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**HOUSE BILL 1659**

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**State of Washington 68th Legislature 2023 Regular Session**

**By** Representatives Dye and Klicker

AN ACT Relating to preventing carbon market price manipulation; amending RCW 70A.65.290 and 70A.65.100; adding a new section to chapter 43.09 RCW; creating new sections; and providing an expiration date.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

NEW SECTION. **Sec.**  (1) The legislature recognizes that following the stock market crash of 1929, the public lost confidence in United States markets. In 1933, congress passed the securities act and in 1934 it passed the securities exchange act. The purpose of these laws was to require companies offering securities for sale to the public to be truthful and transparent about their business, the securities they are selling, and the risks involved in investing in those securities. The laws also required those who sell to treat investors fairly and honestly. The securities exchange act established the securities and exchange commission as an independent regulator to protect investors, maintain fair and efficient markets, and facilitate capital formation. Reflecting on this history, the legislature wishes to maintain, and never lose, the confidence of the public in the functioning of Washington state's first multibillion dollar market of regulatory compliance instruments, which has been created under the climate commitment act. The legislature wishes to study how an independent oversight agency might be best structured to maintain public confidence and prevent market manipulation and bidder collusion. The legislature also wishes to study whether the early years of carbon market operations result in any suboptimal outcomes that would negatively impact Washington consumers in the form of artificially or inordinately high energy and consumer good prices, beyond the substantial price increases that the programs, even when functioning as intended, have been forecast to cause.

(2) The legislature is concerned that the department of ecology is not well suited to police the market and proactively report on any shortcomings that may arise. The department of ecology, consistent with the express and unequivocal priorities of the governor, has advocated before the committees of the legislature for the establishment of the cap and invest program it is now tasked with overseeing and will gain dozens of new full-time equivalent employees to administer this program. It is understandable that department of ecology employees may find it difficult to report news about the cap and invest program that may reflect poorly on its administration of the program or the success of a featured policy initiative championed by those that fund and administer the department. Furthermore, the legislature observes that the department of ecology has no expertise in regulating a billion dollar market in tradeable compliance instruments. It is due to this very lack of expertise that the department of ecology is contracting with a third-party entity to actually run the allowance auctions. For these reasons, it is the intent of the legislature to:

(a) Establish and structure an independent agency for oversight of the market, and integrate it into the existing cap and invest program;

(b) Study mechanisms to guard against bidder collusion and market manipulation;

(c) Thoroughly audit the program's functioning at the conclusion of the first compliance period; and

(d) Ensure that the existing exemption from public disclosure under the climate commitment act does not preclude the release of key information that will allow the public to judge whether the carbon market is functioning with integrity and in a manner that does not result in artificial inflation of consumer prices.

NEW SECTION. **Sec.**  (1) By December 1, 2024, the Washington state institute for public policy must submit a report to the appropriate committees of the legislature that:

(a) Recommends criteria for the legislature to consider in the future establishment of an office, agency, or entity independent from the department of ecology that will be assigned duties for the regulation and oversight of the compliance instrument auctions and markets created by chapter 70A.65 RCW. The primary mission of such an office, agency, or entity is to ensure fair, efficient, and orderly functioning in the markets created by chapter 70A.65 RCW. The recommendations for the establishment of an office, entity, or agency must consider how to maximize its independence from other environmental regulatory agencies and ensure its neutrality with respect to the greenhouse gas emissions reduction policy outcomes intended to be achieved by the program; and

(b)(i)(A) Addresses how other jurisdictions with greenhouse gas emission trading programs balance public transparency with the interests of market participants in confidentiality; and

(B) Identifies any rules or other policies these other jurisdictions have established to prevent agency employees who obtain knowledge of market trading activities exempt from public disclosure under RCW 70A.65.100(9) from accepting employment from or otherwise working to provide advantage or insider information to market participants after leaving state service; and

(ii) Identifies best practices that provide the greatest degree of public information and market oversight without detracting from allowance market participation or other efficient auction or trading market functioning.

(2) The report to the legislature must assess whether the rules adopted by the department of ecology to guard against bidder collusion and minimize the potential for market manipulation are consistent with best practices employed by other jurisdictions with market-based trading programs similar to the program established by chapter 70A.65 RCW for balancing the competing public interests of:

(a) Public disclosure and transparency; and

(b) The need to guard against bidder collusion and minimize the potential for market manipulation.

(3) The report to the legislature may include recommendations for changes to chapter 70A.65 RCW or the rules adopted by the department of ecology under chapter 70A.65 RCW in light of the findings contained in the report.

NEW SECTION. **Sec.**  A new section is added to chapter 43.09 RCW to read as follows:

(1)(a) The legislature finds that a performance audit of the effectiveness and efficiency of the cap and invest program created in chapter 70A.65 RCW, which is currently anticipated to collect as state revenue more than $3,600,000,000 in its first five years, is appropriate for accountability, program improvement, and oversight. The legislature observes that performance audits differ from financial and accountability compliance audits in that performance audits evaluate the efficiency and effectiveness of government programs with the goal of making them work better. Performance audits compare what an agency is doing versus leading practices and look for improved outcomes that could include saving money or better processes for delivering the same service to the public.

(b)(i) The legislature intends for a state auditor's office performance audit to occur and finds it appropriate for several reasons: The legislature finds that public trust and confidence in the audit will be enhanced if it is conducted by a separately elected statewide official who has no constituency that relies on the funding that the auctions under chapter 70A.65 RCW provide, and no constituency that has to pay for the compliance instruments and other program costs, but is instead neutral on whether the program is characterized as having been successfully implemented.

(ii) It is the intent of the legislature that the performance audit provide, at a minimum, a comparative view of pertinent program effectiveness and efficiency including, but not limited to, costs per metric ton of greenhouse gas reduced under chapter 70A.65 RCW compared to costs per metric ton of greenhouse gas reduced under other greenhouse gas emissions reduction programs, the relative cost of program administration born directly or indirectly by regulated entities, and whether state oversight of the third-party auction provider is consistent with best practices.

(iii) The state auditor's office performance audit team may make such recommendations as are consistent with government accounting standards for similar audits.

(2) After December 31, 2026, the state auditor shall conduct a comprehensive performance audit of the cap and invest program established by chapter 70A.65 RCW covering the first compliance period of the program.

(3) The state auditor shall complete the audit and publish a report with its findings by December 31, 2027.

(4) This section expires July 1, 2028.

**Sec.**  RCW 70A.65.290 and 2021 c 316 s 32 are each amended to read as follows:

(1) By December 1, 2029, the joint legislative audit and review committee must analyze the impacts of the initial five years of program implementation and must submit a report summarizing the analysis to the legislature. The analysis must include, at minimum, the following components:

(a) Costs and benefits, including environmental and public health costs and benefits, associated with this chapter for categories of persons participating in the program or that are most impacted by air pollution, as defined in consultation with the departments of ecology and health and as measured on a census tract scale. This component of the analysis must, at a minimum, assess the costs and benefits of changes in the following metrics since the start of the program:

(i) Levels of greenhouse gas emissions and criteria air pollutants for which the United States environmental protection agency has established national ambient air quality standards;

(ii) Fuel prices; and

(iii) Total employment in categories of industries that are covered entities. The categories of industries assessed must include, but are not limited to, electric utilities, natural gas utilities, oil refineries, and other industries classified as emissions-intensive and trade-exposed;

(b) An evaluation of the information provided by the department in its 2027 program evaluation under RCW 70A.65.070(3);

(c) A summary of the estimated total statewide costs and benefits attributable to the program, including state agency administrative costs and covered entity compliance costs. For purposes of calculating the benefits of the program, the summary may rely, in part, on a constant value of the social costs attributable to greenhouse gas emissions, as identified in contemporary internationally accepted estimates of such global social cost. This summary must include an estimate of the total statewide costs of the program per ton of greenhouse gas emissions reductions achieved by the program; ((~~and~~))

(d) An evaluation of the impacts of the program on low-income households; and

(e) An evaluation of whether the rules adopted by the department to guard against bidder collusion and minimize the potential for market manipulation have been successful at achieving those outcomes.

(2) This section expires June 30, 2030.

**Sec.**  RCW 70A.65.100 and 2022 c 181 s 3 are each amended to read as follows:

(1) Except as provided in RCW 70A.65.110, 70A.65.120, and 70A.65.130, the department shall distribute allowances through auctions as provided in this section and in rules adopted by the department to implement these sections. An allowance is not a property right.

(2)(a) The department shall hold a maximum of four auctions annually, plus any necessary reserve auctions. An auction may include allowances from the annual allowance budget of the current year and allowances from the annual allowance budgets from prior years that remain to be distributed. The department must transmit to the environmental justice council an auction notice at least 60 days prior to each auction, as well as a summary results report and a postauction public proceeds report within 60 days after each auction. The department must communicate the results of the previous calendar year's auctions to the environmental justice council on an annual basis beginning in 2024.

(b) The department 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 under (a) of this subsection.

(3) The department shall engage a qualified, independent contractor to run the auctions. The department shall also engage a qualified financial services administrator to hold the bid guarantees, evaluate bid guarantees, and inform the department of the value of bid guarantees once the bids are accepted.

(4) Auctions are open to covered entities, opt-in entities, and general market participants that are registered entities in good standing. The department shall adopt by rule the requirements for a registered entity to register and participate in a given auction.

(a) Registered entities intending to participate in an auction must submit an application to participate at least 30 days prior to the auction. The application must include the documentation required for review and approval by the department. A registered entity is eligible to participate only after receiving a notice of approval by the department.

(b) Each registered entity that elects to participate in the auction must have a different representative. Only a representative with an approved auction account is authorized to access the auction platform to submit an application or confirm the intent to bid for the registered entity, submit bids on behalf of the registered entity during the bidding window, or to download reports specific to the auction.

(5) The department may require a bid guarantee, payable to the financial services administrator, in an amount greater than or equal to the sum of the maximum value of the bids to be submitted by the registered entity.

(6) To protect the integrity of the auctions, a registered entity or group of registered entities with a direct corporate association are subject to auction purchase and holding limits. The department may impose additional limits if it deems necessary to protect the integrity and functioning of the auctions:

(a) A covered entity or an opt-in entity may not buy more than 10 percent of the allowances offered during a single auction;

(b) A general market participant may not buy more than four percent of the allowances offered during a single auction and may not in aggregate own more than 10 percent of total allowances to be issued in a calendar year;

(c) No registered entity may buy more than the entity's bid guarantee; and

(d) No registered entity may buy allowances that would exceed the entity's holding limit at the time of the auction.

(7)(a) For fiscal year 2023, upon completion and verification of the auction results, the financial services administrator shall notify winning bidders and transfer the auction proceeds to the state treasurer for deposit as follows: (i) $127,341,000 must first be deposited into the carbon emissions reduction account created in RCW 70A.65.240; and (ii) the remaining auction proceeds to the climate investment account created in RCW 70A.65.250 and the air quality and health disparities improvement account created in RCW 70A.65.280.

(b) For fiscal year 2024, upon completion and verification of the auction results, the financial services administrator shall notify winning bidders and transfer the auction proceeds to the state treasurer for deposit as follows: (i) $356,697,000 must first be deposited into the carbon emissions reduction account created in RCW 70A.65.240; and (ii) the remaining auction proceeds to the climate investment account created in RCW 70A.65.250 and the air quality and health disparities improvement account created in RCW 70A.65.280.

(c) For fiscal year 2025, upon completion and verification of the auction results, the financial services administrator shall notify winning bidders and transfer the auction proceeds to the state treasurer for deposit as follows: (i) $366,558,000 must first be deposited into the carbon emissions reduction account created in RCW 70A.65.240; and (ii) the remaining auction proceeds to the climate investment account created in RCW 70A.65.250 and the air quality and health disparities improvement account created in RCW 70A.65.280.

(d) For fiscal years 2026 through 2037, upon completion and verification of the auction results, the financial services administrator shall notify winning bidders and transfer the auction proceeds to the state treasurer for deposit as follows: (i) $359,117,000 per year must first be deposited into the carbon emissions reduction account created in RCW 70A.65.240; and (ii) the remaining auction proceeds to the climate investment account created in RCW 70A.65.250 and the air quality and health disparities improvement account created in RCW 70A.65.280.

(e) The deposits into the carbon emissions reduction account pursuant to (a) through (d) of this subsection must not exceed $5,200,000,000 over the first 16 fiscal years and any remaining auction proceeds must be deposited into the climate investment account created in RCW 70A.65.250 and the air quality and health disparities improvement account created in RCW 70A.65.280.

(f) For fiscal year 2038 and each year thereafter, upon completion and verification of the auction results, the financial services administrator shall notify winning bidders and transfer the auction proceeds to the state treasurer for deposit as follows: (i) 50 percent of the auction proceeds to the carbon emissions reduction account created in RCW 70A.65.240; and (ii) the remaining auction proceeds to the climate investment account created in RCW 70A.65.250 and the air quality and health disparities improvement account created in RCW 70A.65.280.

(8) The department shall 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 including: Intent to participate or refrain from participation; auction approval status; intent to bid; bidding strategy; bid price or bid quantity; or information on the bid guarantee provided to the financial services administrator. The department may cancel or restrict a previously approved auction participation application or reject a new application if the department determines that a registered entity has:

(a) Provided false or misleading facts;

(b) Withheld material information that could influence a decision by the department;

(c) Violated any part of the auction rules;

(d) Violated registration requirements; or

(e) Violated any of the rules regarding the conduct of the auction.

(9)(a) Records containing the following information are confidential and are exempt from public disclosure in their entirety:

((~~(a)~~)) (i) Bidding information as identified in subsection (8) of this section;

((~~(b)~~)) (ii) Information contained in the secure, online electronic tracking system established by the department pursuant to RCW 70A.65.090(6);

((~~(c)~~)) (iii) Financial, proprietary, and other market sensitive information as determined by the department that is submitted to the department pursuant to this chapter;

((~~(d)~~)) (iv) Financial, proprietary, and other market sensitive information as determined by the department that is submitted to the independent contractor or the financial services administrator engaged by the department pursuant to subsection (3) of this section; and

((~~(e)~~)) (v) Financial, proprietary, and other market sensitive information as determined by the department that is submitted to a jurisdiction with which the department has entered into a linkage agreement pursuant to RCW 70A.65.210, and which is shared with the department, the independent contractor, or the financial services administrator pursuant to a linkage agreement.

(b) The following records are not exempt from public disclosure under (a) of this subsection:

(i) Records containing information pertaining to the contents of holding accounts that is required to be displayed under RCW 70A.65.090(7)(b);

(ii) Records pertaining to bidding information as identified in subsection (8) of this section that pertains only to concluded allowance auctions. The records referenced in this subsection (9)(b) include all records contained in the post auction public proceeds report and communications to the environmental justice council required under subsection (2)(a) of this section;

(iii) Records pertaining to the public roster made public on the department's website under RCW 70A.65.090(10);

(iv) Other records containing information that is expressly required to be made public under this chapter; and

(v) Records necessary for the joint legislative audit and review committee to complete and publish the analysis required under RCW 70A.65.290(1)(e) or for the state auditor to complete and publish the audit required by section 3 of this act.

(10) Any cancellation or restriction approved by the department under subsection (8) of this section may be permanent or for a specified number of auctions and the cancellation or restriction imposed is not exclusive and is in addition to the remedies that may be available pursuant to chapter 19.86 RCW or other state or federal laws, if applicable.

(11) The department shall design allowance auctions so as to allow, to the maximum extent practicable, linking with external greenhouse gas emissions trading programs in other jurisdictions and to facilitate the transfer of allowances when the state's program has entered into a linkage agreement with other external greenhouse gas emissions trading programs. The department may conduct auctions jointly with linked jurisdictions.

(12) In setting the number of allowances offered at each auction, the department shall consider the allowances in the marketplace due to the marketing of allowances issued as required under RCW 70A.65.110, 70A.65.120, and 70A.65.130 in the department's determination of the number of allowances to be offered at auction. The department shall offer only such number of allowances at each auction as will enhance the likelihood of achieving the goals of RCW 70A.45.020.

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