Washington State
House of Representatives
Office of Program Research

BILL ANALYSIS

Ecology & Parks Committee

HB 1819

Brief Description: Reducing greenhouse gas emissions.

Sponsors: Representatives Upthegrove, Dunshee, Dickerson, McCoy, Rolfes, Eddy, Hunt, White, Appleton, Carlyle, Darneille, Kagi, Pedersen, Conway, Sells, Nelson, Chase, Ormsby, Kenney and Williams; by request of Governor Gregoire.

Brief Summary of Bill

- Authorizes the Department of Ecology to create an allowance trading program.
- Creates a cap-and-trade work group.
- Creates critieria for the cap, allowances, and offsets.
- Specifies the emissions covered in the allowance trading program.
- Requires the Department of Ecology to develop a design for the auctioning of the state's allowances.
- Sets compliance obligations and penalties.
- Creates the Climate Protection Account.
- Sets reporting requirements for fuels.

Hearing Date: 2/3/09

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Background:

Greenhouse Gas Emissions Reductions
In 2008 the Legislature required the following statewide greenhouse gases (GHG) emission reductions:
- by 2020 reduce overall GHG emissions in the state to 1990 levels;
- by 2035 reduce overall GHG emissions in the state to 25 percent below 1990 levels; and

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

- by 2050 reduce overall GHG emissions in the state to 50 percent below 1990 levels, or 70 percent below the state's expected GHG emissions that year.

Multisector Market-Based System
The Department of Ecology (DOE), in coordination with the Western Climate Initiative (WCI), developed a design for a regional multisector market-based system to limit and reduce GHG emissions. The DOE and the Department of Community, Trade and Economic Development were to provide the Legislature with specific recommendations for implementing the design for the multisector market-based system in Washington.

Reporting
Owners or operators of a fleet of on-road motor vehicles that emit at least 2,500 metric tons of direct GHG emissions annually in the state, and a source or combination of sources that emit at least 10,000 metric tons of direct GHG emissions annually in the state, must report their total annual GHG emissions beginning in 2010 for their 2009 emissions.

Emissions Trading
An authority sets a limit or "cap" on the amount of a pollutant that can be emitted. Companies or other groups are issued emission permits and are required to hold an equivalent number of "allowances" or "credits" which represent the right to emit a specific amount. The total amount of allowances and credits cannot exceed the cap, limiting total emissions to that level. Companies that need to increase their emission allowance must buy credits from those who pollute less. The transfer of allowances is referred to as a "trade."

There are active trading programs in several pollutants. In the United States, there is a national market to reduce acid rain (sulfur dioxide) and several regional markets in nitrous oxide. The largest active GHG trading program is the European Union Emission Trading Scheme. In the United States, 10 Northeast and Mid-Atlantic states participate in the Regional Greenhouse Gas Initiative (RGGI). The RGGI is the first mandatory, market-based carbon dioxide emissions reduction program in the United States. The RGGI states will cap carbon dioxide emissions from the power sector, and then require a 10 percent reduction in these emissions by 2018.

Summary of Bill:

Creation of a Trading Program
The DOE is authorized to create an allowance trading program (Program) for covered emissions.

The DOE is not authorized to create a Program that covers only Washington, or is not linked to other regional programs or a national program, nor are they authorized to implement a Program if a majority of the covered emissions of the states and provinces participating in the WCI in January 2009 are not included. The DOE's rules for the Program must be adopted by December 31, 2010. The rules may not go into effect until June 1, 2011, and only after approval by the Governor. The DOE may modify or repeal the rules as necessary to link to, avoid duplication with, or participate in a federal cap-and-trade program.

Cap-and-Trade Work Group
A work group is established to develop and provide a recommendation to the Governor on the timing and terms of Washington's participation in the regional cap-and-trade program. The

recommendation is due by May 1, 2011. The work group must also meet periodically to review the development of the regional cap-and-trade program and the DOE's rule making, including recommendations regarding the distribution of allowances.

When making recommendations on the distribution of allowances, the work group must consider several factors and provide the Director of the DOE recommendations on:

- methodologies and processes by which to distribute Washington's allowances, including the percentage of allowances that should be auctioned;
- actions the state should take to guard against manipulation of the market;
- the amount of allowances from within the state's allowance cap that should be set aside for specific purposes, such as for use in low water years, if any; and
- how to address any disparities in the distributional effects upon individual households, especially low and moderate income populations.

<u>The Cap</u>
The Program must include annual allowance caps that, together with other complementary policies, ensure that Washington meets its emission reduction requirements.

The allowance caps for each year from 2012 to 2020 must be set in advance of the Program start date in 2012. Allowance caps for each year after 2020 must be set at least three years in advance of the start of the next compliance period. The allowance caps must decline an equal amount each year until Washington's GHG emissions meet the required reductions.

The 2012 allowance cap must be set at the expected 2012 emissions, as adjusted by the jurisdiction formula. In 2015, after the annual reduction is made to the cap, the allowance cap must be increased by the expected level of new covered emissions.

The allowance cap may also be adjusted to account for expansion of the capped region through linkage to other governmentally approved cap-and-trade programs, changes in coverage under the regional cap-and-trade program, or discovery of incorrect or inaccurate data used to determine the allowance cap.

<u>Jurisdiction Formula</u>
The jurisdiction formula takes into account:

- production and consumption of electricity megawatt hours within each jurisdiction participating in the regional cap-and-trade program;
- population growth within the jurisdictions participating in the regional cap-and-trade program; and
- Washington's share of the total covered emissions from 2001 through 2005 from jurisdictions participating in the regional cap-and-trade program.

<u>Allowances</u>
Except for early reduction allowances, the number of allowances issued by the DOE may not exceed the allowance cap for any given year or compliance period. The DOE may retire allowances if it determines that the allowance cap exceeds the state's emissions.

When the DOE receives an allowance to meet a compliance obligation, the DOE must retire the allowance. The DOE must ensure that all allowances that it issues are tracked so that the DOE knows who holds a given allowance and when it is retired.

One percent of the 2012 allowance must be contributed into a pool. Those allowances, along with all other participating jurisdiction's one percent contributions, must be reallocated among participating jurisdictions based on the jurisdiction formula.

Covered Emissions
Beginning in 2012, the Program must cover emissions that meet or exceed 25,000 metric tons of carbon dioxide equivalents annually from: (1) electricity that is generated or consumed within the state; (2) combustion at industrial and commercial facilities; and (3) industrial processes.

Beginning in 2015, the Program must also cover emissions that meet or exceed 25,000 metric tons of carbon dioxide equivalents annually from transportation fuel combustion within the state, residential fuel combustion within the state, and fuel delivered or sold for industrial and commercial combustion within the state. The person with the compliance obligation for these fuels is either the terminal operator or the person who imports fuel into the state for delivery to a person other than a terminal operator.

The DOE may expand the Program to include emissions below the 25,000 metric ton threshold or to other persons not initially covered to ensure that the emissions covered by the Program are consistent with the regional cap-and-trade program.

Emissions Not Covered
Carbon dioxide emissions not covered by the Program include emissions from the industrial combustion of biomass in the form of fuel wood, wood waste, wood by-products, and wood residuals, as long as the region's silvicultural sequestration capacity is maintained or increased. Emissions from the combustion of biofuels or the biofuel component of blended fuels is also not covered.

Prevention of Market Manipulation
The DOE must consult with other jurisdictions in the WCI, Washington state agencies with expertise on markets, and other states and federal agencies that have designed or implemented a market for regulating air pollutants in order to design a trading market that includes provisions to prevent market manipulation and ensure a functional and efficient market. The DOE must provide a report to the Legislature by December 31, 2010, on the design of the market that includes an explanation of how manipulation and excessive speculation will be avoided.

Auction Design
The DOE must develop the design for the auctioning of the state's allowances. The design must also include the establishment of a minimum or reserve bid price. In developing the design, the DOE must consult with other jurisdictions in the WCI and other states and federal agencies that have been engaged in auctioning of allowances to regulate air pollutants.

The auction design must be consistent with the regional cap-and-trade program and include the following:

- elements that minimize allowance price volatility, guard against bidder collusion, and minimize the potential for market manipulation;
- provisions to ensure that bidders are financially able to purchase allowances if they are the successful bidder;
- provisions to limit the number of allowances any one party may purchase as necessary to help ensure that available allowances go to persons with a compliance obligation; and
- a flexible process that allows for ongoing modification of the auction design and procedures in response to allowance market conditions and allowance market monitoring data, provided that the process allows for public review and comment.

If a federal program establishes a percentage of auctioned allowances, while allowing regional programs to continue to operate, the state must be consistent with the federal auction percentage.

<u>Offsets</u>
The DOE must set criteria for issuing and accepting credits for offset projects. The DOE may also include a limitation on their use that is consistent with the regional cap-and-trade program. In developing the criteria for offset projects, priority must be given to investigating and developing criteria for projects within the forestry, agriculture, and waste management sectors.

The DOE may issue credits for offset projects located in Washington, or the United States, Mexico, or Canada if they are outside the capped region. One offset credit must be issued for each metric ton of carbon dioxide equivalent emissions.

The DOE may accept offset credits for compliance purposes from other jurisdictions in the capped region, as well as Annex 1 countries from the United Nations Framework Convention on Climate Change, and from developing countries in accordance with the clean development mechanism of the Kyoto Protocol.

The DOE may limit the number of allowances from other jurisdictions outside of those participating in the Program in order to ensure that a majority of emission reductions come from within the jurisdictions participating in the regional cap-and-trade program.

Once the DOE accepts an offset credit to meet a compliance obligation, the DOE must retire the offset credit. The DOE must ensure that all offset credits that it issues are tracked to ensure they know who holds a given offset credit and when it is retired.

<u>Forestry Incentives and Offset Projects</u>
The DOE, in consultation with the Forest Practices Board, the Department of Natural Resources, and the Forest Carbon Working Group, must develop and deliver legislation to implement a financial incentives program for forestry and forest products to the Legislature by December 31, 2010, as well as a preliminary draft of the state's policy for forestry offset projects within Washington.

<u>Compliance Periods and Violations</u>
The compliance periods are a maximum of three years in length. After those three years, persons who have a compliance obligation must submit to the DOE either allowances, offset credits, or both.

If sufficient allowances are not turned in to meet the compliance obligation, a penalty of three allowances must be submitted for every one allowance that is due.

When a person covered under the Program reasonably believes that it will be unable to meet a compliance obligation, the person must immediately notify the DOE. The DOE must issue an order requiring the person to submit the penalty allowances. Failure to submit penalty allowances results in a penalty of up to $5,000 for each penalty allowance that is not submitted.

The DOE may issue penalties and compliance orders. Violations may incur a penalty of up to $10,000 per day per violation for each day that the person has not complied. Appeals of orders and penalties issued must be to the Pollution Control Hearings Board.

Climate Protection Account
The Climate Protection Account (Account) is created in the State Treasury. All receipts from auction of allowances and penalties must be deposited into the Account. Moneys in the Account may be spent only after appropriation. Expenditures from the Account may be used only for reasonable administrative costs to develop, implement, and enforce the Program, including Washington's share of any necessary and reasonable costs of the regional organization.

Additionally, moneys from the Account may only be expended for the following purposes, which are listed in order of priority:

1. reducing price impacts for consumers with incomes within 250 percent of the federal poverty level;
2. strategies to create jobs and provide for worker transition, especially in and for those communities and workers that have been disproportionately affected by economic downturns, through efforts to reduce emissions, reduce energy use, and develop clean energy supplies;
3. supporting transit and transportation projects that will reduce GHG emissions;
4. energy efficiency and renewable energy incentives including matching electric utility sponsored programs that support customer energy efficiency investment, new renewable energy resource development, including related transmission, energy storage, and integration technologies;
5. promoting emission reductions and carbon sequestration in agriculture, forestry, waste management, and other uncapped sectors;
6. efforts funded by local governments to reduce community GHG emissions except for reductions to covered emissions where the local government is the person with the compliance obligation;
7. recognizing early actions to reduce GHG emissions where those actions do not qualify for early reduction allowances;
8. adaptation to climate change impacts, including impacts on affected species, habitats, and communities; and
9. research, development, demonstrations, and deployment of technology to reduce GHG emissions.

Regional Agreement
The Director of the DOE is authorized to enter into an agreement with representatives of other jurisdictions within the capped region for the formation of an organization that may carry out administrative functions. Any agreement entered into must include provisions for Washington to

exercise oversight of the organization, including authority to audit the organization's finances and records. The agreement must also authorize Washington to withdraw from the agreement without penalty if the organization fails to meet its obligations under the agreement.

Public Information
The DOE must compile and post annual summaries of GHG emissions covered by the Program for public information. Public posting of the summaries and underlying data may be subject to a temporary embargo by the DOE prior to a common participating jurisdiction posting schedule. Prior to the common posting date, the summaries and underlying data are exempt from public disclosure.

Governor Delay and Tribal Consultation
The Governor is authorized to issue an order to delay the start of the Program, delay the inclusion of additional sectors, or otherwise suspend the Program to address economic emergencies for up to one year for each order issued. The Governor must provide written notification to the Legislature of the action undertaken. The Director of the DOE must provide a similar notice to the head of the environmental agencies in each jurisdiction participating in the regional cap-and-trade program.

The DOE must consult with tribal governments, upon request, on any elements of the Program that may impact tribal governments, such as their voluntary development of offset projects.

Fuel Reporting Requirements
The importer, seller, deliverer, or distributor of fuels for use in Washington where the combusted fuel delivered equals or exceeds 10,000 metric tons of GHG must report their emissions to the DOE. The importer, seller, deliverer, or distributor of electricity from outside Washington for consumption in Washington must report the emissions of GHG associated with the generation of the electricity delivered into the state where the annual emissions associated with electricity equal or exceed 10,000 metric tons of GHG. Reporting must begin in 2011 for emissions in 2010.

Appropriation: None.

Fiscal Note: Preliminary fiscal note available.

Effective Date: The bill takes effect 90 days after adjournment of the session in which the bill is passed.