

# HOUSE BILL REPORT

## HB 1682

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### As Reported by House Committee On: Environment & Energy

**Title:** An act relating to a compliance pathway specific to emissions-intensive, trade-exposed businesses for achieving their proportionate share of the state's emissions reduction limits through 2050.

**Brief Description:** Concerning a compliance pathway specific to emissions-intensive, trade-exposed businesses for achieving their proportionate share of the state's emissions reduction limits through 2050.

**Sponsors:** Representatives Fitzgibbon, Ramel, Duerr, Berry, Macri, Ormsby and Hackney; by request of Department of Ecology.

**Brief History:**

**Committee Activity:**

Environment & Energy: 1/18/22, 2/1/22 [DPS].

#### Brief Summary of Substitute Bill

- Establishes a formula and criteria for the distribution of no-cost allowances to Emissions-Intensive Trade-Exposed (EITE) facilities under the Climate Commitment Act's Cap-and-Invest Program (Program) between 2035 and 2050.
- Provides for EITE facilities to apply, prior to the fourth or subsequent compliance periods, for an upward adjustment to their no-cost allowance allocations based on a demonstration that the facility employs best available technology or under a plan to implement best available technology on a specified timeframe.
- Eliminates restrictions on state expenditures of Program revenues that would take effect April 1, 2023, unless the Legislature enacts Ecology agency-request legislation outlining a compliance pathway for EITE facilities through 2050.

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

- Authorizes the use of Program revenues deposited in the Climate Commitment Account for programs, activities, or projects that reduce EITE facility emissions for which the facility has a compliance obligation under the Program.

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## HOUSE COMMITTEE ON ENVIRONMENT & ENERGY

**Majority Report:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 8 members: Representatives Fitzgibbon, Chair; Duerr, Vice Chair; Berry, Fey, Harris-Talley, Ramel, Shewmake and Slatter.

**Minority Report:** Do not pass. Signed by 5 members: Representatives Dye, Ranking Minority Member; Klicker, Assistant Ranking Minority Member; Abbaro, Boehnke and Goehner.

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

### Background:

#### Greenhouse Gas Emission Limits.

Since 2008, state law has established statewide limits on the emission of greenhouse gases (GHGs) in Washington (statewide statutory emission limits). The Department of Ecology (Ecology) is responsible for monitoring and tracking the state's progress in achieving the statewide statutory emissions limits. In 2020, additional legislation was enacted to update the statewide statutory emissions limits to the following:

- by 2020, reduce overall emissions of GHGs in the state to 1990 levels, or 90.5 million metric tons of carbon dioxide equivalents (MMT CO<sub>2</sub>e);
- by 2030, reduce overall emissions of GHGs in the state to 45 percent below 1990 levels, or 50 MMT CO<sub>2</sub>e;
- by 2040, reduce overall emissions of GHGs in the state to 70 percent below 1990 levels, or 27 MMT CO<sub>2</sub>e; and
- by 2050, reduce overall emissions of GHGs in the state to 95 percent below 1990 levels, or 5 MMT CO<sub>2</sub>e, and achieve net-zero GHG emissions.

#### The Climate Commitment Act's Cap-and-Invest Program.

Under the 2021 Climate Commitment Act, in order to ensure that GHG emissions are reduced consistent with the state's 2030, 2040, and 2050 statewide statutory emissions limits, Ecology must implement a cap on GHG emissions from covered entities and a program to track, verify, and enforce compliance through the use of compliance instruments, which include allowances or eligible offset credits. The Cap-and-Invest Program (Program) must commence by January 1, 2023.

The Program must consist of:

- establishing annual allowance budgets that limit emissions from covered entities;
- defining those entities covered by the Program, and those entities that may voluntarily opt into coverage under the Program;
- distributing emissions allowances;
- providing for offset credits as a method for meeting compliance obligations;
- defining the compliance obligations of covered entities;
- providing for the transfer of allowances and recognition of compliance instruments, including those issued by jurisdictions with which Washington may have linkage agreements in the future; and
- providing monitoring and oversight of the sale and transfer of allowances.

Ecology must consider opportunities to implement the Program in a manner that allows linking the Program with those of other jurisdictions.

Compliance obligations under the Program are phased in over the following four-year compliance periods:

- first compliance period: 2023 through 2026;
- second compliance period: 2027 through 2030; and
- subsequent four-year compliance periods beginning in 2031.

By October 1, 2022, Ecology must adopt annual allowance budgets for the first compliance period to be distributed from January 1, 2023, through December 31, 2026. Ecology must also adopt annual allowance budgets for the second compliance period. By October 1, 2028, Ecology must adopt by rule the annual allowance budgets for the calendar years 2031 through 2040. The annual allowance budgets established under the Program must be set to achieve the share of reductions by covered entities necessary to achieve the 2030, 2040, and 2050 statewide statutory emissions limits.

If a Program participant does not submit sufficient compliance instruments to meet its compliance obligation by the specified dates, a penalty of four allowances for every one compliance instrument that is missing must be submitted to Ecology within six months. When a covered or opt-in entity reasonably believes that it will be unable to meet a compliance obligation, the entity must immediately notify Ecology. Upon receiving notification, Ecology must issue an order requiring the entity to submit the appropriate penalty allowances. If a covered or opt-in entity fails to submit the appropriate penalty allowances, Ecology must issue an order or a penalty of up to \$10,000 per day per violation, or both, for failure to submit penalty allowances. The order may include a plan and schedule for coming into compliance.

#### Emissions-Intensive Trade-Exposed Facilities.

The following industry process descriptions in the North American Industry Classification System (NAICS) are considered emissions-intensive and trade-exposed:

- metals manufacturing (NAICS 331-);

- paper manufacturing (NAICS 322-);
- aerospace product and parts manufacturing (NAICS 3364-);
- wood products manufacturing (NAICS 321-);
- nonmetallic manufacturing (NAICS 327-);
- chemical manufacturing (NAICS 325-);
- computer and electronic product manufacturing (NAICS 334-);
- food manufacturing (NAICS 311-);
- cement manufacturing (NAICS 327310);
- petroleum refining (NAICS 324110);
- asphalt paving mixtures and block manufacturing from refined petroleum (NAICS 324121);
- asphalt shingle and coating manufacturing from refined petroleum (NAICS 324122); and
- all other petroleum and coal products manufacturing from refined petroleum (NAICS 324199).

By July 1, 2022, for purposes of the second compliance period, Ecology must adopt by rule objective criteria for emissions intensity and trade exposure to identify Emissions-Intensive Trade-Exposed (EITE) businesses, in addition to the EITE facilities with the above-listed NAICS codes.

Emissions-Intensive Trade-Exposed Emission Reporting and No-Cost Allowance Allocation.

By September 2022, each EITE facility must submit its carbon intensity baseline to Ecology, using 2015-2019 data unless the facility experienced abnormal periods of operation. Ecology must review and approve the baseline by November 2022. During the first compliance period, each EITE must record its facility-specific carbon intensity baseline using actual production.

Owners or operators of EITE facilities that are required to participate in the Program must receive an allocation of allowances at no cost as follows:

- for the first compliance period beginning in 2023, the annual allocation of allowances must equal the facility's baseline carbon intensity, under which emissions are measured relative to facility production, as established using 2015-2019 data, multiplied by EITE facility's actual production for each calendar year of the compliance period;
- for facilities using a mass-based approach, the allocation of allowances must equal the facility's mass-based baseline established using 2015-2019 data, unless there were abnormal circumstances during those years. Facilities may use a mass-based baseline if it is not able to feasibly determine a carbon intensity benchmark based on its unique circumstances. In general, a facility may not switch from using a mass-based baseline to a carbon intensity baseline;
- for the second compliance period beginning in 2027, the annual allocation of no-cost allowances is reduced to 97 percent of first compliance period allocations (for mass-

- based facilities); or 3 percent below the first compliance period benchmark; and
- for the third compliance period beginning in 2031, the annual allocation of no-cost allowances is 94 percent of first compliance period allocations (for mass-based facilities) or 3 percent below the second compliance period benchmark.

Prior to the second, third, or subsequent compliance periods, Ecology may adjust benchmarks upward after determining that additional reductions in carbon intensity or mass emissions by an EITE facility are not technically or economically feasible. Ecology may base this upward adjustment on an EITE facility's best available technology analysis. By rule, Ecology must provide for EITE facilities to apply for upward benchmark adjustments, based on any significant changes in an EITE's competitive environment or manufacturing processes or an EITE facility experiencing abnormal operating periods.

If an EITE facility's actual emissions exceed its assigned allowance allocation, it must acquire additional compliance instruments. Ecology must limit the use of offset credits for compliance so that the provision of offset credits plus no-cost allowances does not exceed 100 percent of an EITE facility's total compliance obligation.

If an EITE facility ceases production and closes, Ecology must withhold or withdraw allowances allocated to the facility.

If an EITE facility curtails production, it retains its allowances, does not receive new free allowances, and cannot sell, transfer, or trade its allowances. The allowances of a curtailed facility that closes are transferred to the emissions containment reserve (which is managed by Ecology, and which contain allowances that are distributed to new or expanded EITE facilities).

An owner or operator of multiple EITE facilities may transfer allowances among eligible facilities.

Ecology must adopt rules for the allocation of allowances at no cost to newly-constructed EITE facilities. A new or expanded EITE facility during the first compliance period receives, from the emissions containment reserve, allowances equal to the amount of its emissions.

**Required Ecology Engagement with the Legislature Regarding Emissions-Intensive Trade-Exposed Facilities.**

During the 2022 regular legislative session, Ecology must propose agency-request legislation outlining a compliance pathway for EITE facilities to achieve a proportionate share of reductions to achieve the state's 2050 statewide statutory emission limits. No expenditures may be made from three of the accounts that Program auction proceeds are deposited into unless the Legislature enacts Ecology-request legislation that outlines a compliance pathway specific to EITE facilities for achieving their proportionate share of emission reductions under the statewide statutory emission limits.

By December 2026, Ecology must report to the Legislature on alternative methods for determining the amount and schedule of allowances allocated to EITE facilities covering the 2035-2050 period of Program implementation. Ecology must form an advisory committee that includes EITE manufacturers in developing the report. If the Legislature does not adopt a compliance obligation for EITE facilities by December 1, 2027, EITE facilities must continue to receive allowances as provided for in the third compliance period beginning in 2031.

Climate Commitment Account.

The Climate Commitment Account receives a portion of the auction revenues from the Program. Projects, activities, and programs eligible for funding from the Climate Commitment Account must be physically located in Washington and must meet high labor standards, including family-sustaining wages, benefits including health care and employer-contributed retirement plans, career development opportunities, and access to economic benefits from such projects for local workers and diverse businesses. Eligible uses of Climate Commitment Account funds include, but are not limited to, those that involve the following:

- implementing the Working Families Tax Rebate;
- supplementing the Growth Management Planning and Environmental Review Fund for the purpose of making grants or loans to local governments;
- reducing and mitigating impacts from GHGs and co-pollutants in overburdened communities, including strengthening air quality monitoring networks;
- deploying renewable energy resources, such as solar and wind power, and projects to deploy distributed generation, energy storage, demand-side technologies and strategies, and other grid modernization projects;
- increasing the energy efficiency or reducing the GHG emissions of industrial facilities including, proposals to implement combined heat and power, district energy, or on-site renewables;
- achieving energy efficiency or emissions reductions in the agricultural sector, including 11 specified types of activities;
- increasing energy efficiency in new and existing buildings or promoting low-carbon architecture, including use of newly emerging alternative building materials that result in a lower carbon footprint in the built environment over the life cycle of the building and component materials;
- promoting the electrification and decarbonization of new and existing buildings, including residential, commercial, and industrial buildings;
- assisting affected workers or people with lower incomes transition to a clean energy economy, or growing and expanding clean manufacturing capacity in communities across Washington; and
- supporting efforts to mitigate and adapt to the effects of climate change affecting Indian tribes, including capital investments in support of the relocation of Indian tribes located in areas at heightened risk due to anticipated sea level rise, flooding, or other disturbances caused by climate change.

Money in the Climate Commitment Account may not be used for projects or activities that would violate tribal treaty rights or result in significant long-term damage to critical habitat or ecological functions. Investments from the Climate Commitment Account must result in long-term environmental benefits and increased resilience to the impacts of climate change.

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**Summary of Substitute Bill:**

Emissions-Intensive Trade-Exposed (EITE) facilities identified in statute by North American Industry Classification System (NAICS) code category are identified based on the NAICS code categories that existed as of January 1, 2021.

For the year beginning January 1, 2035, EITE facilities are awarded no-cost allowances equal to 88 percent of the facility's mass-based baseline, if the EITE facility is using a mass-based baseline, or 88 percent of the facility's carbon-intensity benchmark multiplied by the facility's actual production, if the EITE facility is using a carbon-intensity benchmark.

Each year from 2036 through 2050:

- for EITE facilities using a carbon-intensity benchmark, the benchmark upon which no-cost allowance distributions are annually based is 6 percent below the benchmark of the preceding year; and
- for EITE facilities using a mass-based baseline, a facility must annually be awarded no cost allowances that are six percent below the percentage of no-cost allowances it was awarded the previous year.

By rule, the Department of Ecology (Ecology) may modify the no-cost allowance allocations to EITE facilities between 2035 and 2050 if necessary to ensure proper market functioning, the achievement of the proportionate share of the statewide statutory emission limits, or to provide for alignment with other jurisdictions to which the state has linked.

Ecology must adopt a rule to provide a process for an EITE facility to apply to Ecology for an upward adjustment in its allocation of direct no-cost allowances prior to the fourth or subsequent compliance periods. The process must allow an EITE facility to claim that it is already employing best available technology (BAT), and must require the submission of data and information necessary to allow Ecology to make a BAT determination. Emissions-Intensive Trade-Exposed facilities that already employ BAT must receive no-cost allowance allocations equal to 100 percent of their emissions.

An EITE facility that is not already employing BAT may submit a BAT plan to Ecology. Such BAT plans:

- must propose to employ BAT within a reasonable period not to exceed 12 years;
- must describe each action or investment element towards the achievement of BAT, and the timeline and emission reductions associated with deployment; and

- must include a proposal for financing the deployment of BAT.

Emissions-Intensive Trade-Exposed facilities that are implementing a BAT deployment plan must receive no-cost allowance allocations equal to 100 percent of their projected emissions under the BAT plan for each year of the plan.

The distribution of no-cost allowances to EITE facilities that are already employing BAT or that are operating under a BAT plan may not be greater than the amount that the EITE facility would have received for the year beginning January 1, 2035.

Emissions-Intensive Trade-Exposed facilities must re-submit plan plans prior to each compliance period, but may use previously-approved plans as the basis for a re-submitted plan.

Ecology may request or consider information about BAT for an EITE facility sourced from any person. Ecology must reject any BAT plan for which Ecology does not have sufficient data or information to make a BAT determination. Emissions-Intensive Trade-Exposed facilities that fail to employ BAT as scheduled under the BAT plan are subject to penalties for each allowance it received under the upward adjustment, so that the EITE facility must submit four allowances for each extra allowance it received. Emissions-Intensive Trade-Exposed facilities that fail to employ their BAT plan as scheduled are also precluded from submitting a new BAT plan. Any person may appeal a BAT plan approval or disapproval decision by Ecology to the Pollution Control Hearings Board.

An adjustment in the allocation to an EITE facility may not increase the Cap-and-Invest Program's (Program) annual allowance budget for any calendar year of the compliance period in which the adjustment was made or any future calendar years, and may not prevent the achievement of the statewide statutory emission limits.

Ecology is no longer required to submit a report to the Legislature on EITE facility allowance schedules in 2026. There is no longer a restriction on expenditures of Program revenues beginning in April 1, 2023.

Money in the Climate Commitment Account authorized for industry facility emission reduction projects is also specifically authorized for programs, activities, or projects that reduce EITE facility emissions for which the EITE facility has a compliance obligation under the Program.

#### **Substitute Bill Compared to Original Bill:**

The substitute makes the following changes to the original house bill:

- amends the process for Emissions-Intensive Trade-Exposed (EITE) facilities to apply to the Department of Ecology (Ecology) prior to the beginning of the fourth compliance period for an upward adjustment to their benchmark allocation of no-cost

allowances, including by:

- describing the process by which an EITE facility may claim that it is already employing best available technology (BAT), including the submission of data and information necessary to allow Ecology to make a BAT determination;
- providing for EITE facilities that already employ BAT to receive no-cost allowance allocations equal to 100 percent of their emissions;
- describing the process by which an EITE facility that is not already employing BAT may submit a BAT plan to Ecology. Such BAT plans:
  - must propose to employ BAT within a reasonable period not to exceed 12 years;
  - must describe each action or investment element towards the achievement of BAT, and the timeline and emission reductions associated with deployment; and
  - must include a proposal for financing the deployment of BAT;
- limiting the distribution of no-cost allowances to EITE facilities operating under a BAT plan to no greater than the amount that the EITE facility would have received for the year beginning January 1, 2035;
- providing for EITE facilities that are implementing a BAT deployment plan to receive no-cost allowance allocations equal to 100 percent of their projected emissions under the BAT plan for each year of the plan;
- requiring EITE facilities to re-submit plans prior to each compliance period, but authorizing EITE facilities to use previously-approved plans as the basis for a re-submitted plan;
- authorizing Ecology to request or consider information about BAT for an EITE facility sourced from any person;
- providing for Ecology to reject any BAT plan for which Ecology does not have sufficient data or information to make a BAT determination;
- providing for penalties for an EITE facility that fails to employ BAT as scheduled under the BAT plan, and precluding such an EITE facility from submitting a new BAT plan; and
- authorizing any person to appeal a BAT plan approval or disapproval decision by Ecology to the Pollution Control Hearings Board;
- amends the criteria by which Ecology may by rule modify allocations of no-cost allowance amounts to EITE facilities to include circumstances in which modification is necessary to ensure proper market functioning, and to allow modification of the amounts proposed for allocation under a BAT plan;
- specifies that North American Industry Classification System (NAICS) codes used for identifying EITE facilities are those NAICS codes in place as of January 1, 2021;
- specifies that Climate Commitment Act funding for EITE facilities is within the existing category of industrial facility emission programs, activities, and projects, rather than creating a new EITE-specific category of allowable fund uses; and
- makes changes to use consistent terminology, such as standardizing references to EITE facilities and owners or operators of EITEs, rather than referencing EITE businesses.

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**Appropriation:** None.

**Fiscal Note:** Available.

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

**Staff Summary of Public Testimony:**

(In support) Last year's Climate Commitment Act (CCA) required the Department of Ecology (Ecology) to bring forward agency-request legislation addressing a compliance pathway for Emissions-Intensive Trade-Exposed (EITE) facilities. Balancing state emission reduction goals and economic competitiveness issues for EITE industries is a challenging problem. Leakage of jobs to other jurisdictions is one of the worst possible outcomes. The CCA's generous allocation of free allowances to EITEs in the early years of the Cap-and-Invest Program needs to be reconciled with the longer-term steep decline of the overall state emissions cap under the law. The CCA's early allocation of no-cost allowances to EITEs amounts to billions of dollars in value that EITEs can use to help invest in their transition to lower-emitting practices. Using best available technology (BAT) should be a compliance option for EITEs. Best available technology must be independently evaluated against international standards. Each EITE has individual emissions, process, and trade characteristics. Reducing the long-term allocation of free allowances to EITEs will reduce the compliance burden on other regulated industries subject to the CCA's cap. The allocation of allowances early in the program, plus a commitment of state funding to EITE decarbonization projects, will help EITEs capitalize the longer-term emission-reduction investments necessary for them to proportionately contribute to meeting state emission reduction targets. There are a variety of state programs in place to help Washington industries reduce their emissions, and other incentives, such as tax preferences for green hydrogen, will contribute to EITE compliance pathways under the CCA's cap. Low-emission technology for EITEs to deploy will continue to be invented and become more widely available and cost-competitive as the world increasingly demands cleaner energy and manufacturing. The CCA helps incentivize low-carbon innovations. It is important that Washington's program be designed in a manner that allows linkage with California's emission reduction program. It is important that EITE greenhouse gas emission reductions be accompanied by reductions in criteria air pollutants, and not disproportionately impact overburdened communities.

(Opposed) This bill does not provide a clear and achievable compliance option for EITE businesses after the third compliance period of the program. The steep decline in emission allowances to EITEs will lead to leakage of jobs and emissions to other jurisdictions that do not have a program that makes emitting greenhouse gases more expensive. Washington

manufacturers will be at a competitive disadvantage due to program compliance costs. Emissions-Intensive Trade-Exposed businesses employ thousands of union-based jobs. Compliance with the CCA program as envisioned in this bill could cost individual businesses tens or hundreds of millions of dollars. Many EITE businesses have already substantially reduced greenhouse gas emissions in recent years, and many of the easiest methods of reducing emissions have already been implemented. The steep decline in the allocation of free allowances errantly assumes that fundamental process or fuel source changes will be possible soon. Electrification of boilers may require new technology, in addition to rapid and costly infrastructure build-out by the electric utilities upon which EITEs depend. Best available technology must be a compliance pathway that does not require a specific level of emissions reduction, and that reflects the ability of each type of EITE industry to realistically decarbonize. Facility emissions from the use of BAT should be excluded from the CCA program cap. Some greenhouse gas emissions are inherent emissions of the process of making certain EITE products, and can't be avoided with any technology currently in use. Current technology for many EITEs is a limiting factor in their ability to reduce greenhouse gas emissions. The products produced by EITEs should have their emissions considered on a lifecycle basis, in some instances. The program must balance the emission allowance allocations granted to EITE facilities with the needs of other CCA program participants to obtain compliance instruments. Emissions-Intensive Trade-Exposed facilities should be required to reduce their emissions by 50 percent by 2035, in order to make EITE emission reductions keep pace with the state's overall emission reduction goals.

(Other) Washington's public ports own and operate shipping terminals, railroads, and similar facilities. All ports in Washington are dependent on manufacturing businesses, agriculture, and trade. It is in the state's best interest to negotiate a fair compliance pathway that will allow EITE businesses to remain in Washington.

**Persons Testifying:** (In support) Representative Joe Fitzgibbon, prime sponsor; Luke Martland, Department Ecology; Becky Kelley, Office of the Governor; Tom Wolf; David Mendoza, The Nature Conservancy; Kelly Hall, Climate Solutions; Cliff Traisman, Washington Environmental Council and Washington Conservation Voters; and Isaac Kastama, Clean and Prosperous Washington.

(Opposed) Craig Smith, Food Northwest; Jessica Spiegel, Western States Petroleum Association; Chris McCabe, Northwest Pulp and Paper Association; KC Klosterman, Ash Grove Cement; Patrick Jablonski, Nucor; Joshua Estes, Association of Western Pulp and Paper Workers; Michael Ruby; Peter Godlewski, Association of Washington Business; Brent Downey, Kaiser Aluminum; Dan Wilson, United Steelworkers Local 338; and Brandon Houskeeper, Alliance of Western Energy Consumers.

(Other) James Thompson, Washington Public Ports Association.

**Persons Signed In To Testify But Not Testifying:** None.