HOUSE BILL REPORT
HB 1975

As Reported by House Committee On:
Environment & Energy
Appropriations

Title: An act relating to amending the climate commitment act by adjusting auction price containment mechanisms and ceiling prices, addressing the department of ecology's authority to amend rules to facilitate linkage with other jurisdictions, and providing for market dynamic analysis.

Brief Description: Amending the climate commitment act by adjusting auction price containment mechanisms and ceiling prices, addressing the department of ecology's authority to amend rules to facilitate linkage with other jurisdictions, and providing for market dynamic analysis.

Sponsors: Representatives Fitzgibbon, Dye and Parshley.

Brief History:

Committee Activity:

Environment & Energy: 2/17/25, 2/20/25 [DPS];
Appropriations: 2/25/25, 2/27/25 [DP2S(w/o sub ENVI)].

Brief Summary of Second Substitute Bill

- Amends price containment mechanisms related to the Climate Commitment Act (CCA) allowance markets, including by amending the allowance price containment reserve and the price ceiling.
- Requires the Department of Ecology to provide analysis and forecasts of the CCA allowance and offset credit markets.

HOUSE COMMITTEE ON ENVIRONMENT & ENERGY

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 21 members: Representatives Doglio, Chair; Hunt, Vice Chair; Dye, Ranking

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.

Minority Member; Klicker, Assistant Ranking Member; Abbarno, Abell, Barnard, Berry, Duerr, Fey, Fitzgibbon, Kloba, Ley, Mena, Mendoza, Ramel, Stearns, Street, Stuebe, Wylie and Ybarra.

Staff: Jacob Lipson (786-7196).

Background:

State Emission Limits.

The United States Environmental Protection Agency (EPA) and the Department of Ecology (Ecology) identify carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, and sulfur hexafluoride as greenhouse gases (GHGs) because of their capacity to trap heat in the Earth's atmosphere. According to the EPA, the global warming potential (GWP) of each 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 to the emission of an identical volume of carbon dioxide over a 100-year timeframe (carbon dioxide equivalent or CO2e).

Since 2008 state law has established limits on the emission of GHGs in Washington. 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.

In order to ensure that GHG emissions are reduced consistent with the state's 2030, 2040, and 2050 emissions limits under the 2021 Climate Commitment Act (CCA), 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) commenced on January 1, 2023.

The Program:

- establishes annual allowance budgets that limit emissions from covered entities;
- defines those entities covered by the Program (covered entities), those entities that may voluntarily opt-in to coverage under the Program (opt-in entities) and other

persons that participate in auctions or allowance markets by purchasing, holding, selling, or voluntarily retiring compliance instruments (general market participants);
- provides for the distribution of emissions allowances at no cost to certain covered entities, or by purchase at auction;
- provides for offset credits as a method for meeting compliance obligations;
- defines the compliance obligations of covered entities;
- provides 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
- provides monitoring and oversight of the sale and transfer of allowances.

<u>Linkage with Other Jurisdictions</u>.
Ecology must seek to link the Program with the programs of other jurisdictions in order to achieve specified objectives. The state of California and the Canadian province of Quebec currently have a linked, combined carbon emission market that functions, in many respects, in a manner similar to the Program implemented by Ecology. The Director of Ecology (Director) is authorized to execute linkage agreements with other jurisdictions with established external GHG emissions trading programs. Prior to finalizing a linkage agreement, Ecology must follow a specified process and must determine that the linkage agreement will satisfy a specified series of standards. In 2023 the Director made a preliminary determination to pursue linkage with California and Quebec's carbon emission markets, but as of February 2025, a linkage agreement has not yet been finalized.

<u>Climate Commitment Act Allowance Budgets and Compliance Periods</u>.
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. Under Ecology's rules adopted to implement the Program, the allowance budgets are set to be reduced:
- by 7 percent each year between 2023 and 2030;
- by 1.8 percent from 2031 to 2042; and
- by 2.6 percent each year from 2043 to 2049.

Compliance obligations under the Program are phased in over the following four-year compliance periods:
- The first compliance period is 2023 through 2026.
- The second compliance period is 2027 through 2030.
- There will be subsequent four-year compliance periods beginning in 2031.

However, if Ecology enters into a linkage agreement, and the linked jurisdictions do not amend their rules to synchronize with Washington's compliance periods, Ecology must amend its CCA rules to synchronize Washington's compliance periods with those of the linked jurisdictions.

<u>Climate Commitment Act Allowance Auctions, Compliance Obligations, Price</u>

Containment.

Except for 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. Specific entities are limited in the number of allowances that they may hold at once or may purchase at a single 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.

To help minimize allowance price volatility in an auction, the Program's rules establish 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. The program establishes 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.

The Program also includes mechanisms to limit extraordinary prices and that determine when to offer allowances through Allowance Price Containment Reserve (APCR) auctions. 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. Ecology has the discretion to determine, by rule, the number of allowances to be placed in the APCR after the first compliance period. The APCR must be designed to assist in containing compliance costs for covered and opt-in entities in the event of unanticipated high costs for compliance instruments. Auctions of allowances from the APCR must be held, separate from other CCA auctions, when the settlement prices in the preceding auction approach the adopted auction ceiling price. By rule, Ecology has established two tiers of prices at which bidders may bid for allowances in the APCR: in 2025, the first tier of allowances from the APCR are to be sold at $60.43, and the second tier of allowances are to be sold at $77.63. The APCR tier prices increase by 5 percent plus the rate of inflation annually.

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. The PCUs 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. The price ceiling must be set at a level sufficient to facilitate investments to achieve further emission reductions beyond those enabled by the price ceiling, with the stated intent that investments facilitate the state's achievement of GHG emission limits. The price ceiling increases, in proportion to the APCR price floor, at a rate of 5 percent per year plus inflation. For 2025 Ecology set the price ceiling at $94.85. Revenues from PCU sales must be placed into a Price Ceiling Unit Emissions Reduction Investment Account and must be expended to achieve emission reductions that are real, permanent, quantifiable, verifiable, and enforceable.

Summary of Substitute Bill:

Ecology is required to provide analysis and forecasts of the market for allowances and offset credits, including prices in primary and secondary markets, trends in supply and demand, market activities categorized by type of participant, and the share of the Program's allowance budget consumed by categories of market participants.

The directive to Ecology to establish Program allowance budgets that reduce the emissions of covered entities necessary to achieve the 2030, 2040, and 2050 statewide emissions limits are specified to apply by December 31 of each of those years.

Ecology must place between 2 and 5 percent of allowances from the allowance budgets for the years 2027 through 2040 into the APCR. Ecology must amend its rules that establish the schedule of allowance allocations to the APCR to make available, in the second compliance period of the CCA, all allowances scheduled to be placed in the APCR through 2040.

The price ceiling for calendar years 2026 and 2027 is set at $80. Ecology is no longer directed to set the price ceiling at a level sufficient to facilitate investments in emission reductions beyond those enabled by the price ceiling, but is still required to increase the price ceiling annually in proportion to the reserve auction floor price and must adjust the allowance price containment reserve tier prices to reflect the 2026 and 2027 price ceiling. If Ecology enters into a linkage agreement, and linked jurisdictions do not amend their price ceiling to synchronize with Washington's price ceiling, Ecology may amend its rules to synchronize the price ceiling with those of the linked jurisdictions. The price ceiling may not be set at a level below $80 plus annual increases relative to the APCR price floor, unless Ecology determines that amending the price ceiling is necessary to enter into a linkage agreement.

Substitute Bill Compared to Original Bill:

The substitute provides for the CCA's price ceiling to be set at $80 for calendar 2027, in addition to 2026, and requires Ecology to adjust the allowance price containment reserve tier prices to reflect the new 2026 and 2027 price ceiling.

Appropriation: None.

Fiscal Note: Requested on February 13, 2025.

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) This legislation is aimed at ensuring that allowance markets retain liquidity in the second compliance period between 2027 and 2030, and to make sure allowance prices do not rise too fast for regulated parties to manage. The current operational costs of the CCA are about 43 cents per gallon of gas and 52 cents per gallon of diesel. Linkage with other jurisdictions will help ease allowance prices, but the price relief offered by linkage has not been experienced in the market yet. This proposal will help provide some short-term allowance price relief while the longer-term goal of linkage, which might take several years to carry out, is in the process of being implemented. Economic analysis of allowance markets will help stakeholders evaluate the success of the program, and whether changes are warranted.

(Opposed) None.

(Other) The Cap-and-Invest Program is the primary component of the state's climate policy, and was recently protected by state voters at the ballot box. It would be useful to have Ecology analyzing allowance markets. Linkage with the programs of other jurisdictions is expected to help relieve allowance prices in coming years. This proposal might be allotting too many future reserve allowances for use in the short-term, especially based on currently available market forecasts and expectations about the availability of banked allowances from the programs in other jurisdictions. Market analysis is needed before deciding to reduce the price ceiling to $80 in 2026. This proposal should not remove Ecology's ability to flexibly respond to allowance market conditions.

Persons Testifying: (In support) Representative Joe Fitzgibbon, prime sponsor; Jessica Spiegel, WSPA; Isaac Kastama, Clean and Prosperous Washington; and Peter Godlewski, Association of Washington Business.

(Other) Leah Missik, Climate Solutions; David Mendoza, The Nature Conservancy; Caitlin Krenn, Washington Conservation Action; and Joel Creswell, Washington State Department of Ecology.

Persons Signed In To Testify But Not Testifying: None.

HOUSE COMMITTEE ON APPROPRIATIONS

Majority Report: The second substitute bill be substituted therefor and the second substitute bill do pass and do not pass the substitute bill by Committee on Environment & Energy. Signed by 30 members: Representatives Ormsby, Chair; Gregerson, Vice Chair; Macri, Vice Chair; Couture, Ranking Minority Member; Connors, Assistant Ranking Minority Member; Penner, Assistant Ranking Minority Member; Schmick, Assistant Ranking Minority Member; Berg, Bergquist, Burnett, Caldier, Corry, Cortes, Doglio, Dye, Fitzgibbon, Keaton, Leavitt, Lekanoff, Manjarrez, Marshall, Peterson, Pollet, Rude, Ryu, Springer, Stonier, Street, Thai and Tharinger.

Staff: Dan Jones (786-7118).

Summary of Recommendation of Committee On Appropriations Compared to Recommendation of Committee On Environment & Energy:

The second substitute bill:
- eliminates the directive to Ecology to adjust the tier 1 allowance price containment reserve price to reflect the 2026 and 2027 statutory price ceiling of $80;
- requires Ecology to periodically perform economic modeling of the program that includes both baseline models and additional modeling scenarios, with initial modeling results to be posted on Ecology's website by December 2026, and updated results in 2027 and every two years thereafter; and
- makes the bill null and void if specific funding is not provided in the operating budget by June 30, 2025.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Second Substitute Bill: The bill takes effect 90 days after adjournment of the session in which the bill is passed. However, the bill is null and void unless funded in the budget.

Staff Summary of Public Testimony:

(In support) The bill makes modest changes that would introduce greater liquidity in the market and bring forward many of the anticipated benefits of linkage. Analysis of the secondary market will become increasingly important over time. The change to the allowance price containment reserve tier 1 price should be removed. The bill would increase allowance price stability. Washington's climate program has had a greater impact on gas prices than California's program and the bill would help with fuel affordability.

(Opposed) None.

Persons Testifying: Representative Joe Fitzgibbon, prime sponsor; Isaac Kastama, Clean and Prosperous Washington; Peter Godlewski, Association of Washington Business; and Jessica Spiegel.

Persons Signed In To Testify But Not Testifying: None.