

WSR 23-19-007

PROPOSED RULES

DEPARTMENT OF ECOLOGY

[Order 23-02—Filed September 7, 2023, 9:40 a.m.]

Original Notice.

Preproposal statement of inquiry was filed as WSR 23-13-007.

Title of Rule and Other Identifying Information: WAC 173-446-150 Accounts for registered entities and 173-446-370 Allowance price containment reserve account.

Hearing Location(s): On October 24, 2023, at 10:00 a.m., via webinar. Join online and see instructions <https://waecy-wa-gov.zoom.us/meeting/register/tZEsdEypRDMsE9L6Qk4Y4SDv0YnuuvOwAP83>. Presentation and question and answer session followed by the hearing. This is an online meeting that you can attend from any computer using internet access.

Date of Intended Adoption: February 21, 2024.

Submit Written Comments to: Nikki Harris, Department of Ecology, Climate Pollution Reduction Program, P.O. Box 47600, Olympia, WA 98504-7600, email nikki.harris@ecy.wa.gov, <https://aq.ecology.commentinput.com?id=7VWB4Jcsg>, by November 1, 2023.

Assistance for Persons with Disabilities: Contact Nikki Harris, phone 360-764-6018, speech disability call TTY 877-833-6341, impaired hearing call Washington relay service 711, email nikki.harris@ecy.wa.gov, by November 1, 2023.

Purpose of the Proposal and Its Anticipated Effects, Including Any Changes in Existing Rules: Ecology is making two clarifications to the rules governing the cap and invest program under chapter 70A.65 RCW (chapter 173-446 WAC). These rule clarifications concern the operation of the allowance price containment reserve (APCR). Ecology will make two rule changes to clarify:

1. That the existing holding limits specified in WAC 173-446-150 (2)(a) that apply to allowances with a "vintage" also apply to the "vintage less" allowances that are acquired through APCR auctions. "Vintage year" means the annual allowance allocation budget year to which an individual Washington greenhouse gas (GHG) allowance is assigned. This means that one entity can hold only a certain number of allowances in its account at a time.

2. Adding language to WAC 173-446-370 to clarify that any allowances purchased in an APCR auction must be deposited directly into the entity's compliance account. This change would prevent those allowances from being sold or traded on the secondary market, thereby ensuring that the allowances will be used to meet compliance obligations and not for speculative purposes.

We have also adopted emergency rules on this subject. Please visit our website for information and to participate in the permanent rule-making process <https://ecology.wa.gov/regulations-permits/laws-rules-rulemaking/rulemaking/wac-173-446-apcr>.

Reasons Supporting Proposal: The cap and invest program under chapter 70A.65 RCW establishes an emissions trading market intended to help meet the state's emission limits specified in RCW 70A.45.020. The program relies on a well-functioning market to discover the appropriate price for allowances, thereby efficiently allocating GHG emission reductions while minimizing overall costs to the economy and consumers. In order to ensure the program works as designed, ecology is required to adopt measures to maintain the integrity of the market and prevent market manipulation. This rule making clarifies that APCR al-

allowances are subject to holding limits and can only be used for compliance. These changes limit the number of APCR allowances an entity may hold at any given time and ensure that APCR allowances cannot be further traded. Without this rule making, the cap-and-invest rules lack clarity on the nature of APCR allowances. Some entities might think that one entity would be able to hold an unlimited number of APCR allowances, and would be able to trade those allowances, giving that entity sufficient market power to unfairly manipulate the market while undermining the purpose of the APCR, which is to assist in containing compliance costs for covered and opt-in entities. This rule making is therefore necessary to ensure market integrity and achieve GHG emissions reductions in an economically efficient manner. Without this rule making, the market could be distorted, allowing an inefficient distribution of allowances, which could be sold at distorted prices. This market distortion could affect not only program participants but consumers more generally.

Statutory Authority for Adoption: Chapter 70A.65 RCW, Greenhouse gas emissions—Cap and invest program.

Statute Being Implemented: Chapter 70A.65 RCW, Greenhouse gas emissions—Cap and invest program.

Rule is not necessitated by federal law, federal or state court decision.

Name of Proponent: Washington state department of ecology, governmental.

Name of Agency Personnel Responsible for Drafting, Implementation, and Enforcement: Luke Martland, Lacey, Washington, 360-764-3666.

A school district fiscal impact statement is not required under RCW 28A.305.135.

A cost-benefit analysis is required under RCW 34.05.328. A preliminary cost-benefit analysis may be obtained by contacting Nikki Harris, Department of Ecology, Climate Pollution Reduction Program, P.O. Box 47600, Olympia, WA 98504-7600, phone 360-764-6018, email nikki.harris@ecy.wa.gov.

This rule proposal, or portions of the proposal, is exempt from requirements of the Regulatory Fairness Act because the proposal:

Is exempt under RCW 19.85.025(4).

Scope of exemption for rule proposal:

Is fully exempt.

The proposed rule does impose more-than-minor costs on businesses.

Small Business Economic Impact Statement

This information is excerpted from ecology's complete set of regulatory analyses for this rule making. For complete discussion of the likely costs, benefits, minimum compliance burden, and affected entities, see the associated Regulatory Analyses document (Ecology publication no. 23-02-093, September 2023).

The proposed rule amendments are not likely to result in costs or benefits as compared to the baseline, considering the following in conjunction with the baseline rule:

- The Climate Commitment Act's law requirements for consistency and for prevention of market manipulation.
- The intended contents of compliance and holding accounts.
- Which parties may participate in APCR auctions under the baseline (covered and opt-in entities).

- Differentiation between attributes of allowances from the APCR and regular auction allowances.
- The purpose of APCR auctions being intended to allow covered and opt-in entities to purchase additional allowances needed for compliance at a reasonable price.
- Attributes of other jurisdictions' allowances from reserves with no vintage.

In the absence of the above considerations, we also do not expect the proposed rule to result in costs to small businesses. During the initial rule making for the baseline rule, we chose to complete the requirements under the Regulatory Fairness Act (RFA) out of an abundance of caution, though it was not likely that small businesses would incur compliance costs under the rule (see Washington Department of Ecology, 2022. Final regulatory analyses for chapter 173-446 WAC, Climate Commitment Act program. Ecology publication no. 22-02-047. September 2022. See Chapter 7 for discussion of business sizes). In the current rule making, and using the alternative interpretation that does not account for the above considerations, a business that could potentially incur costs would likely be large and have significant resources and assets to be able to make additional strategic purchases of allowances from the APCR.

As the proposed rule amendments are not likely to impose compliance costs on small businesses, this rule making is exempt from the requirements of the RFA under RCW 18.85.025(4), which states, "This chapter does not apply to the adoption of a rule if an agency is able to demonstrate that the proposed rule does not affect small businesses."

A copy of the statement may be obtained by contacting Nikki Harris, Department of Ecology, Climate Pollution Reduction Program, P.O. Box 47600, Olympia, WA 98504-7600, phone 360-764-6018, email nikki.harris@ecy.wa.gov.

September 7, 2023
Heather R. Bartlett
Deputy Director

OTS-4563.1

AMENDATORY SECTION (Amending WSR 22-20-056, filed 9/29/22, effective 10/30/22)

WAC 173-446-150 Accounts for registered entities. (1) Creation of accounts.

(a) After ecology receives the required disclosures of corporate association and complete documents for the certification and designation of the primary and alternate account representatives, ecology will set up two accounts for each covered entity and two accounts for each opt-in entity:

(i) A compliance account through which compliance instruments are transferred to ecology for retirement. Compliance instruments in compliance accounts may not be sold, transferred, traded, or otherwise provided to another account or party.

(ii) A holding account for compliance instruments that may be bought, sold, transferred to another registered entity, or traded.

(b) For each electric utility and each natural gas utility registering in the program, ecology will also set up a limited use holding account. Electric utilities and natural gas utilities must transfer their no cost allowances to the limited use holding account in order to consign them to auction for the benefit of ratepayers as described in WAC 173-446-300 (2) (b).

(c) After ecology receives the required disclosures of corporate association and complete documents for the certification and designation of the primary and alternate account representatives, ecology will set up a holding account for each general market participant.

(2) Holding limits.

(a) Except as provided in (c) and (d) of this subsection, the maximum total number of allowances of the current (~~(0#)~~) vintage, prior vintage, or that have no vintage, that a registered entity may hold in its holding account, its compliance account, or combination of both, is determined by the following:

$$HL_i = 0.1 \times 25,000,000 + 0.025 \times (C_i - 25,000,000)$$

Where:

HL_i = holding limit for year i
C_i = annual allowance budget for year i
i = current year

(b) Except as provided in (c) and (d) of this subsection, the maximum number of allowances of each vintage subsequent to the current year that a registered entity may hold in its holding account, its compliance account, or a combination of both, is determined by the following:

$$HL_j = 0.1 \times 25,000,000 + 0.025 \times (C_j - 25,000,000)$$

Where:

HL_j = holding limit for year j
C_j = annual allowance budget for year j
j = year subsequent to the current year

(c) The holding limits set in (a) and (b) of this subsection do not apply to the allowances held in the compliance account of a covered entity or opt-in entity that are needed to cover estimated GHG emissions for the current year or emissions for preceding years.

(d) The holding limits set in (a) and (b) of this subsection do not apply to allowances held in a limited use holding account that are to be consigned to auction.

(e) In addition to the holding limits described above, a general market participant may not in aggregate hold more than 10 percent of the total number of allowances of any vintage year.

(f) A registered entity that reaches or exceeds one-half of its holding limit must, within 10 business days of a request from ecology, explain its strategy and the reason for holding the allowances.

(g) When its holding limit is exceeded, a registered entity must, within five business days after the limit is exceeded, divest itself of the excess emission allowances, transfer into its compliance account the number of allowances needed to cover its emissions for the current year or preceding years, or, in the case of consolidated entities, amend the distribution of the overall holding limit to become compliant. If a registered entity fails to comply with this require-

ment, ecology will withdraw the excess allowances and make them available for auction.

(3) Ecology will post anonymized information about the contents of each holding account including, but not limited to, the number of allowances in the account, on ecology's cap and invest public website. Ecology will also maintain on its website a public roster of all covered entities, opt-in entities, and general market participants.

(4) When the ownership of a registered entity changes, the following information must be submitted to ecology within 30 calendar days of finalization of the ownership change:

(a) A description of the merger or acquisition and the effective date of the change of ownership, including whether the merger or acquisition is the purchase of a registered entity or entities from another party or the purchase of a party that owns a registered entity or entities;

(b) Both the legal and operating names and the tracking system IDs of the parties owning the registered entity or entities prior to the change in ownership;

(c) The legal name, operating name, and the tracking system ID of the purchasing party, if any;

(d) Written direction regarding whether the purchased registered entity or entities will be added to a consolidated entity account or whether the purchased registered entity or entities will be associated with a party that will opt out of account consolidation;

(e) Documentation with signatures (original or electronic) by a director or officer from the seller of the registered entity or entities, the registered entity or entities, and from the purchasing party, notifying ecology of the change of ownership;

(f) Any changes to disclosures or new disclosures required under WAC 173-446-110, 173-446-120, and 173-446-130;

(g) Direction regarding the disposition of compliance instruments that must be transferred by ecology to the purchasing party. Compliance instruments can be transferred. Any administrative transfers required may be requested as a one-time occurrence scheduled to occur within five business days after the facility or facilities are transferred in the tracking system to the purchasing party;

(h) It is the responsibility of the parties participating in the change of ownership to transfer any compliance instruments from tracking system holding accounts that they control prior to closure. Prior to closure, ecology may transfer compliance instruments from a registered entity's compliance account to its holding account upon request by the registered entity. If a party no longer owns or operates any active registered entity in its tracking system account due to a change in ownership, then that party may exit the program and close its tracking system accounts within five business days after the registered entity or entities are transferred in the tracking system to the purchasing party.

[Statutory Authority: RCW 70A.65.220. WSR 22-20-056 (Order 21-06), § 173-446-150, filed 9/29/22, effective 10/30/22.]

AMENDATORY SECTION (Amending WSR 22-20-056, filed 9/29/22, effective 10/30/22)

WAC 173-446-370 Allowance price containment reserve account.

(1) Ecology shall maintain an allowance price containment reserve account.

(a) Allowances in the allowance price containment reserve have no vintage and are therefore eligible to be submitted for compliance at any time.

(b) Allowances purchased from the allowance price containment reserve are placed directly into the purchaser's compliance account.

(c) On January 1, 2023, ecology shall place into the allowance price containment reserve account:

(i) Five percent of the allowances in the annual allowance budgets for each year of the first compliance period; and

(ii) Five percent of the allowances in the annual allowance budgets for each year of the second compliance period, as determined without taking into account the increase in the allowance budgets caused by the addition of waste-to-energy facilities as covered entities in the second compliance period.

(2) Ecology shall hold separate auctions for allowances from the allowance price containment reserve:

(a) When the settlement price in the preceding auction of current and prior vintage allowances reaches the Tier 1 price for allowances in the allowance price containment reserve;

(b) When new covered and opt-in entities enter the program and allowances from the emissions containment reserve account are exhausted; and

(c) Once each year before the compliance deadline.

(3) Only covered entities and opt-in entities may participate in allowance price containment reserve auctions. General market participants may not participate in allowance price containment reserve auctions.

(4) Allowance price containment reserve auctions shall follow the procedures described in WAC 173-446-310 through 173-446-362, except:

(a) The purchase limits in WAC 173-446-330 do not apply to allowance price containment reserve auctions.

(b) In place of an auction floor price, there are two tiers of allowance prices at which bidders may bid:

(i) Tier 1 price for 2023 shall be \$46.05 increased by five percent plus the rate of inflation as measured by the most recently available 12 months of the consumer price index for all urban consumers as of the first business day in December of 2022.

(ii) Tier 2 price for 2023 shall be \$59.17 increased by five percent plus the rate of inflation as measured by the most recently available 12 months of the consumer price index for all urban consumers as of the first business day in December of 2022.

(iii) The allowance price containment reserve tier prices for a year after 2023 shall be the allowance price containment tier prices for the prior calendar year increased annually by five percent plus the rate of inflation as measured by the most recently available 12 months of the consumer price index for all urban consumers as of the first business day in December of the prior year.

(iv) Beginning in 2022, on the first business day in December of each year, ecology shall announce the allowance price containment reserve tier prices for the next year.

(c) Bidders in an allowance price containment reserve auction may submit multiple bids. Each bid must be at either the Tier 1 price or the Tier 2 price.

(d) Tier 1 allowances shall be sold first, then Tier 2 allowances. The auction of Tier 1 allowances shall continue until all Tier 1 allowances are sold or all bids are filled, whichever occurs first. If any Tier 1 allowances remain, ecology will award them to bidders for Tier 2 allowances at the Tier 1 price using a random number selection process that assigns random numbers to each lot bid and awards Tier 1 allowances starting with the lowest random number until all Tier 1 allowances are sold. The subsequent auction of Tier 2 allowances shall continue until all Tier 2 allowances are sold or all bids are filled, whichever occurs first.

(e) Ecology shall reject bids or portions of bids, starting with the smallest of the registered entity's Tier 2 bids, until the total of the registered entity's bids remaining would, if accepted, not result in contravention of a holding limit.

(f) The registered entity's actual maximum bid value is determined as follows:

(i) Multiply the Tier 1 bid price by the total number of allowances the registered entity proposed to purchase at that bid price.

(ii) Multiply the Tier 2 bid price by the total number of allowances the registered entity proposed to purchase at that bid price.

(iii) The registered entity's actual maximum bid value is the sum of the results obtained in (i) of this subsection added to the results obtained in (ii) of this subsection.

(g) If the actual maximum bid value of a registered entity's bids exceeds the value of the registered entity's bid guarantee, ecology shall, starting with the registered entity's Tier 2 bids, remove enough lots, such that the remaining bids would not result in the actual maximum bid value exceeding the value of the bid guarantee.

(h) If the sum of the bids accepted for a tier is greater than the number of allowances in the tier, ecology will follow the process in WAC 173-446-357(5) to distribute the allowances from each tier.

(i) After a sale, ecology will transfer purchased allowances directly to each purchaser's compliance account.

(j) Allowances remaining unsold at the end of an allowance price containment reserve auction remain in the allowance price containment reserve to be available for sale at the next allowance price containment reserve auction.

[Statutory Authority: RCW 70A.65.220. WSR 22-20-056 (Order 21-06), § 173-446-370, filed 9/29/22, effective 10/30/22.]