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## Environment Committee

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### HB 1314

**Brief Description:** Implementing a carbon pollution market program to reduce greenhouse gas emissions.

**Sponsors:** Representatives Fitzgibbon, Hunter, Moeller, Carlyle, Peterson, Goodman, McBride, Jinkins, Tarleton, Kagi, Appleton, Cody, Ryu, Pollet, Hudgins, Fey, Lytton, Robinson, Ormsby, Farrell, Dunshee, Bergquist, Stanford, S. Hunt, Pettigrew, Walkinshaw, Reykdal, Wylie, Riccelli, Tharinger, Senn, Sawyer, Gregerson, Sells, Moscoso, Ortiz-Self and Van De Wege; by request of Governor Inslee.

#### Brief Summary of Bill

- Establishes a market-based greenhouse gas (GHG) emissions program to be implemented by the Department of Ecology.
- The GHG emissions program must limit statewide emissions to levels established for 2020, 2035, and 2050 by requiring facilities, fuel suppliers, and electricity importers whose annual GHG emissions exceed 25,000 metric tons of carbon dioxide equivalent to obtain emissions allowances, beginning July 1, 2016.
- Distributes allowance auction proceeds to transportation projects, education, housing assistance programs, a sales tax rebate to low-income persons, a business and occupation tax credit for certain energy-intensive industries, and rural economic assistance programs.

**Hearing Date:** 1/27/15

**Staff:** Jacob Lipson (786-7196).

#### Background:

The United States Environmental Protection Agency (EPA) and state Department of Ecology (ECY) identify carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, and sulfur hexafluoride as greenhouse gasses (GHGs) as a result of their capacity to trap heat in the earth's atmosphere. According to the EPA, the global warming potential (GWP) of each

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GHG is a function of how much of the gas is concentrated in the atmosphere, how long the gas stays in the atmosphere, and how strongly the particular gas affects global atmospheric temperatures. Under state law, the GWP of a gas is measured in terms of the equivalence, over a 100-year timeframe, to the emission of an identical volume of carbon dioxide (carbon dioxide equivalent). For example, rules adopted by ECY identify the GWP of carbon dioxide as one, the GWP of methane as 21, and the GWP of nitrous oxide as 310.

### Current Federal and Washington Regulation of Greenhouse Gasses

Under the federal Clean Air Act, GHGs are regulated as an air pollutant and are subject to several air regulations administered by the EPA. These federal Clean Air Act regulations include a requirement that facilities and fuel suppliers whose associated annual emissions exceed 25,000 metric tons of carbon dioxide equivalent report their emissions to the EPA.

At the state level, GHGs are regulated by the ECY under the state Clean Air Act. This state law requires facilities, sources, and sites whose emissions exceed 10,000 metric tons of carbon dioxide equivalent each year to report their annual emissions to the ECY or to local air authorities that implement the state Clean Air Act. Liquid motor vehicle and aircraft fuel suppliers that supply fuel whose combustion would exceed that same 10,000 ton volumetric threshold must also report their annual emissions.

Apart from reporting and other regulations under the state and federal clean air acts, several other state laws and programs explicitly address GHG emissions. State law prohibits Washington utilities from investing in or making a long-term financial commitment to sources of electricity whose generation exceeds a GHG emission performance standard of 1,100 pounds of GHGs per megawatt hour, or a separate standard for natural gas generation as determined by the Department of Commerce.

State law also establishes the following limits for statewide GHG emission levels:

- By 2020, overall GHG emissions in the state must be reduced to 1990 levels;
- By 2035, overall GHG emissions in the state must be reduced to 25 percent below 1990 levels;
- By 2050, overall GHG emissions in the state must be reduced to 50 percent below 1990 levels or 70 percent below the state's expected emissions that year.

These emission limits do not specify how the state must achieve the established limits, nor does it require emission reductions to be achieved by particular entities or types of entities. The ECY is responsible for monitoring and tracking the state's progress towards the emission limits.

### Context for Market-Based Air Emissions Programs

Cap and trade programs, sometimes also called market-based emission programs, generally operate by setting a fixed jurisdiction-wide limit on emissions of a particular air pollutant. The persons and businesses subject to the cap must not collectively exceed this limit. Covered participants must then generally pay a price to obtain the permits, allowances, or other mechanisms that authorize an entity to emit the capped pollutant (allowances). These allowances can often be purchased either directly from the implementing jurisdiction, from others required to participate in the program, or from participants in the program's market that elect to buy, sell, and trade allowances. Some of the policy choices that determine how a cap and trade program for an air pollutant is structured and implemented include:

- whether the allowances are auctioned or allocated to the persons covered by the program;
- whether dedicated portions of the jurisdiction-wide allowance limit are allocated to specific covered economic sectors;
- whether the program includes policies to establish or incentivize a minimum or maximum price for allowances, or both;
- when and how frequently allowances are auctioned to those covered by the program; and
- how the revenues from any auctions of allowances are distributed.

The state of California operates a GHG cap and trade program that covers most of that state's emission sources. As of January 1, 2014, California has linked its GHG emissions program with that of Quebec, meaning that emission allowances are jointly auctioned by the programs, and may be traded across jurisdictional boundaries by program participants. Separately, Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New York, Rhode Island, and Vermont participate in the multi-state Regional Greenhouse Gas Initiative program to cap GHG specifically from the generation of electricity for participating states. Other programs to limit GHG emissions using market-based mechanisms also operate in some jurisdictions outside of North America.

#### Other Washington Program Context.

The Pollution Control Hearings Board (PCHB) is an appeals board with jurisdiction to hear appeals of certain decisions, orders, and penalties made by ECY and several other state agencies. Parties aggrieved by a PCHB decision may obtain subsequent judicial review.

The Public Records Act requires state and local government agencies to make all public records available for public inspection and copying unless the records fall within a statutory exemption.

State agency rulemaking procedures are determined by the Administrative Procedure Act, and normally require public notice and a period of opportunity for the public to submit comments. However, an agency may adopt an emergency rule that takes effect upon filing, and that may remain in place for up to 120 days, if the rule is necessary for public health, safety, or general welfare.

Money in the Education Legacy Trust Account is used to fund K-12 schools, to expand access to higher education, and for other educational improvements.

Washington imposes a business and occupation tax (B&O tax) on the gross receipts of business activities conducted within the state. B&O tax revenues are deposited into the State General Fund. There are several categories of B&O tax rates that apply to businesses engaged in different activities; in addition, credits against B&O tax obligations are available to businesses involved in certain types of activities.

State law requires that legislation establishing a new tax preference must include a tax preference performance or legislative intent statement. The Joint Legislative Audit and Review Committee (JLARC) periodically reviews the performance of tax preferences and determines whether the tax preference's stated public policy objectives are being met.

In 2008 the Legislature enacted a state sales tax remittance for low-income persons, which is also referred to as the Working Families Tax Rebate. To be eligible for the credit a person must file a

federal income tax return, receive a federal Earned Income Tax Credit, have resided in Washington for more than 180 days in the year that the exemption is claimed, and pay the sales tax in the year for which the exemption is claimed. The amount of the remittance is either \$50 or equal to 10 percent of the person's earned income tax credit, whichever is greater. For any fiscal period, the Working Families Tax Rebate must be approved in the state Omnibus Appropriations Act.

The Department of Commerce administers the Housing Assistance Program, which, using funds in the Housing Trust Fund Account, provides loan and grant monies to organizations to provide housing for low-income and special needs populations.

### **Summary of Bill:**

A carbon pollution market program (program) is created, and implemented by the ECY beginning July 1, 2016. The program must distribute, by auction, tradable GHG allowances to persons covered by the program. The ECY must set a budget of total auctioned GHG allowances for the program at such a level that the state achieves the GHG limits established in state law. The ECY is directed to seek to link the state's program to similar market-based carbon programs in other jurisdictions, but is not required to utilize this authority to link with other programs. Revenues generated by the auctioning of allowances under the program are to be used for transportation projects and distributed to the State General Fund, among other uses.

### Entities Required to Participate in the Program.

Certain businesses, government bodies, and other types of entities in Washington are required to participate in the program by obtaining auctioned emission allowances or offset credits equal to their expected GHG emissions for the relevant time period of compliance. All entities required to participate in the program must register with the ECY, and note any affiliation with other registering entities.

The following entities are required to participate in the program:

- an entity that operates a facility covered by state GHG emission reporting rules must participate in the program if the facility's emissions equal or exceed 25,000 metric tons of carbon dioxide equivalent per year;
- the first entity over which Washington has jurisdiction that generates or buys electricity to import for in-state use, if the associated emissions are at least 25,000 metric tons of carbon dioxide equivalent per year; and
- a fuel supplier that has supplied fuels whose complete combustion or oxidation would emit at least 25,000 metric tons of carbon dioxide equivalent per year.

Certain emissions sources are explicitly exempted from the program, including biofuel and biomass combustion emissions, emissions from sources such as landfills and manure management that are not required to report their emissions, and emissions from coal-fired electric generation facilities that are subject to the GHG performance standard in state law.

Compliance obligations under the program begin or end based on an entity's recent or anticipated GHG emissions exceeding the 25,000-ton of carbon dioxide equivalent threshold for a calendar year:

- If a facility, fuel supplier, or electricity importer exceeded the 25,000 metric ton emissions threshold in 2012, 2013, or 2014, they must participate in the program from the program's outset.
- If a facility, fuel supplier, or electricity importer begins, modifies, or continues operations after January 1, 2014 to exceed the 25,000-ton emissions threshold, but had not previously exceeded the 25,000 ton emission threshold or did not have to report emissions in 2012, 2013, or 2014, then it must begin participating in the program at whichever time comes first: The year that it emits at least 25,000 tons of emissions, or after being formally notified by the ECY that its emissions are expected to exceed 25,000 tons.
- If a facility, fuel supplier, or electricity importer initially required to participate in the program drops below the 25,000 tons of carbon dioxide equivalent threshold, then it must participate in the program through the end of the current three-year compliance period. If the facility, fuel supplier, or electricity importer demonstrates emissions below 25,000 tons of carbon dioxide equivalent during the entire three-year compliance period, or demonstrates that it has ceased the operations related to its emissions during the entire compliance period, then it is released from program participation responsibilities.

#### Entities Allowed to Participate in the Program.

A person that is responsible for GHG emissions but not required to participate in the program may voluntarily register with the ECY and participate in the program under the same compliance mechanisms as a required program participant. A person that elects to participate in the program may later opt out of the program. In addition, other persons may register to participate in the program as a general market participant. Tribal governments and federal agencies may participate in the program under either of these voluntary participation mechanisms.

#### GHG Emission Budgets

The ECY must determine the expected total combined emissions from the required program participants. Based on the expected emissions of those entities, the ECY must adopt rules that establish annual budgets for the total number of allowances that will be auctioned to program participants. The Department must set the total number of allowances such that the total combined emissions from the program's required participants meets those participants' combined share of the statewide emission reductions necessary for the state to achieve the GHG emission limits in state law.

The ECY must adhere to the following schedule for developing annual allowance budgets:

- By January 1, 2016, the ECY must establish budgets for calendar years 2016 and 2017.
- By January 1, 2017, the ECY must establish budgets for calendar years 2018 through 2026.
- After an evaluation of program performance that the ECY must conduct by the end of 2024, the Department must adopt allowance budget rules for the years 2027 through 2036, by January 1, 2026.

The ECY must also adopt a rule that specifies the conditions under which it may revise annual allowance budgets; however, the ECY may not revise annual allowance budgets until after 2020.

#### Auctions of Emission Allowances.

Emission allowances are distributed to program participants by the ECY via auction. Auctions are open to entities that are required to participate in the program, and to entities that elect to participate in the program. Auctioned allowances must be sold for no less than a minimum sales price that the ECY adopts by rule. This price floor must increase every year through 2026. Individual program participants and interrelated entities are subject to volume limits on the allowances they may purchase at auction. Auction procedures must be designed to allow linkage with similar programs in other jurisdictions, and ECY may conduct joint auctions under a linkage agreement.

Procedural details of allowance auctions include:

- The ECY may hold up to four auctions per year, which are to be operated as a single round of sealed online bids during a three-hour window.
- Auctions may include the sale of allowances from the current year and unsold allowances from previous auctions, but future allowances must be auctioned separately.
- The ECY must hire an independent contractor to run the auctions, and a financial services administrator to manage the auction bid guarantees.
- Auction participants must not disclose information about their bid, in order to guard against collusion or market manipulation.

Separate from the general auction allowances, the ECY must also set aside 4 percent of all available allowances as a price-containment reserve designed to assist in containing the compliance costs of entities required to participate in the program. In general, reserve auctions are subject to the same procedures and auction proceed distributions as other allowance auctions, except that general market voluntary participants are not allowed to participate in the reserve auctions. In addition, the ECY must set a minimum sales price for allowances in reserve auctions in advance of the auction that is high enough to incentivize direct emissions reductions.

### Offset Credits

The ECY must adopt rules establishing protocols for offset projects that provide a credit equivalent to an emissions allowance for entities required to participate in the program. Offset projects must result in real, quantifiable, permanent, verifiable, and enforceable GHG emission reductions that occur in addition to other existing requirements.

Through 2020, the ECY may only adopt offset protocols and allow offset credits for projects commencing after January 1, 2016 that:

- anaerobically digest organic waste;
- reduce ozone depleting substances;
- capture methane from mining and resource extraction activities; or
- sequester carbon through forestry or agriculture.

Offset credits must take place within the United States, Canada, or Mexico, and must be in addition to emissions reductions that would otherwise occur or be legally required. An entity required to participate in the program may submit offset credits for up to eight percent of the emission allowances that it would otherwise be required to submit.

In developing offset protocols, the ECY must work with the Department of Natural Resources to consider sequestration or emission reduction opportunities associated with forestry and land management activities.

### Oversight of the Allowance and Offset Credit Market.

Offset credits and auctioned allowances may be bought, sold, and transferred under rules the ECY is directed to adopt. The ECY is directed to contract with an independent organization to monitor the allowance and offset market, including the organization's development of a monitoring and security plan, auction review and auditing protocols, and trade, holding, and other market activity monitoring.

The ECY must create a financial advisory committee of market professionals to independently assess program performance and market monitoring mechanisms. The committee must provide an assessment to the ECY every two years, beginning July 1, 2018.

The ECY must use a secure online electronic system to track program registration, allowance and offset credit ownership, and other aspects of program compliance. This system must be the same system used by the GHG emission allowance trading programs in jurisdictions to which the state's program could link. This system must allow required and voluntary program participants to maintain an account that contains allowances or offset credits to be used to fulfill the participant's compliance obligations associated with their emissions. The system must also allow those same entities to maintain a second account containing the participant's allowances or offset credit holdings that it buys, sells, or trades. The ECY must also maintain an account in this system that it must use to receive the submitted allowances and offset credits from program participants and to subsequently retire the credits from the possibility of future use.

### Uses of Allowance Auction Revenue

The Carbon Pollution Reduction Account (Account) is created, and receives receipts from the auction of allowances. Account funds are distributed to the State General Fund and other specific accounts to pay for the purposes described below.

- Forty percent of Account monies, and up to \$400 million each fiscal year, support transportation system maintenance and safety and for transportation projects with a priority given to transit and GHG emission-reducing projects.
- Forty percent of Account monies, plus additional funds as needed to equal or exceed \$380 million per fiscal year, go to the Education Legacy Trust Account.
- Ten percent of Account monies, plus additional funds as needed to equal or exceed \$108 million per fiscal year, are distributed to the State General Fund to implement the Working Families Tax Rebate.
- Two percent of Account monies, and up to \$15.5 million in fiscal year 2017, \$19.5 million in fiscal year 2018, and \$20 million per fiscal year beginning in 2019, are distributed to the Washington Housing Trust Fund to provide loan and grant monies to organizations to provide housing for low-income and special needs populations
- Two percent of Account monies, plus additional funds as needed to exceed \$20 million per fiscal year, are distributed to fund a B&O tax credit available to energy-intense and trade-exposed businesses subject to the B&O tax and covered by the program. These businesses are eligible for a B&O tax credit of up to half of the cost of obtaining their required allowances or offset credits. The Department of Commerce must adopt rules to identify and certify businesses eligible for the tax credit. Businesses may carry tax credits forward for up to 10 years. Credits are available on a first-in-time basis, meaning that filings for credits will be disallowed after the total amount allocated to the tax credit has been claimed. A statement of legislative intent to mitigate program participation

impacts for certain energy-intensive and trade-exposed businesses is included for purposes of JLARC evaluation of the performance of the tax preference.

- Two percent of Account monies, plus additional funds as needed to equal or exceed \$20 million per fiscal year, are distributed for rural economic assistance programs to be identified or created by the Department of Commerce, working with the Department of Agriculture and the Department of Natural Resources.
- Remaining money in the Account is directed to the program administration costs of the ECY and other state agencies, and to investments in clean energy and to other programs that achieve GHG emission reductions.

#### Linkage to Other Carbon Market Programs.

The ECY is directed to adopt rules and implement the program in such a way so as to allow the state's program to be linked with other jurisdictions with similar carbon market programs. The ECY holds the authority to execute a linkage agreement with established market-based carbon emission reduction programs. Linkage agreements must include provisions addressing:

- quarterly auction eligibility and procedures;
- holding limits that ensure entities in a program are not disadvantaged relative to program participants in other participating jurisdictions;
- offset protocols;
- registration, reporting, oversight, administration, enforcement, and public participation; and
- dispute resolution and linkage agreement amendment or withdrawal.

If the ECY does elect to execute a linkage agreement, Washington must still retain legal and policymaking authority over program design and enforcement.

#### Changes to GHG Emission Reporting Requirements.

The ECY's GHG emission reporting rules must support implementation of the program. Fuel suppliers required to report associated GHG emissions are expanded to include suppliers that supply all types of fuel whose combustion would exceed 10,000 metric tons of carbon dioxide equivalent each year. Electric power entities that supply electric power whose associated emissions exceed 10,000 metric tons must also report their GHG emissions to the ECY. Landfills, industrial wastewater treatment plants, and manure management activities are exempted from facility GHG reporting requirements.

Annual emission reports are due to the ECY by April 10, except for abbreviated reports, which are due on June 1. The ECY may allow facility operators that are not required to participate in the program to submit abbreviated emission reporting data. Annual emission reports are no longer required to be submitted concurrently with GHG emission reports due to the EPA. Local air authorities are not responsible for enforcing GHG emission reporting requirements, which is an ECY responsibility.

The ECY may assign emissions levels for any entities that fail to submit a required GHG emission report. The ECY must also establish a rule for verifying the accuracy of GHG emission reports submitted by required program participants. Verification requirements must include third-party certification from a verification body certified by the ECY. Verification statements are due on September 1 for the preceding calendar year.

### Other Aspects of Program Implementation.

The program's first compliance period is from July 1, 2016 through the end of 2017; all subsequent compliance periods last three years. During a compliance period, an entity required to participate in the program must turn over to the ECY emission allowances or offset credits equal to their GHG emissions. Emission allowances do not expire and may be banked towards future obligations.

Except for the first compliance period, in which all allowances and offset credits must be turned over to the ECY by November 1, 2018, the program requires allowances and offsets to be periodically turned in, over the course of the three-year compliance period:

- By November 1, 2019, and every three years afterwards, 30 percent of the allowances or offsets for the first year of the three-year compliance period must be turned in.
- By November 1, 2020, and every three years afterwards, 30 percent of the allowances or offsets for the second year of the three-year compliance period must be turned on.
- By November 1, 2021, and every three years afterwards, the program participant must submit to the ECY the remainder of the allowances or offset credits owed for the compliance period that ended on the preceding December 31.

Apart from the other rules to implement the program that the ECY is directed to adopt, the ECY also must adopt emergency rules to implement the 2015-2017 budget and to allow for program details to be determined in time to provide early notice to required program participants.

The ECY must create an economic justice and environmental equity advisory committee to periodically evaluate the socioeconomic effects of the program. The committee is comprised of citizen and community representatives. In support of this committee, the ECY must conduct a study using geospatial methods to identify communities of color as well as communities that are potentially subject to disproportionate impacts of climate changes and to the effects of carbon pollution reduction actions.

Beginning November 1, 2016, the ECY must submit a report on program implementation to the Governor and Legislature every two years. Beginning November 1, 2017, the ECY must also report to the Legislature and Governor every two years on the findings of the economic justice and environmental equity committee.

Financial, commercial, and proprietary information submitted to the ECY and whose release would place the submitter at a competitive disadvantage is exempted from disclosure under the Public Records Act. Contractors working on the program must also comply with public disclosure restrictions.

### Penalties, Enforcement, and Appeals

If the ECY determines that a required program participant has not submitted a sufficient number of allowances or offset credits by the required deadlines, the participant is subject to a penalty. If a participant fails to submit an allowance or offset credit, it must subsequently submit four allowances or offset credits within six months, one of which must be retired and three of which may be subsequently re-auctioned by the ECY. If the participant fails to submit the four penalty allowances or offset credits within six months, the ECY may issue a civil penalty of up to \$10,000 per day per penalty. The ECY may also issue an order or a civil penalty of up to \$10,000 per day for failure to comply with other program requirements. During the first

compliance period ending December 31, 2017, the ECY may reduce these penalty amounts. Penalties are deposited into the State General Fund.

Civil penalties and orders issued by the ECY are appealable to the PCHB.

**Appropriation:** None.

**Fiscal Note:** Requested on January 19, 2015.

**Effective Date:** The bill contains an emergency clause and takes effect immediately, except for section 26 of the bill, which takes effect June 30, 2019.