SENATE BILL REPORT
2SHB 1975

As of March 18, 2025

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: House Committee on Appropriations (originally sponsored by Representatives Fitzgibbon, Dye and Parshley).

Brief History: Passed House: 3/10/25, 84-11.
Committee Activity: Environment, Energy & Technology: 3/19/25.

Brief Summary of Bill

- Directs the Department of Ecology to analyze the Cap-and-Invest Program's (Program) compliance instrument markets and perform economic modeling.
- Adjusts cost containment mechanisms in the Program, including the price ceiling and allowance price containment reserve.

SENATE COMMITTEE ON ENVIRONMENT, ENERGY & TECHNOLOGY

Staff: Matt Shepard-Koningsor (786-7627)

Background: Greenhouse Gases and State Greenhouse Gas Emission Limits. The United States Environmental Protection Agency (EPA) and the Department of Ecology (Ecology)

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identify carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, sulfur hexafluoride, as greenhouse gases (GHGs) because of their capacity to trap heat in the Earth's atmosphere. The global warming potential 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 global warming potential 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 (CO2e).

Since 2008, state law has established limits on the emissions of GHGs in Washington. Ecology is responsible for monitoring and tracking the state's progress in achieving the emissions limits. 2020 legislation updated the statewide emissions limits as follows:

- by 2020, reduce overall emissions of GHGs in the state to 1990 levels, or 90.5 million metric tons of CO2e (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.

<u>Cap-and-Invest Program.</u> *Generally.* In 2021, as part of the Climate Commitment Act (CCA), the Legislature directed Ecology to implement a Cap-and-Invest Program (Program), which is a market-based system designed to achieve the GHG emission limits set in state law. At a high level, the Program requires Ecology to set a limit, or cap, on statewide GHG emissions, which declines over time consistent with the state GHG emission limits. Covered entities must either reduce their emissions or obtain allowances or offset credits (compliance instruments) equal to their covered emissions during each Program compliance period. Other entities may opt-in to comply with the Program. Allowances are obtained through state auctions, provided for free to certain entities, and transacted between entities, including through secondary allowance markets. Offset credits are transacted between entities and are subject to several other requirements. One compliance instrument represents one metric ton of CO2e emissions.

Compliance Period. The Program currently operates within four-year compliance periods, with the first compliance period occurring between January 1, 2023, and December 31, 2026, the second compliance period occurring between January 1, 2027, and December 31, 2030, and so on, until December 31, 2049. Compliance periods may change if Washington enters into a linkage agreement with other jurisdictions.

Annual Allowance Budget. Ecology determines the annual allowance budget—the total number of allowances offered in a particular calendar year—based on a calculation adopted in rule and which is dependent on other factors. For the first compliance period, the annual allowance budgets are as follows:

- 2023—63,288,565 allowances;
- 2024—58,524,909 allowances;
- 2025—53,761,254 allowances; and
- 2026—48,997,596 allowances.

Allowance Auctions and Cost Containment Mechanisms. There are four regular allowance auctions (regular auction) held each year, where a portion of the allowances from the annual allowance budget are offered for sale to registered entities. In some regular auctions, there are additional allowances offered for sale, including allowances from future allowance budgets and allowances consigned by certain utilities. A covered entity, an opt-in entity, and a general market participant may register and participate in a regular auction, but different purchase and holding limits apply to these entities. The auction settlement price is the lowest accepted bid price and is the price all successful bidders pay.

Since February 2023, there have been nine regular auctions with settlement prices for current year allowances ranging from $25.76 to $63.03. Auction nine, held in March 2025, had a settlement price for current year allowances of $50.00.

To help minimize allowance price volatility and provide cost protection for covered entities, the Program requires Ecology to set an auction floor price and a price ceiling. The auction floor price must increase by a predetermined amount each year, which Ecology rules specify is by 5 percent and adjusted for inflation. The price ceiling must increase annually in proportion to the auction floor price. The 2025 auction floor price is $25.85 and the price ceiling is $94.85.

Ecology must also set a reserve auction floor price, which determines when an allowance price containment reserve (APCR) auction must occur. Ecology sets a Tier 1 and Tier 2 auction reserve floor price, which is adjusted annually by 5 percent and for inflation. The 2025 auction reserve floor prices are: Tier 1—$60.43; and Tier 2—$77.63.

During the first compliance period, between 2023 and 2026, Ecology must place no less than 2 percent of the total number of allowances from the annual allowance budgets in those years in an APCR Account. After the first compliance period, Ecology must adopt rules establishing the number of allowances to be placed in the APCR Account. Ecology is currently placing 5 percent of the allowances in the annual allowance budgets for each year of the first and second compliance periods in the APCR Account. Allowances in the APCR Account are offered for sale through APCR auctions, which are separate from regular auctions and operate with different requirements. An APCR auction is held:
- following any quarter in which the auction settlement price is at or above the Tier 1 price;
- when a new covered or opt-in entity enters the Program and allowances from the Emissions Containment Reserve Account are exhausted; and
- before each annual compliance deadline.

Under certain circumstances, when no allowances remain in the APCR Account after the last APCR auction before a compliance period deadline, Ecology must issue the number of price ceiling units sufficient to provide cost protection for covered entities to comply with the Program. These units must be sold at the applicable ceiling price.

Linkage with Other Jurisdictions. In 2021, the CCA directed Ecology to explore linkage with other jurisdictions with external GHG emissions trading programs with the goals of reducing the cost of compliance and Program administration, enhancing market security, and providing consistent requirements for entities operating in numerous jurisdictions. Several specified provisions of linkage were included, relating to, in part, holding limits, reporting, and public notice. Ecology was also directed to provide agency-request legislation if it found any CCA provision prevented linking the Program with another jurisdiction. California and Quebec have operated a joint carbon market since 2014, which is approximately six times larger than Washington's.

Ecology's proposed agency-request legislation facilitating linkage was enacted in 2024. The legislation, among several other things, authorized Ecology to synchronize the Program with another jurisdiction's by modifying the length of compliance periods, auction purchase limits, and allowance holding limits. It also contained several provisions related to electricity importing and offset projects.

In 2024, Washington, California, and Quebec issued joint statements expressing mutual interest in linking carbon markets. According to Ecology, linkage is a multi-step process that includes opportunities for public input, and it expects to enter into a linkage agreement in 2026, which would link the markets in 2026 or 2027. Each jurisdiction is currently amending its Program.

Summary of Bill: <u>Compliance Instrument Market Analysis and Forecasting.</u> Ecology must provide analysis and forecasts of the Program's compliance instrument markets, including:

- the prices in primary and secondary compliance instrument markets;
- trends in compliance instrument supply and demand, and prices;
- activities in the markets, categorized by type of market participant; and
- the share of the allowance budget consumed by various categories of registered entities.

Ecology must consider the analysis in adopting rules and implementing requirements under the CCA.

<u>Economic Modeling.</u> Ecology must periodically perform economic modeling to analyze design features of the Program. The analysis must include a baseline model assuming implementation of complementary emission reduction measures and additional modeling scenarios Ecology staff deem necessary. The additional modeling scenarios must include current available technology and known adoption rates to better understand how to

administer the Program.

By December 31, 2026, Ecology must include a modeling scenario reflecting linkage with other jurisdictions. Ecology must post the economic modeling results on its website by December 31, 2026, and post updated results by December 31, 2027, and by December 31st every two years thereafter.

Economic modeling results posted by Ecology must contain:
- an estimate of Program benefits including the total social cost of carbon;
- an estimate of the compliance costs for regulated sectors;
- Ecology's identification of Program design features contributing toward achieving Washington's emission reduction limits; and
- a description of assumptions, policy decisions, and model design used in the baseline and each additional modeling scenario.

Annual Allowance Budgets. For the purposes of Ecology: setting annual allowance budgets to achieve the applicable emission reduction limits in state law; adopting allowance budgets on a calendar year basis providing progressively equivalent reductions year-over-year; and adjusting allowance budgets based on its review of the Program after the third compliance period, the emission reduction limits apply as of December 31, 2030, 2040, and 2050.

Price Ceiling Modification. The price ceiling for calendar years 2026 and 2027 must be $80. If Ecology enters into a linkage agreement, and the linked jurisdictions do not amend their rules to synchronize with the $80 price ceiling, Ecology may amend its rules to synchronize Washington's price ceiling with those of the linked jurisdictions. The price ceiling may not be set below $80 unless Ecology determines it is necessary to enter into a linkage agreement.

Allowance Price Containment Reserve Allowances and Prices. Ecology must place no less than 2 percent and no more than 5 percent of the total number of allowances from the 2027-2040 allowance budgets in the APCR, which must be placed in the APCR and made available in the second compliance period, beginning in 2027.

Ecology must adjust the APCR Tier 2 price to reflect the 2026 and 2027 price ceiling of $80.

Other. The legislation contains a state severability clause.

Appropriation: The bill contains a null and void clause requiring specific funding be provided in an omnibus appropriation act.

Fiscal Note: Available.

Creates Committee/Commission/Task Force that includes Legislative members: No.

Effective Date: Ninety days after adjournment of session in which bill is passed.