

HOUSE BILL REPORT

E2SSB 5842

As Passed House - Amended:

March 2, 2022

Title: An act relating to state laws that address climate change.

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 History:

Committee Activity:

Environment & Energy: 2/18/22, 2/24/22 [DPA].

Floor Activity:

Passed House: 3/2/22, 81-15.

Brief Summary of Engrossed Second Substitute Bill (As Amended by House)

- 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.
- Requires the Office of Financial Management to submit a report to the Legislature by December 1, 2023, addressing greenhouse gas emission laws other than the CCA.
- Makes other substantive, logistical, clarifying, and technical changes to the CCA.

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.

HOUSE COMMITTEE ON ENVIRONMENT & ENERGY

Majority Report: Do pass as amended. 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; Abbarno, Boehnke and Goehner.

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 metric tons of carbon dioxide equivalents (MMT CO₂e);
- by 2030, reduce overall emissions of GHGs in the state to 45 percent below 1990 levels, or 50 MMT CO₂e;
- by 2040, reduce overall emissions of GHGs in the state to 70 percent below 1990 levels, or 27 MMT CO₂e; and
- by 2050, reduce overall emissions of GHGs in the state to 95 percent below 1990 levels, or 5 MMT CO₂e, 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.

If no allowances remain in the APCR, Ecology must issue a number of price ceiling units (PCUs) for sale sufficient to provide cost protection for facilities at a price level set by Ecology. Price ceiling units may only be purchased by entities that do not have sufficient eligible allowances or offset credits to meet their compliance obligation for the current compliance period. Funds raised in connection with PCU sales must be expended to achieve emission reductions that are real, permanent, quantifiable, verifiable, and enforceable.

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.

Climate Commitment Act Accounts.

Five accounts are created by the CCA, and into which revenues from Program auctions are or are intended to be deposited:

- the Carbon Emissions Reduction Account, used for specified types of transportation uses. Deposits into this account must not exceed \$5.2 billion over the first 16 years of the Program;
- the Climate Investment Account, which distributes money into the Climate Commitment Account and the Natural Climate Solutions Account;
- the Natural Climate Solutions Account, used for certain types of climate resiliency expenditures;
- the Climate Commitment Account, used for certain types of emission reduction and other uses; and
- the Air Quality and Health Disparities Account, used for certain types of environmental justice and air quality monitoring expenditures.

Environmental Justice Provisions in the 2021 Climate Commitment Act.

In 2021 the Legislature enacted Senate Bill 5141 (SB 5141), which established several requirements applicable to how state agencies consider environmental justice in their decision-making. The departments of Agriculture, Commerce, Ecology, Health, Natural Resources, and Transportation and the Puget Sound Partnership must apply and comply with specified environmental justice requirements. The environmental justice duties of these agencies include creating and adopting a community engagement plan by July 1, 2022, that describes planned engagement with overburdened communities and vulnerable populations, and that identifies and prioritizes overburdened communities for purposes of implementing the agency's environmental justice responsibilities. State agencies must also conduct an environmental justice assessment for certain types of agency activities. An Environmental Justice Council was formed for purposes of advising state agencies in the implementation of their responsibilities under SB 5141. The Environmental Justice Council consists of 14 members that meet specified criteria.

Senate Bill 5141 passed the Legislature two weeks prior to the enactment of the CCA, and

numerous provisions of the CCA explicitly reference and build upon provisions established in SB 5141.

To ensure that the Program achieves reductions in criteria pollutants (which are certain traditional monitored pollutants under the Clean Air Act, such as particulate matter),

Ecology must:

- identify overburdened communities, which may occur through the SB 5141 process;
- deploy an air monitoring network in overburdened communities; and
- within overburdened communities, analyze and identify the greatest contributors of criteria pollutants, and develop a high priority list of emitters.

Beginning in 2023, Ecology must review levels of criteria pollutants and health impacts every two years in overburdened communities, with the Department of Health. After review, Ecology must:

- establish targets, with local air pollution control authorities, to achieve air quality consistent with the more protective of either federal standards (National Ambient Air Quality Standards or "NAAQS") or the air quality experienced in neighboring non-overburdened communities;
- identify the greatest stationary and mobile sources of non-decreasing emissions;
- achieve the reduction targets through emission control strategies or other methods;
- adopt stricter air quality standards, emission standards, or emission controls on criteria pollutants, and may consider alternative mitigation actions to achieve criteria pollution reductions;
- issue enforceable orders (or the local air authority must issue enforceable orders) as necessary for compliance with these new stricter air quality standards. The process of issuing enforceable orders must be initiated within six months of the adoption of stricter air quality standards or other limitations; and
- impose only requirements on stationary sources that are proportionate to the stationary source's relative contributions of a pollutant in an overburdened community.

Ecology must adopt a supplement to its SB 5141 community engagement plan. The supplement specifically focuses on criteria air pollutant emissions and emitters in overburdened communities.

Each year or biennium, when allocating funds or administering grants or programs from three CCA Accounts (the Carbon Emissions Reduction Account, the Climate Investment Account, and the Air Quality and Health Disparities Improvement Account), state agencies must:

- conduct an environmental justice assessment consistent with the requirements of SB 5141; and
- establish a minimum of 35 percent, and a goal of 40 percent, of total investments that provide direct and meaningful benefits to vulnerable populations within the boundaries of overburdened communities.

Funding allocated through these three CCA Accounts must adhere to the requirements that apply to funding and expenditure decisions by covered agencies under SB 5141, and must also adhere to four principles:

- funding and programs should be directed to areas and targeted to vulnerable populations and overburdened communities to reduce health disparities;
- investments and benefits should be made roughly proportional to health disparities experienced by communities;
- investments and programs should create environmental benefits in targeted communities; and
- efforts should be made to balance investments and benefits across the state and jurisdictions to reduce disparities by location.

State agencies allocating or administering funds from these three accounts must:

- report annually to the Environmental Justice Council created in SB 5141;
- consider the Environmental Justice Council's recommendations; and
- create and adopt a community engagement plan, if the agency is not an agency subject to SB 5141.

In addition to its duties under SB 5141, the Environmental Justice Council must:

- provide recommendations to the Legislature, agencies, and Governor on the Program established in the CCA, and on the use of funds generated by that program;
- provide recommendations on specific components of Cap-and-Invest market program design, including linkage, offset projects, the designation of energy-intensive trade-exposed facilities, and the administration of program allowances;
- provide a forum to analyze CCA policies' effects on overburdened communities;
- recommend procedures and criteria for evaluating programs and projects;
- recommend co-pollutant emission reduction goals for overburdened communities;
- evaluate the level of funding allocated to specified populations and in overburdened communities;
- recommend environmental justice and environmental health goals for CCA policies and programs; and
- recommend how to consult with vulnerable populations and to support public participation.

Two additional tribal members are added to the Environmental Justice Council for purposes of its CCA-focused duties.

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 PCUs, 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 eight 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 5 cents per gallon becoming law.

Summary of Amended 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 (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 a state statute in effect as of July 1, 2022, 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 by covered or opt-in entities;
- compliance may occur through the transfer of price ceiling units (PCUs), in addition to allowances and offset credits;
- price ceiling units may be used by any covered entity for compliance purposes, rather than just facilities with a compliance obligation;

- 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 July 25, 2021, or within two years prior to that 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.

Climate Commitment Act Accounts and Environmental Justice Provisions.

A Price Ceiling Unit Emission Reduction Investment Account is created to receive receipts from PCU sales. The allowable uses of the Account are the same emission reduction investment allowable uses for funds from PCU sales as specified in the 2021 CCA.

The \$5.2 billion, 16-year limit on deposits into the Carbon Emission Reduction Account (used for specified types of transportation uses) is specified to be measured on a fiscal year basis.

The environmental justice assessment and other environmental justice provisions that apply to the Climate Investment Account, the Carbon Emissions Reduction Account, and the Air Quality and Health Disparities Investment Account also apply to the Climate Commitment Account and the Natural Climate Solutions Account. The duties of the Environmental Justice Council with respect to expenditures from the other accounts created by the CCA are extended to apply to expenditures from the Natural Climate Solutions Account and the Climate Commitment Account. The duties assigned to the Environmental Justice Council in the CCA are enumerated and integrated with the other duties assigned to the Environmental Justice Council.

Other.

The Office of Financial Management (OFM) must submit a report to the Legislature by December 1, 2023, that summarizes:

- other state laws besides the CCA that effectuate GHG emission reductions; and
- other state laws besides the CCA that regulate GHG emissions from stationary sources, including the GHG emission reductions attributable to those laws.

Fifteen specific state laws, including the state Clean Air Act, Clean Fuels Program, and Clean Energy Transformation Act, are listed as topics that the report may address. OFM may contract for all or part of the work product related to the 2023 report

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.

An eligible facility sited after July 25, 2021, that receives no-cost allowance allocations as an emissions-intensive trade-exposed facility 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: Available.

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

Staff Summary of Public Testimony:

(In support) The Climate Commitment Act (CCA) is set to begin implementation in 2023, and the changes in this bill will help resolve conflicts in existing law that might prove a barrier to the program working as intended. Sensitive market information needs to be exempted from public disclosure, both to preserve market integrity and to allow linkage with other climate programs in other states in the future. The changes to the preemption provisions are consistent with the Legislature's intent in enacting last year's law. This bill does not address every remaining policy question with respect to the CCA, such as the treatment of emissions-intensive trade-exposed facility emissions, which are addressed in separate legislation this year. Linkage to other climate programs in other jurisdictions will be important in order to contain CCA program costs. Washington's law should be amended

to support linkage with other jurisdictions in a number of ways. The Department of Ecology should adopt a rule sooner than in 2026 to address the emissions from electricity from centralized electricity markets, since electricity is covered in the first compliance period of the program.

(Opposed) None.

(Other) There should be additional flexibility given to regulated entities to smooth their compliance obligations over a four-year period, in order to account for years in which hydroelectric power generation is low and emissions spike from the need to replace that power. Washington's program design does not need to mirror that of California's in all respects in order to allow for linkage with their program. The emission reductions in the CCA will be unprecedentedly steep beginning in 2023, and it is not clear how a 7 percent reduction in statewide emissions will be able to be achieved by regulated parties. Additional changes to the CCA should be considered in the coming years as the program begins to be implemented in order to address practicality and feasibility issues with compliance. The CCA should be the state's primary greenhouse gas emission program, and should broadly preempt other state programs to regulate covered greenhouse gas emissions. Washington gets food and other products from thousands of miles away, which is an environmental catastrophe not addressed by the CCA due to its exemption for interstate shipping and aviation emissions.

Persons Testifying: (In support) Clare Breidenich, Western Power Trading Forum; Luke Martland, Department of Ecology; Kelly Hall, Climate Solutions; and Isaac Kastama, Clean and Prosperous Washington.

(Other) John Worthington; Jessica Spiegel, Western States Petroleum Association; Peter Godlewski, Association of Washington Business; and John Rothlin, Avista.

Persons Signed In To Testify But Not Testifying: None.