

SENATE BILL REPORT

E2SSB 6058

As Passed Senate, February 12, 2024

Title: An act relating to facilitating linkage of Washington's carbon market with the California-Quebec carbon market.

Brief Description: Facilitating linkage of Washington's carbon market with the California-Quebec carbon market.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senators Nguyen, Hunt, Kuderer, Lias, Mullet, Pedersen, Saldaña, Shewmake and Stanford; by request of Department of Ecology).

Brief History:

Committee Activity: Environment, Energy & Technology: 1/12/24, 1/26/24 [DPS-WM, DNP, w/oRec].

Ways & Means: 2/02/24, 2/05/24 [DP2S, DNP, w/oRec].

Floor Activity: Passed Senate: 2/12/24, 29-20.

Brief Summary of Engrossed Second Substitute Bill

- Authorizes the Department of Ecology (Ecology) to change the length of the compliance periods under the Cap and Invest Program (Program).
- Modifies the definitions and policies related to electricity importing and reports.
- Increases the percent of allowances a covered or opt-in entity may buy from 10 percent to 25 percent in a single auction.
- Continues to prohibit a general market participant from owning more than 10 percent of the total allowances issued in any calendar year, until Washington's Program is linked with another jurisdiction.
- Clarifies when offset projects on tribal lands or from jurisdictions linked with Washington apply toward compliance obligations.

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.

- Eliminates Ecology's discretion to reduce penalties for failure to submit compliance instruments, after Ecology enters into a linkage agreement or at the end of the first compliance period.
- Authorizes Ecology to establish greenhouse gas emissions reporting methodologies that are different from the Environmental Protection Agency.

SENATE COMMITTEE ON ENVIRONMENT, ENERGY & TECHNOLOGY

Majority Report: That Substitute Senate Bill No. 6058 be substituted therefor, and the substitute bill do pass and be referred to Committee on Ways & Means.

Signed by Senators Nguyen, Chair; Lovelett, Vice Chair; Lovick, Trudeau and Wellman.

Minority Report: Do not pass.

Signed by Senator Short.

Minority Report: That it be referred without recommendation.

Signed by Senators MacEwen, Ranking Member; Boehnke.

Staff: Kimberly Cushing (786-7421)

SENATE COMMITTEE ON WAYS & MEANS

Majority Report: That Second Substitute Senate Bill No. 6058 be substituted therefor, and the second substitute bill do pass.

Signed by Senators Robinson, Chair; Mullet, Vice Chair, Capital; Nguyen, Vice Chair, Operating; Billig, Conway, Dhingra, Hunt, Keiser, Pedersen, Randall, Saldaña, Van De Wege and Wellman.

Minority Report: Do not pass.

Signed by Senators Wilson, L., Ranking Member, Operating; Gildon, Assistant Ranking Member, Operating; Schoesler, Ranking Member, Capital; Rivers, Assistant Ranking Member, Capital; Warnick, Assistant Ranking Member, Capital; Boehnke, Braun, Muzzall, Torres and Wagoner.

Minority Report: That it be referred without recommendation.

Signed by Senator Hasegawa.

Staff: Michael Bezanson (786-7449)

Background: Cap and Invest Program. In 2021 the Legislature directed the Department of

Ecology (Ecology) to implement a cap and invest program (Program), also known as the Climate Commitment Act, to reduce greenhouse gas (GHG) emissions consistent with the statewide statutory emissions limits.

Starting on January 1, 2023, the Program will cover industrial facilities, certain fuel suppliers, in-state electricity generators, electricity importers, and natural gas distributors with annual greenhouse gas emissions above 25,000 metric tons of carbon dioxide equivalent (CO₂e). Covered entities must either reduce their emissions, or obtain allowances to cover any remaining emissions. The total number of allowances will decrease over time to meet statutory limits. Some utilities and industries will be issued free allowances; other allowances will be auctioned.

Compliance Instruments, Obligations, and Periods. The Program must track, verify, and enforce compliance through the use of compliance instruments. A compliance instrument is an allowance or offset credit issued by Ecology or a trading program linked with Washington's Program. One compliance instrument is equal to one metric ton of CO₂e.

Covered and opt-in entities may not buy more than 10 percent of the allowances offered during a single auction. A General Market Participant (GMP) may not buy more than 4 percent of allowances offered during a single auction and own more than 10 percent of the total allowances issued in any calendar year.

If a covered or opt-in entity fails to submit sufficient compliance instruments to meet its compliance obligations by the specified transfer dates, it must submit a penalty of four allowances for every one allowance missing within six months. Civil penalties are levied if a covered or opt-in entity fails to submit penalty allowances.

A compliance period is four years, and the first compliance period is January 1, 2023, through December 31, 2026.

Offsets. A portion of a covered or opt-in entity's compliance obligation may be met through offset credits from projects that result in GHG reductions or removals that are real, permanent, quantifiable, verifiable, and enforceable. Offset projects must be in addition to emissions reductions required by law and a certain percentage must provide direct environmental benefits to Washington State.

Linkage Agreement. The Program requires Ecology to seek to enter linkage agreement with other jurisdictions. Ecology must conduct a public comment process and establish a finding that the linking jurisdiction and linkage agreement meet specified criteria before any linkage program can go forward, including requiring that linkage broadens GHG emission reduction opportunities to reduce costs of compliance on covered entities and consumers and providing consistent requirements for covered entities across jurisdictions. A linkage agreement must also ensure the distribution of benefits from the Program to vulnerable populations and overburdened communities and not adversely impact Washington's ability

to achieve its statutory emission reduction limits.

In October 2023 Ecology published a Cap-and-Invest Linkage Criteria Preliminary Analysis report, with the recommendation that joining a larger, more liquid market with a greater number of participants would likely lead allowance prices to be lower, provide greater price stability, and lead to a more durable program.

The Director of Ecology is authorized to executive linkage agreements with other jurisdictions with GHG trading programs consistent with Washington's Program. In November 2023 the Director of Ecology announced a preliminary decision to pursue linking Washington's carbon market with the California-Quebec market. Current law requires Ecology to provide agency request legislation if it finds any statutory provision prevents linking Washington's Program with another jurisdiction.

Greenhouse Gas Emissions Reporting. Under the state Clean Air Act, GHG emissions associated with electricity must be reported if they reach 10,000 metric tons of CO₂e per year. Ecology is required to review and, if necessary, update Washington's GHG emissions reporting whenever the U.S. Environmental Protection Agency (EPA) adopts GHG emissions reporting requirements.

Initiatives to the Legislature. The Washington State Constitution authorizes the initiative process, allowing the people to place a proposition on the ballot or to submit the proposed law to the Legislature. If an initiative to the Legislature is certified for sufficient signatures, the Legislature may approve the measure, reject or take no action on the measure, or pass an alternative proposal. If the Legislature takes no action, the measure is submitted to the voters at the next general election for approval or rejection. If the Legislature approves an alternative measure, both the alternative and original measures are submitted to the voters at the next general election for approval or rejection.

As of January 9, 2024, Initiative Measure No. 2117 (I-2117), concerning carbon tax credit trading, has been granted provisional certification while signatures are verified.

Summary of Engrossed Second Substitute Bill: Compliance Periods. 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 rules to synchronize with those of a linked jurisdiction. Ecology may not amend the length of the first compliance period, which must end December 31, 2026. Statutory references to a four-year compliance period and dates for the second compliance period and beyond are removed. Ecology's comprehensive review of the Program reporting requirement, beginning December 1, 2027, must continue one year after a compliance period ends, rather than every four years.

Emission intensive trade-exposed facility no-cost allowance allocation is set based on four-year periods, rather than being based on the length of a compliance period.

Electricity. Ecology may define by rule an electricity importer where:

- electricity is provided as balancing energy located in Washington State that is also inside a balancing authority area not located entirely within Washington State; and
- imported electricity is not otherwise assigned an electricity importer under the Program.

The definition of imported electricity is amended so it no longer needs to exclude imports of unspecified electricity netted by exports of unspecified electricity under certain circumstances. Imported electricity, however, does not include any electricity that Ecology determines by rule to be wheeled through Washington or separately accounted for.

An electricity importer of specified sources continues to become a covered entity once they report emissions or provide data that indicates their emissions equal or exceeds a threshold of 25,000 metric tons of CO₂e. If Ecology determines that electricity purchased from a federal power marketing administration is not from a specified source, the electricity importer is a covered entity when the emissions associated with the electricity exceeds 25,000 metric tons of CO₂e. An electricity importer of unspecified sources unless purchased from a federal power marketing administration as stated above, is a covered entity regardless of their level of emissions.

A federal power marketing administration (FPMA) may elect to voluntarily participate in CCA by registering as an opt-in entity, according to Ecology's registration requirements. The FPMA may assume compliance obligations associated with either all the electricity it markets in Washington or only the electricity it markets in Washington through a centralized electricity market.

A FPMA should register with Ecology as an opt-in entity in CCA at least 90 days prior to January 1st of the calendar year it would assume compliance obligations associated with federally marketed electricity in Washington. If a FPMA registers as an opt-in entity, then a covered or opt-in entity should not include in its covered emissions those associated with the electricity the FPMA has assumed in its the compliance obligation.

Electric utilities may voluntarily transfer or automatically distribute their allocated no-cost allowances to the FPMA to be used for direct compliance. The electric utility may transfer allowances from its holding account to the FPMA's holding account by submitting a request to Ecology requesting and providing specific information, including the number and vintage of no cost allowances to be transferred. Ecology may transfer the allowances only if:

- the electric utility has an agreement the to purchase electricity from the FPMA; and
- the transfer does not violate the FPMA's holding limit.

For an automatic distribution, an electric utility must inform Ecology by September 1st of year where the allocation or portion of the allocation of no cost allowances will be automatically distributed, otherwise Ecology must place all directly allocated allowances in

the electric utility's holding account.

Linkage Provisions. Ecology is authorized to withdraw from a linkage agreement. Every linkage agreement must provide that Ecology reserves the right to withdraw.

Allowance Purchase Limits. The percentage of allowances a covered or opt-in entity may buy during a single auction is increased from 10 to 25 percent.

A general market participant continues to be prohibited from owning more than 10 percent of the total allowances issued in any calendar year, until Washington links with a jurisdiction that does not have this requirement.

Offsets. A covered or opt-in entity may meet up to 5 percent of its first compliance period obligation with offset credits and up to 4 percent during the second compliance period, regardless of whether or not the offset project is located on federally recognized tribal land. It is clarified that up to an additional 3 percent of compliance obligations during the first compliance period and up to additional 2 percent during the second compliance period may be met with offset projects on federally recognized tribal land.

For any offset credits issued by a jurisdiction that Washington has linked with, the offset credits must come from offset projects located in Washington or the linked jurisdiction.

Ecology must take into consideration current Washington forest practices rules and the state's unique forest species and structures when adopting protocols governing offset projects and use of offset credits.

Penalties. Ecology's discretion to reduce the penalty amount for an entity that fails to submit compliance instruments to meet its compliance obligation for the first compliance period is removed once the first compliance period ends or when Ecology enters into a linkage agreement, whichever is sooner.

Greenhouse Gas Emissions Reporting. Under the Clean Air Act, Ecology may require entities that supply electricity to report emissions of GHG from all electricity purchased, sold, imported, exported, or exchanged in Washington, regardless of how many metric tons of CO₂e.

Ecology must establish GHG emission reporting methodologies for persons required to report under the CCA. Ecology's reporting methodologies must be designed to address the needs of accuracy and consistency over time, and may, to the extent practicable, be similar to reported methodologies in the linked jurisdictions.

Ecology is no longer required to review and update its rules whenever the EPA adopts federal reporting requirements for GHG emissions nor to ensure consistency with emissions reporting requirements in jurisdictions with a linkage agreement with Washington.

Contingent Null and Void Clause. This act is declared not to be a conflicting measure with I-2117, but if the Washington State Supreme Court directs the Secretary of State to place this act on the 2024 ballot as an alternative to I-2117, this act is null and void and may not be placed on the ballot.

Appropriation: None.

Fiscal Note: Available.

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

Effective Date: The bill takes effect on January 1, 2025, only if I-2117 is not approved by a vote of the people in the 2024 general election. If I-2117 is approved by a vote of the people in the 2024 general election, this act is null and void.

Staff Summary of Public Testimony on Original Bill (Environment, Energy & Technology): *The committee recommended a different version of the bill than what was heard.* PRO: This bill allows us to join forces with California and Quebec in the climate market. Climate change is here and our response is our legacy to leave behind for future generations. This a reliable framework for businesses and investors and vital in our transition for a more sustainable economy. The CCA is a gold standard for climate policies. The Program is generating revenue that is already going back into communities. Right now the CCA operates as a standalone program, but when the Legislature passed the CCA, it recognized that linkage is the best tool that we have to ensure program can operate long-term, achieve carbon reduction requirements, and minimize consumer costs. The Program was designed with linkage in mind. These changes will not weaken the stringency of Washington's Program and will secure further benefits of decarbonization, investments in clean energy, and a cleaner environment. The market is new and evolving and the bill makes essential changes that will provide long-term benefits and stability. It is also about a profound impact on global emissions. We have some technical changes to further align programs and to allow the Bonneville Power Administration to opt in to CCA. Linking CCA creates a larger, more efficient market and sends a message to other states that this approach works. This bill gives Ecology what they need to get started. It is important to maintain predictability and sustainability. By aligning program structure, it presents a big opportunity and stronger protections for overburdened communities. Ecology may explore linkage but it is not required. We appreciate that the offsets remain below the cap and there are no restrictions to the projects that can take place on tribal lands.

CON: Oil companies don't pay proportionally for their pollution.

OTHER: We support elements of bill, including the purchase limits, but it will take several years to link and the current allowance prices in California should not be relied on as future prices. The bill should adjust the biofuels definition to match with California, which will

allow further opportunity for compliance. Linkage is generally a good idea in cap and trade systems. Small markets are more volatile and more likely to be manipulated. Ultimately, we will have to adopt the California system. The bill makes the offset rules more strict and should instead increase offsets. CCA is about creating tax revenue not about reducing GHG emissions. There is no requirement that government programs demonstrate effectiveness unlike offset projects. Linkage does not require the program be identical to external markets. Preserve the netting language that is being removed. A shorter compliance period provides less protection against low hydro years. The bill gives Ecology authority for new reporting requirements that would result in documentation well beyond what is needed. Increasing purchase limit to 25 percent should only be changed once linkage occurs. This is the best draft of the bill yet, but we look forward to additional elements, including changing the reduction curve to make it a straight line to 2050 while waiting for linkage to occur. We are concerned that reducing the cost at which carbon credits are sold will also reduce funds for investments. California's program allows for too many allowances. We need to ensure there is a public process when considering linkage and keep Washington's Program as strong as possible. The bill adds new language regarding unspecified electricity that would make all co-ops covered entities. The impact of this would be the reduction of the assignment of no-cost allowances, because they would need to be used for compliance instead of benefitting our customers. We support linkage to broaden the market of allowances but encourage the Legislature to retain control to maintain the uniqueness of the program.

Persons Testifying (Environment, Energy & Technology): PRO: Senator Joe Nguyen, Prime Sponsor; Isaac Kastama, Clean & Prosperous Washington; Tom Wolf, bp America; Joel Creswell, Washington State Department of Ecology; Mary Wiencke, Public Generating Pool; Kiyomi Keckemet, Seattle City Light; Matt Miller, Puget Sound Energy; Darcy Nonemacher, Washington Conservation Action; Kelly Hall, Climate Solutions; Skippy Shaw, The Nature Conservancy.

CON: John Worthington.

OTHER: Jessica Spiegel, WSPA; Todd Myers, Washington Policy Center; John Rothlin, Avista; Sept Gernez, Sierra Club, Washington State; Peter Godlewski, Association of Washington Business; Brandon Houskeeper, Alliance of Western Energy Consumers; Paul Griffin, Washington Rural Electric Cooperative Association.

Persons Signed In To Testify But Not Testifying (Environment, Energy & Technology): No one.

Staff Summary of Public Testimony on First Substitute (Ways & Means): *The committee recommended a different version of the bill than what was heard.* PRO: This is Ecology request legislation. Linkage is the best tool to maintain stable prices and meet reduction targets. Growing the size of the market will mean more predictability. Linking creates a larger more stable market to help companies and to lower costs. It sends a positive signal to companies. Ecology has worked to reduce barriers to linkage. We have been

engaging with California and Quebec. The negotiation process can be completed by late 2025 but realistically 2026. The climate commitment monies are important and help secure federal funding. They helped secure the hydrogen hub.

CON: We are not similar partners as California and Quebec. There needs to be a look at whether we would hit zero emissions. This bill will dilute the leadership of the Legislature by linking to California and Quebec. The costs have gone up and we need to be able to connect to people who are elected and responsible.

OTHER: Linkage is not expected before 2026. California is in rulemaking now and those changes could increase the price. There is also some disconnect between the definitions of biofuels between Washington and the California and Quebec markets. Parts of this bill are removing carefully crafted language. The new imported electricity definition will over calculate the emissions. Accurately counting electricity is imperative to counting emissions accurately. The programs do not have to be identical.

Persons Testifying (Ways & Means): PRO: Senator Joe Nguyen, Prime Sponsor; Tom Wolf, bp America; Isaac Kastama, Clean & Prosperous Washington; Joel Creswell, Washington State Department of Ecology; Matt Miller, Puget Sound Energy.

CON: John Worthington; Eric pratt, America.

OTHER: Greg Alderson, Portland General Electric; Jessica Spiegel, WSPA; John Rothlin, Avista.

Persons Signed In To Testify But Not Testifying (Ways & Means): No one.