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## Environment & Energy Committee

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### E2SSB 5842

**Brief Description:** Concerning state laws that address climate change.

**Sponsors:** Senate Committee on Ways & Means (originally sponsored by Senators Carlyle, Lias, Das, Nguyen and Nobles).

#### **Brief Summary of Engrossed Second Substitute Bill**

- Creates a Public Records Act exemption for certain records related to the Climate Commitment Act (CCA).
- Modifies the CCA's preemption of state agency greenhouse gas regulatory programs.
- Recodifies and modifies certain vetoed provisions addressing the logistics of compliance obligations under the CCA.
- Makes other substantive, logistical, clarifying, and technical changes to the CCA.

**Hearing Date:** 2/18/22

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

#### **Background:**

##### State Emission Limits.

Since 2008, state law (RCW 70A.45) has established limits on the emission of greenhouse gases (GHGs) in Washington. The Department of Ecology (Ecology) is responsible for monitoring and tracking the state's progress in achieving these emissions limits. In 2020, additional legislation was enacted to update the statewide emissions limits to the following:

- by 2020, reduce overall emissions of GHGs in the state to 1990 levels, or 90.5 million

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- 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.

#### Climate Commitment Act Overview.

Under the 2021 Climate Commitment Act (CCA), in order to ensure that GHG emissions are reduced consistent with the state's 2030, 2040, and 2050 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.

#### Allowance Budgets.

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 state's 2030, 2040, and 2050 emissions limits. Annual allowance budgets must be set such that the use of offsets as compliance instruments does not prevent the achievement of the state's emissions limits.

### Allowance Auctions, Compliance Obligations, and Enforcement.

Except for directly distributed, no-cost allowances allocated to certain entities, allowances must be distributed via allowance auctions. Auctions are open to covered entities, opt-in entities, and general market participants that are registered entities in good standing. Ecology must hold a maximum of four auctions each year, plus any necessary reserve auctions. An auction may include allowances from the allowance budget of the current year and those from prior years that remain to be distributed. Ecology must make future vintage allowances available through parallel auctions at least twice annually, in addition to the auctions through which current vintage allowances are exclusively offered. Ecology must engage a qualified, independent contractor to run the auctions. Ecology must also engage a qualified financial services administrator to hold the bid guarantees, evaluate bid guarantees, and inform Ecology of the value of bid guarantees once the bids are accepted.

Ecology must adopt by rule provisions to guard against bidder collusion and minimize the potential for market manipulation. A registered entity may not release or disclose any bidding information. Ecology may cancel or restrict a previously approved auction participation application or reject a new application if the agency determines that a registered entity has:

- provided false or misleading information;
- withheld material information that could influence a decision by Ecology;
- violated any part of the auction rules;
- violated registration requirements; or
- violated any of the rules regarding the conduct of the auction.

All covered and opt-in entities are required to submit compliance instruments in a timely manner to meet their compliance obligations, and must comply with all requirements for monitoring, reporting, holding, and transferring emission allowances. If a covered or opt-in entity does not submit sufficient compliance instruments to meet its compliance obligation by the specified transfer 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.

### Offset Credits.

Ecology must adopt by rule protocols for establishing offset projects and securing offset credits. The protocols adopted by Ecology must align with specified policies, including policies identifying the role of the forest products sector in carbon sequestration.

Offset projects must:

- provide direct environmental benefits to the state or be located in a jurisdiction with which the state has entered into a linkage agreement;
- result in GHG emission reductions or removals that:
  - are real, permanent, quantifiable, verifiable, and enforceable; and

- are in addition to GHG emission reductions or removals otherwise required by law and other GHG emission reductions or removals that would otherwise occur; and
- have been certified by a recognized registry after the effective date of the CCA or within two years prior to the effective date of the CCA.

In adopting protocols governing offset projects and covered and opt-in entities' use of offset credits, Ecology must:

- take into consideration standards, rules, or protocols for offset projects and offset credits established in other states, provinces, and countries with programs comparable to the Program;
- encourage opportunities for the development of offset projects in the state by adopting offset protocols that may include protocols that make use of aggregation or other mechanisms to reduce transaction costs related to the development of offset projects and that support the development of carbon dioxide removal projects; and
- adopt a process for monitoring and invalidating offset credits, as necessary to ensure quality control.

The use of offset credits by covered entities is limited to specified percentages of their compliance obligations. Program allowance budgets must be set so that the use of offsets does not prevent the achievement of state emission limits. In setting annual allowance budgets, Ecology must reduce the number of allowances in the budget in an amount equivalent to offset use, or according to a similar methodology that Ecology may adopt by rule.

#### Exempt Emissions.

The following emissions are exempt from coverage under the Program, regardless of emission level:

- emissions from the combustion of aviation fuels;
- emissions from watercraft fuels supplied in Washington that are combusted outside of Washington;
- emissions from the TransAlta coal-fired electric generation facility;
- carbon dioxide emissions from the combustion of biomass or biofuels, including motor vehicle fuel or special fuel that is used exclusively for agricultural purposes; and
- emissions from national security facilities.

#### Allowance Price Containment.

To help minimize allowance price volatility in an auction, Ecology must adopt by rule an auction floor price and a schedule for the floor price to increase by a predetermined amount every year. Ecology may not sell allowances at bids lower than the auction floor price. Ecology's rules must specify holding limits that determine the maximum number of allowances that may be held for use or trade by a registered entity at any one time.

Ecology must also establish an auction ceiling price to limit extraordinary prices and to determine when to offer allowances through Allowance Price Containment Reserve (APCR) auctions. The ceiling price must increase annually in proportion to the price floor.

For calendar years 2023 through 2026, Ecology must place no less than 2 percent of the total number of allowances available from the allowance budgets for those years in the APCR. The APCR must be designed as a mechanism to assist in containing compliance costs for covered and opt-in entities in the event of unanticipated high costs for compliance instruments.

Ecology must adopt rules for holding auctions of allowances from the APCR when the settlement prices in the preceding auction approach the adopted auction ceiling price. The auction must be separate from auctions of other allowances.

Allowances must also be distributed from the APCR by auction when new covered and opt-in entities enter the Program and allowances in the APCR are exhausted.

#### Preemption.

No city, town, county, township, or other subdivision or municipal corporation of the state may implement a charge or tax based exclusively upon the quantity of GHG emissions.

No state agency may adopt or enforce a program that regulates GHG emissions from a stationary source except as provided under the CCA.

The CCA preempts Ecology's Clean Air Rule (Ch. 173-442 WAC), which had been adopted in 2016 to limit emissions of GHGs from certain stationary emission sources and from fuel supplied by petroleum product producers and importers and natural gas distributors, and which was subsequently partially invalidated by a state supreme court decision.

#### Vetoed Provisions of the Climate Commitment Act.

Section 22 of the CCA was vetoed by Governor Inslee. Among other Program details included in Section 22 that were not included elsewhere in the CCA, Section 22:

- established a November 1 deadline each year for the transfer of instruments, including price ceiling units, to satisfy compliance obligations;
- required Ecology to adopt a rule that establishes a minimum percentage of compliance obligations to be satisfied in each year of the compliance period, in a manner similar to other jurisdictions and that allow the compliance obligation to be smooth over a four year period;
- limited the duration for which an allowance can be used to meet a compliance obligation to 8 years after the allowance was first issued;
- required older vintages to be retired before newer vintage allowances;
- prohibited entities from borrowing allowances from future years; and
- had an effective date that was contingent upon a transportation revenue act that increases the state fuel tax rates by at least five cents per gallon becoming law.

#### **Summary of Bill:**

#### Public Records Act Exemption.

The following Climate Commitment Act (CCA) records are confidential and are exempt from public disclosure in their entirety:

- auction bidding information;
- information contained in the Department of Ecology's (Ecology) secure, online electronic tracking form used to register entities, issue compliance instruments, track ownership, enable transfers, facilitate Cap-and-Invest Program compliance, and support market oversight; and
- financial, proprietary, and other market-sensitive information, as determined by Ecology, submitted to Ecology, the independent contractor, the financial services administrator engaged by Ecology, or another jurisdiction with which Ecology has entered into a linkage agreement.

#### Preemption.

State agencies may not adopt or enforce a greenhouse gas (GHG) pricing or market-based emissions cap and reduce program for stationary sources, or enforce GHG emission limitations from stationary sources, except as provided in the CCA, as authorized or directed by state statute, or as required to implement a federal rule, statute, rule, or program. The CCA preempts the provisions of Ecology's Clean Air Rule, and Ecology must repeal the Clean Air Rule.

#### Allowance Budgets, Auctions, and Compliance Obligation Logistics.

Some, but not all, of the provisions contained in vetoed Section 22 of the CCA are re-enacted in identical or amended form, and provide that:

- covered or opt-in entities have a compliance obligation for each four-year compliance period;
- Ecology, by rule, must require the annual transfer of a percentage of compliance instruments to smooth covered or opt-in entities' compliance obligations;
- compliance may occur through the transfer of price ceiling units, in addition to allowances and offset credits;
- older vintage allowances must be retired before newer vintage allowances; and
- Ecology must retire allowances or offset credits upon receipt of a transfer from a covered or opt-in entity.

The emissions baseline for the Program in 2026 must incorporate the proportionate share of emissions from new covered entities in the second compliance period, as measured using 2015 through 2019 emissions data, rather than 2023 through 2025 emissions data.

Offset credits are no longer required to be certified by a recognized register after July 25, 2021, or within two years prior to July 25, 2021. Instead, offset credits must have been issued for reporting periods wholly after the effective date, or within two years prior to the effective date. Offset credits used must be consistent with offset protocols adopted by Ecology.

The "auction ceiling price" that limits extraordinary prices by determining when to offer allowances through an allowance price containment reserve auction is renamed as the "reserve auction floor price". Ecology must adopt rules for holding auctions of allowances from the price

containment reserve when the settlement prices in the preceding auction exceed the adopted reserve auction floor price.

If a jurisdiction with which Ecology might enter into a linkage agreement does not have an emissions containment trigger price, Ecology may suspend the trigger price that it is otherwise required to adopt by rule in order to ensure that allowance prices are sufficient to incentivize reductions in GHG emissions, and which functions by requiring Ecology to withhold allowances at auction if the trigger price is met.

Other.

Annual GHG emission reports to Ecology by electric power entities are due by June 1 of each year instead of the March 31 deadline that applies to other types of reporting emission sources.

Municipal wastewater solids are added to the types of biomass that are exempt from CCA program coverage when combusted.

Eligible facilities sited after July 25, 2021, that receive no-cost allowance allocations as emissions-intensive trade-exposed facilities must mitigate increases in particulate matter in overburdened communities due to its emissions.

Various clarifications and technical corrections are included, including updated codification references, and revised references to use defined terms.

**Appropriation:** None.

**Fiscal Note:** Requested on February 14, 2022.

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