recommendation 11, lines 96-97: Consider rewording to "Agencies should ensure that all compliance obligations in a marketable permitting program are enforceable and that penalties have sufficient deterrent effect; agencies should review the availability of administrative, civil, and potentially criminal enforcement authority, as well as authority for corrective-action plans and other equitable remedies."

<u>Recommendations: Oversight of Marketable Permitting Program</u>

- Recommendations 13 and 14: See comments above regarding distinguishing between ensuring compliance and the integrity of the program in terms of achieving its regulatory goal versus functions relevant to "market oversight." These recommendations do not distinguish between these two "spheres" of oversight.