

## **Green Tier Advisors**

August 3, 2007

Proportionality 1.0

**ISSUE SUMMARY:** The Department is tasked with working with the Advisors to: Assess “whether incentives provided under a participation contract are proportional to the environmental benefits committed to under a participation contract.” There are a variety of ways that this could be approached and this is the first discussion to get a sense for the questions that Advisors have on this subject and to get a preliminary indication from the Advisors as to how they would like the issue developed for subsequent meetings in order to develop a recommendation

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### **BACKGROUND:**

A little bit of history on the subject of proportionality is provided. That history is supplemented by what actually ended up in the Green Tier Statute. This is followed by a brief description of some of the practical questions that the Green Tier program expects to confront as the interest in and use of Tier 2 participation contracts accelerates.

During the deliberations that led up to the drafting of the Green Tier law, the Green Tier committee considered several ways to come at the issue of granting incentives for entities that participated at the Tier 2 level of the program. Their deliberations considered generating lists of incentives and then linking those to the performance that they would expect if those incentives were granted. Ultimately this proved to be both confusing and restrictive. The confusion was the result of the complexity of incentives that might be right in some circumstances and not in others and not having a way to clearly communicate the circumstances that an incentive would be granted. The restrictive element was that the Green Tier Committee concluded that a specific list of incentives and related performance was likely to be equally as restrictive as current rule structures and equally as unlikely to anticipate the widely divergent needs and capabilities of prospective participants. Hence the approach was taken in the legislation to provide for the Department to grant incentives proportional to the superior environmental performance in Tier 2 contracts accompanied by clear expectations of what the incentives “shall attempt to do.” At the time that the draft legislation was being debated, there was a general sense that proportionality would be appropriately addressed based on experience with the program rather than being specifically framed by the legislation at the start of the program.

The statute provides some insight on the question of proportionality but more about the expectations than a definition or working model that drives the decision making. The role of the advisors is succinctly stated in the Issue Description with quotes around the language taken from the statute. The decision about proportionality is also clear when directing that “The department shall ensure that the incentives provided under a participation contract are proportional to the environmental benefits that will be provided by the participant under the participation contract .” For the most part, the statutes do not specifically enumerate incentives. Rather, the statutes speak in general terms such as “promote, reward and sustain superior environmental performance”, “provide clear incentives for participation that will result in real benefits to participants”, “lower the administrative costs associated with environmental requirements”, etc. Equally as general is the language about performance although that language has since been supplemented by the “Areas of Emphasis” recommendation from the Advisors. The statutory

language, for example, states “promote environmental performance that voluntarily exceeds legal requirements”, “promote attention to unregulated environmental problems and provide opportunity for conservation of resources”, “promote the transfer of technological and practical innovations that improve environmental performance”, etc. The balance between incentives and performance, however, is not addressed in these sections. One last element from the statutory language is that the law anticipated that the action of granting incentives and managing performance was something that might need to be supplemented by rules. The language gives rule making authority which states: “In the rules, the department may specify incentives, that are consistent with federal laws and other state laws, that the department may provide to participants in tier II of the program.” In short, while providing some general guidance, the law anticipates an experience based examination of proportionality and provides rules as a tool to deliver on the incentives side of the proportionality equation.

Finally, there are some practical aspects to the question of proportionality. The two to be addressed here are timing and experience. First, timing is an issue in that quite soon we expect to have to make some judgments about participation contracts. The first two Tier 2 contracts did not ask for customized flexibility so the analysis of the participant’s commitments was strictly in relation to the statutory incentives granted under Tier 1. The only question to answer was whether the commitments were consistent with the commitments that had been made by Tier 1 companies to obtain those statutory incentives. As the existing Tier 2 participants see opportunities for flexibility, they are more likely to ask for flexibility within their contracts. Equally as important, we know that Tier 1 companies are anxious to pursue Tier 2 and charters contain language about providing model terms for Tier 2 participation. In short, we know that the requests are going to come. The counsel from the advisors could be quite helpful as we prepare to work with those and other companies.

Second, experience suggests that there are some obvious lessons but there are also some very difficult scenarios that could be presented as we work through issues with participants. Actions within a media (air, waste, water, etc.) tend to be straight forward such as the mining of coal ash from landfills. Opening the landfills is a waste flexibility and the processing results in beneficial reuse of the re-burned ash. While it was not easy, the issue was straight forward. Actions across media tend to be quite complex such as deciding not to install specific air controls and managing constituents while those constituents are still in the liquid part of the process. While methanol in this example was reduced six fold, getting past not having required air controls and having alternate control was difficult as air and water engineers worked through both territorial and regulatory concerns. We know from the discussions that we have had with companies that the need for having that overarching view that enables consideration of environmental benefits across program boundaries is going to be especially important and that even within programs there need to be quick ways to assess the benefits derived from an alternate approach.

The other practical perspective of the experience is that these decisions need to be made relatively quickly. Tier 2 sets the goal of having contracts in place within 12 months. While this might seem like a long time, working “custom” issues can take longer as programs are not accustomed to weighing the benefits of alternative approaches and almost never weigh benefits across program boundaries. Upcoming decisions could be aided greatly by some framework within which the proportionality decisions could be made.

## **ALTERNATIVE**

When Proportionality was originally discussed with the Advisors during the development of the Advisors’ Work Plan more than a year ago, there were a number of options for the process that could be used to address the issue. Those included:

- Set some general side boards that the department would use to make the judgments about proportionality.
- Review existing agreements to draw some principles that would be used as the base from which future decisions could be made.
- Direct review of participation contracts as they are drafted
- Design a process under which the proportionality review would take place (i.e. with the right people and the right transparency proportionality decisions are likely to be defensible.)

At the time that these were presented, none was specifically excluded and there was not time for discussion about other alternatives that the advisors might have.

### **DISCUSSION:**

There purpose for this issue is to introduce the topic of proportionality and get direction from the Advisors how they would like to proceed with the issue. If there are some approaches that the Advisors know they do not want to pursue, those can be eliminated but the principle focus is to get direction from the Advisors on the alternatives that should be developed and the timing for that development effort. It would also be important to know if there are other background materials that would be useful for the more in depth discussion when that is scheduled.

### **DISCUSSION SYNOPSIS (from prior meetings):**