FINAL BILL REPORT
E2SSB 5126

Synopsis as Enacted

Brief Description: Concerning the Washington climate commitment act.

Sponsors: Senate Committee on Ways & Means (originally sponsored by Senators Carlyle, Saldaña, Conway, Das, Frockt, Hunt, Liias, Nguyen, Pedersen, Salomon, Stanford and Wilson, C.; by request of Office of the Governor).

Senate Committee on Environment, Energy & Technology
Senate Committee on Ways & Means
House Committee on Environment & Energy
House Committee on Appropriations

Background: Cap and trade is a market-based, economy-wide approach to reduce pollution, which is comprised of two key components—a limit or cap on carbon emissions and tradable allowances. In the United States, nine states participate in the Regional Greenhouse Gas Initiative, a cap and trade program established in 2009. California began operating a cap and trade program in 2013, and it is linked with a program in Quebec, Canada. European countries have operated a cap and trade program since 2005.

Greenhouse Gasses. The United States Environmental Protection Agency (EPA) and state Department of Ecology (Ecology) identify carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, and sulfur hexafluoride as greenhouse gasses (GHGs) as a result 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, over a 100-year timeframe, to the emission of an identical volume of carbon dioxide (carbon dioxide equivalent).

Current Federal and Washington Regulation of Greenhouse Gasses. Under the federal Clean Air Act, GHGs are regulated as an air pollutant and are subject to several air regulations administered by the EPA. These federal Clean Air Act regulations include a requirement that facilities and fuel suppliers whose associated annual emissions exceed

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25,000 metric tons of carbon dioxide equivalent report their emissions to the EPA.

At the state level, GHGs are regulated by Ecology under the state Clean Air Act (CAA). Facilities, sources, and sites whose emissions exceed 10,000 metric tons of carbon dioxide equivalent each year are required to report their annual emissions to Ecology or to local air authorities that implement the state CAA. Liquid motor vehicle and aircraft fuel suppliers that supply fuel whose combustion would exceed that same 10,000 ton volumetric threshold must also report their annual emissions.

Apart from reporting and other regulations under the state and federal clean air acts, several other state laws and programs explicitly address GHG emissions.

In 2020, the Legislature updated statewide GHG emissions reduction limits (emissions limits) set in 2008 to: a 95 percent reduction below 1990 levels by 2050, with interim economy-wide emissions limits of 45 percent below 1990 levels by 2030 and 70 percent below 1990 levels by 2040. The state must achieve net zero emissions by 2050.

Ecology is responsible for monitoring and tracking the state's progress toward the emission limits.

<u>Clean Energy Transformation Act.</u> In 2019, the Legislature passed the Clean Energy Transformation Act (CETA), which requires Washington's electric utilities to meet 100 percent of their retail electric load using non-emitting and renewable resources by January 1, 2045. CETA requires electric utilities to eliminate coal-fired resources from their allocation of electricity by December 31, 2025, and make all retail sales of electricity GHG neutral by January 1, 2030. CETA also requires electric utilities to develop a clean energy implementation plan every four years, starting January 1, 2022, to establish interim targets for energy efficiency and renewable energy.

<u>Environmental Justice Task Force Report.</u> A proviso in the 2019-2021 biennial operating budget directed the Governor's Interagency Council on Health Disparities to convene and staff an Environmental Justice Task Force. The task force was directed to recommend strategies for incorporating environmental justice principles into future state agency actions across Washington. The task force report, published in fall 2020, includes:

- guidance for using the Washington Environmental Health Disparities Map to identify communities that are highly impacted by environmental justice issues with current demographic data;
- measurable goals for reducing environmental health disparities for each community in Washington State and ways in which state agencies may focus their work towards meeting those goals; and
- model policies that prioritize highly impacted communities and vulnerable populations for the purpose of reducing environmental health disparities and advancing a healthy environment for all residents.

Office of Equity. In 2020, the Legislature established the Office of Equity to promote access to equitable opportunities and resources that reduce disparities and improve outcomes statewide across state government. Duties of the office include facilitating state policy and systems change to promote equitable policies, practices, and outcomes.

Summary: Environmental Justice Review. Ecology must conduct an environmental justice review every two years, beginning in 2023, to ensure the cap and invest program achieves reductions in criteria pollutants as well as GHG emissions in overburdened communities highly impacted by air pollution. Ecology must deploy an air monitoring network in high priority overburdened communities to collect sufficient air quality data for the 2023 review and subsequent reviews.

Once the review determines the levels of criteria pollutants in an identified overburdened community , Ecology must:

- in consultation with local air pollution control authorities, establish air quality targets to achieve air quality consistent with whichever is more protective for human health:
    1. national ambient air quality standards established by EPA; or
    2. the air quality experienced in neighboring communities that are not identified as overburdened;
- identify the stationary and mobile sources that are the greatest contributors of those emissions that are either increasing or not decreasing;
- achieve the reduction targets through adoption of emission control strategies or other methods;
- adopt stricter air quality standards, emission standards, or emissions limitations on criteria pollutants; and
- after adoption of the stricter air quality standards, emission standards, or emissions limitations, issue an enforceable order on affected permittees or registered sources to comply with the stricter standards or limitations.

Ecology may not impose requirements on a permitted stationary source that are disproportionate to their contribution to air pollution compared to other permitted stationary sources and other sources of criteria pollutants in the overburdened community. Environmental Justice Assessment. When allocating funds or administering grants funded by any of the program accounts, agencies must conduct an environmental justice assessment and establish a minimum of not less than 35 percent, and a goal of 40 percent, of total investments to provide direct and meaningful benefits to vulnerable populations within overburdened communities. Benefits may be achieved through reducing environmental burdens and cumulative risk from environmental burdens, supporting community-led projects, or meeting an identified community need.

An additional 10 percent minimum target is established for projects supported by tribal resolution, with priority to projects directly administered or proposed by a tribe.

Environmental Justice Council. The Environmental Justice Council, established under

E2SSB 5141, must provide recommendations to the Legislature, agencies, and the Governor on the development and implementation of the cap and invest program, and programs funded from the auction revenues.

Duties of the council include:

- providing recommendations to the Legislature, agencies, and the Governor in the development of the cap and invest program and investment plans and funding proposals from the Climate Investment Account;
- recommending environmental justice and environmental health goals for programs, activities, and projects funded from the account, and reviewing agency annual reports on outcomes and progress toward meeting goals; and
- providing a forum to analyze policies adopted under the comprehensive climate commitment program to determine if policies lead to improvements within overburdened communities.

Tribal Consultation. Before allocating funding or administer grant programs funded from the Climate Investment Account, agencies must offer consultation with federally recognized tribes on all funding decisions that may impact, infringe upon or impair the governmental efforts of federally recognized tribes to adopt or enforce their own standards governing, or protect the tribe's resources or other rights and interests in their tribal lands and lands within which a tribe or tribes possess rights reserved by treaty. The consultation must comply with state government-to-government laws and be independent of any public participation process required by state law, or by a state agency, and occur regardless of whether the agency receives a request for consultation from a tribe.

Governance Structure. The Governor must establish a governance structure to implement the state's climate commitment to provide accountability for achieving the state's emission limits, establish a coordinated and strategic statewide approach to climate resilience, build an equitable and inclusive clean energy economy, and ensure the government provides clear policy and requirements, financial tools, and other mechanisms to support achieving those limits.

The governance structure for implementing the climate commitment must be holistic; address emissions reductions from all relevant sectors and sources; support an equitable transition for vulnerable populations and overburdened communities; build increasing climate resilience for at-risk communities and ecosystems through cross-sectoral coordination, planning and policies; and apply scientific and technical information. The governance structure must include the following elements:

- a strategic plan for aligning existing law, rules, policies, programs, and plans with the state's emissions limits to the full extent allowed;

- common state policies, standards, and procedures for addressing GHG emissions and climate resilience;
- a process for prioritizing and coordinating funding consistent with strategic needs for GHG reductions, equity and environmental justice, and climate resilience actions;
- an updated statewide strategy for addressing climate risks and improving resilience of communities and ecosystems;
- a comprehensive community engagement plan for vulnerable populations, overburdened communities, and other historically or currently marginalized groups; and
- an analysis of gaps and conflicts in state law and programs.

The Governor's Office must develop policy and budget recommendations to the Legislature necessary to implement the state's climate commitment by December 31, 2021. The governance structure does not create legal authority for Ecology or other state agencies to enact, adopt, issue an order, or in any way implement additional regulatory programs beyond this act or current law.

Cap and Invest Program. Ecology must implement a GHG emissions cap and invest program (program) to reduce GHG emissions consistent with the statewide emissions limits. The program must track, verify, and enforce compliance through the use of compliance instruments.

By December 1, 2027, and at least every four years thereafter, Ecology must submit a report to the Legislature and the Environmental Justice Council that includes a comprehensive review of the implementation of the program to date, including, but not limited to, outcomes relative to the state's emissions reduction limits, overburdened communities, covered entities, and EITEs.

Program Budget and Timeline. By January 1, 2023, Ecology must begin the program. Ecology must determine an emissions baseline establishing the proportionate share that the total GHG emissions of covered entities bears to the total anthropogenic GHG emissions in the state during 2015 through 2019, based on reported data.

The first compliance period is January 1, 2023, through December 31, 2026. By October 1, 2022, Ecology must adopt annual allowance budgets for the first compliance period of the program. Data reported from 2015 through 2019 is sufficient for adopting annual allowancebudgets and demonstrating compliance for the first compliance period.

The second compliance period is January 1, 2027, through December 31, 2030. By October 1, 2026, Ecology must add to its emissions baseline by incorporating the proportionate share the total GHG emissions of new covered entities in the second compliance period bear to the total anthropogenic GHG emissions in the state during 2023 through 2025. In determining the addition to the baseline, Ecology may exclude a year from the determination if it has been an outlier due to a state of emergency. Ecology must adopt

annual allowance budgets for the second compliance period. Data reported to Ecology for 2023 through 2025 is sufficient for adopting annual allowance budgets and demonstrating compliance under the second compliance period of the program.

For calendar years 2031 through 2040, Ecology must adopt by rule the annual allowance budgets. The annual allowance budgets must be set to achieve the covered entities' share of reductions necessary to meet the 2030, 2040, and 2050 statewide emissions limits. Ecology must reduce the annual allowance budget in an amount equivalent to offset use so the use of offsets as compliance instruments does not prevent the state from achieving the emissions limits. Ecology must adopt annual allowance budgets that provide progressively equivalent reductions year over year. An allowance distributed under the program does not expire and may be held or banked.
By December 31, 2027, and December 31, 2035, Ecology must evaluate the performance of the program, including the reduction of GHG, and make adjustments to annual allowances budgets if needed to achieve the 2030 and 2040 emissions limits.

By December 31, 2040, and December 31, 2045, Ecology must complete additional evaluations of the program and make adjustments in annual allowance budgets if needed to ensure that covered entities achieve their proportionate share of the 2050 emission limits.

<u>Participating Entities.</u> Covered entities are required to register to participate in the program. At the beginning of the first compliance period, and for all subsequent compliance periods, a covered entity is a person who has reported emissions or provided data that indicates emissions equal or exceed a threshold of 25,000 metric tons of carbon dioxide equivalent for:
- facilities;
- electricity generated in the state;
- first jurisdictional deliverer importing electricity into the state from specified or unspecified sources;
- fuel suppliers other than natural gas; and
- natural gas suppliers to non-covered entities.

Ecology, in consultation with the Department of Commerce (Commerce) and the UTC, must adopt a methodology for addressing imported electricity associated with a centralized electricity market.

The amounts for fuel products produced or imported with a documented final point of delivery outside of Washington and combusted outside of Washington for fossil fuel suppliers are excluded for purposes of program coverage. Industrial gas customers who purchase gas from someone other than a natural gas company are responsible for their own emissions.

At the beginning of the second compliance period, and for all subsequent compliance periods, a covered entity is a person who has reported emissions or provided data that

indicate emissions equal or exceed a threshold of 25,000 metric tons of carbon dioxide equivalent for waste to energy facilities used by county and city solid waste management programs.

Beginning January 1, 2031, and for all subsequent compliance periods, a covered entity is a person who has reported emissions or provided data that indicate emissions equal or exceed a threshold of 25,000 metric tons of carbon dioxide equivalent for:

- landfills used by county and city solid waste management programs; and
- railroad companies.

Landfills with gas capture systems that capture at least 75 percent of landfill gas and produce renewable natural gas or electricity from landfill gas are not covered entities under the program. It is the intent of the Legislature to adopt a GHG reduction policy specific to landfills, and if such a policy is not enacted by January 1, 2030, the requirements of the program relative to landfills take full effect.

Ecology must notify the Legislature whenever a covered entity is no longer covered by the cap and invest program.

An opt-in entity is a person responsible for GHG emissions that is not a covered entity but may voluntarily participate and register in the program. An opt-in entity must meet the same requirements for registration and compliance obligations as a covered entity. An opt-in entity may opt out of the program by giving Ecology notice six months prior to the end of the compliance period, but will have compliance obligations through a compliance period. An opt-in entity is not eligible to receive allowances directly distributed to emissions-intensive, trade-exposed (EITE) industries, electric utilities, or natural gas companies under this program.

A general market participant is not a covered or opt-in entity, but may also voluntarily register in the program to purchase, trade, hold, sell, transfer, or retire compliance instruments. Federally recognized tribes and federal agencies may elect to participate in the program as opt-in entities or general market participants. Ecology must maintain a public roster of all covered entities, opt-in entities, and general market participants on its website. Participating entities must describe any direct or indirect affiliation with other registered entities.

Ecology must adopt rules for program registration procedures.

Exemptions. Regardless of reporting requirements, the emissions exempt from coverage are from:

- the combustion of aviation fuel;
- watercraft fuels;

- coal-fired electric generation, exempt from GHG limitations and requirements;
- carbon dioxide emissions from the combustion of biomass or biofuels that have a 40 percent lower GHG emissions based on a full-life cycle analysis compared to petroleum fuels;
- motor vehicle and special fuel used for agricultural purposes by a farm fuel user; and
- national security facilities.

Ecology must determine a method for expanding the exemption for agricultural purposes to include fuels used for transporting agricultural products on public highways for five years.

Auctions. Ecology must distribute allowances through a maximum of four auctions annually. The auction may include allowances from the current year annual allowance budgets and allowances yet to be distributed from prior allowance budget years. Ecology must engage a qualified, independent contractor to run the auctions. Additionally, Ecology must engage a qualified financial services administrator to hold and evaluate bid guarantees and to inform Ecology of the value of the bid guarantees when the bids are accepted.

Registered entities in good standing may participate in auctions. A registered entity must submit an application to participate and is only eligible to participate in an auction after receiving approval by Ecology. Ecology may require a bid guarantee in an amount greater than or equal to the sum of the maximum value of bids that will be submitted by the registered entity.

Registered entities with a direct corporate association are subject to the following auction purchase limits:
- covered or opt-in entity may not buy more than 10 percent of allowances offered during a single auction;
- general market participants may not buy more than 4 percent of 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; and
- no registered entity may buy more than its bid guarantee or allowances that would exceed its holding limit at the time of the auction.

Ecology must adopt rules to guard against bidder collusion and minimize the potential for market manipulation. A registered entity may not disclose bidding information such as intent to participate in an auction, auction approval status, bidding strategy, bid price or quantity, or bid guarantee. Ecology may cancel or restrict an approved application or reject a new application to participate in an auction if it determines that the registered entity has provided false or misleading facts, withheld material information that could influence a decision by Ecology, or violated auction rules or registration requirements. Ecology may cancel or restrict participation permanently or for a specified number of auctions, which is in addition to any other penalties and fines.

Ecology must consider the number of no cost allowances in the marketplace in setting the

number of allowances offered at each auction and only offer a number of allowances at each auction that will enhance the likelihood of achieving the statewide emission limits.

Emissions Intensive, Trade-Exposed. Facilities owned or operated by a covered entity must receive an allocation of allowances at no cost if it is classified as an EITE, as determined by being engaged in one or more of the processes described within specified North American industry classification system codes. Ecology must adopt by rule objective criteria to identify EITE manufacturing businesses during the second compliance period. If a manufacturing business can demonstrate it meets this criteria, it is eligible for free allocation of allowances as an EITE industry under Ecology's rules, which must consider the locations of facilities potentially identified as EITE manufacturing businesses relative to overburdened communities

For the first compliance period, the annual allocation of no cost allowances for direct distribution to a facility identified as EITE must be equal to the facility's baseline carbon intensity established using data from 2015 through 2019, or other data allowed, multiplied by the facility's actual production for each calendar year during the compliance period. If an EITE facility is not able to feasibly determine a CI benchmark, it may elect to use a mass-based baseline that does not vary based on changes in production volumes. For facilities using the mass-based approach, the allocation of no cost allowances must be equal to the facility's mass-based baseline using data from 2015 through 2019, or other data allowed. For the second compliance period and each subsequent compliance period, the annual allocation of new cost allowances must be adjusted according the specified benchmark reduction schedules multiplied by the facility's actual production during the period.

EITE facilities must be awarded no cost allowances equal to:

- 100 percent of the CI benchmark or mass-based baseline for each year of the first compliance period;
- 97 percent of the CI benchmark or mass-based baseline for each year of the second compliance period; and
- 94 percent of the CI benchmark or mass-based baseline for each year of the third compliance period.

An aerospace products and parts manufacturing facility using a mass-based baseline must receive an additional no cost allocation to accommodate an increase in production which increases its emissions above the baseline on a basis equivalent in principle to those awarded to entities using a carbon intensity benchmark. Ecology must establish methods to award additional no cost allowance allocations for EITE facilities, if appropriate based on projected production, to achieve a similar on-going result through the adjustment of the facility's mass-based baseline.

An EITE facility's benchmark can also be adjusted prior to the second or third or subsequent compliance periods if an EITE facility demonstrates additional reductions in CI are not technically or economically feasible based on a facility’s best available technology

analysis. Ecology may make adjustments based on specified changes for the EITE facility.

Ecology must provide a report to the Legislature describing alternative methods for determining the amount and schedule of allowances to be provided to EITE facilities from 2035 to 2050. The report must include best practices in ensuring against emissions leakage and economic harm to businesses in carbon pricing programs. If the Legislature does not adopt a compliance obligation for EITE facilities by December 1, 2027, those facilities must continue to receive allowances as provided in the third compliance period.

If the actual emissions of an EITE facility exceeds the facility's no cost allowances assigned in a compliance period, the EITE facility must purchase additional compliance instruments to equal these emissions. An EITE facility must be allowed to bank unused allowances to be used for future sale and investment in best available technology when economically feasbile. Ecology may limit offset credit use if the no cost allowances plus offset credits exceed one hundred percent of total compliance.

A curtailed facility can retain, but not trade, sell, or transfer, allowances except to transfer to a new operator of the facility operating under the same industrial classification. All unused allowances must be transferred to the emissions containment reserve if the curtailed facility becomes a closed facility. A curtailed facility is not eligible to receive free allowances during a period of curtailment.

An an owner or operator of more than one facility receiving no cost allowances for EITE facilities may transfer allowances among the eligible facilities.

Rules adopted by Ecology for allocation of allowances at no cost to EITE facilities must include protocols for allocating allowances to an eligible facility built after the effective date of section. These protocols must include consideration of products and criteria pollutants produced by the facility, as well as local environmental and health impacts associated with the facility. The protocols for a facility built on tribal lands or determined to impact tribal lands or resources must be developed in consultation with affected tribal nations.

During the 2022 regular legislative session, Ecology must have agency request legislation developed in consultation with EITEs, covered entities, environmental advocates, and overburdened communities that outlines a compliance pathway specific to EITEs for achieving their proportionate share of the state's emission reduction limits through 2050. If, by April 1, 2023, the Legislature has not considered and enacted Ecology's request legislation, no expenditures may be made from the Carbon Emissions Reduction Account, the CI Account, or the Air Quality and Health Disparities Improvement Account.

Electric Utilities. The Legislature intends to allocate allowances to all consumer-owned utilities (COUs) and investor-owned electric utilities (IOUs) subject to CETA to mitigate the cost burden of the program on electricity customers.

In consultation with Commerce and the UTC, Ecology must adopt rules for establishing the methods and procedures for allocating allowances and set allocation schedules for the provision of allowances at no cost to COUs or IOUs. These allocations must be consistent with a forecast of each utility's supply and demand and the cost burden resulting from the inclusion of the covered entities in each compliance period.

Allowances allocated at no cost to COUs and IOUs must be consigned to auction for the benefit of ratepayers, deposited for compliance, or a combination of both. Utilities may use allowances for compliance equal to their covered emissions in any calendar year they were not subject to potential penalty under CETA. Under no circumstances may utilities receive any free allowances after 2045.

Ecology must allocate allowances at no cost to the electric utility or power marking administration providing electricity to an EITE entity, unless allowances have already been allocated, in an amount equal to the forecasted emissions for the entity's electricity consumption for the compliance period. Ecology may allow for allowances to be transferred between a power marking administration and electric utility and used for direct compliance.

Rules establishing the allocation of allowances to COUs and IOUs to consider the impact of electrification of building, transportation, and industry on the electricity sector. Nothing in this section affects the requirements of CETA.

A COU that is party to a contract that meets certain conditions must be issued no cost allowances for emissions associated with imported electricity, to prevent impairment of the value of the contract to either party.

Natural Gas Companies. Natural gas utilities must be allocated allowances at no cost for the benefit of ratepayers. Ecology must set allocation schedules by rule, in consultation with the UTC, to provide allowances at no cost equal to emissions for the sector and declining consistent with the cap. Allowances must be provided at no cost for the benefit of ratepayers, deposited for compliance, or a combination of both.

Sixty-five percent of the no cost allowances, increasing at 5 percent annually, must be consigned to auction for the benefit of customers, prioritizing low-income customers. Revenues from allowances sold at auction must be returned by providing nonvolumetric credits on ratepayer bills, prioritizing low-income customers, or may be used to minimize cost impact on low-income, residential, and small business customers for a actions such as weatherization, decarbonization, conservation and efficiency services, and bill assistance. The customer benefits provided from allowances consigned to auction must be in addition to existing requirements in law.

Except for low-income customers, the nonvolumetric credits are reserved exclusively for customers at locations connected to a natural gas utility's system on the effective date of the

act. These credits may not be provided to customers of the gas utility at a location connected to the system after the effective date of the act.

Natural gas utilities must provide to Ecology copies of GHG reports filed with the U.S. Environmental Protection Agency, and continue reporting to receive no cost allowances.

Emissions Containment Reserve. To help ensure that the price of allowances available for auction in the program remains sufficient to incentivize reductions in GHG emissions, Ecology must establish an Emissions Containment Reserve and set an emissions containment reserve trigger price by rule. The price must be set at a reasonable amount above the auction floor price and equal to the level established in linked jurisdictions .

If the price of allowances falls below the emissions containment reserve trigger price, Ecology will automatically withhold allowances from auction. Any allowances that have been withheld from auction must be transferred to the Emissions Containment Reserve Account.

Allowances must be transferred to the emissions containment reserve when allowances are unsold in auctions, facilities are curtailed or closed, or when facilities fall below 25,000 metric tons.

Allowances must be distributed from the Emissions Containment Reserve by auction for new covered and opt-in entities, provided the distribution will not jeopardize the state's emissions reduction limits. If the reserve is exhausted, allowances must be distributed from the allowance price containment reserve by auction for new entities.

Allowance Price Containment Reserve. To help minimize price volatility and limit the potential for extraordinary prices, Ecology must adopt by rule auction floor and auction ceiling prices. The auction floor price shall increase by a predetermined amount every year. Ecology may not sell allowances at bids lower than the auction floor prices.

An Allowance Price Containment Reserve must be designed as a mechanism to contain compliance costs in the event of unanticipated high costs for compliance instruments. For the first compliance period, Ecology must place no less than 2 percent of the total number of allowances available from the allowance budgets in the reserve. Only covered and opt-in entities may participate in the auction of allowances from the Allowance Price Containment Reserve. A reserve auction must be separate from auctions of other allowances. However, the process for the reserve auctions is the same as the process for described above for general auctions. The auction proceeds must be deposited in the Climate Investment Account.

Ecology must adopt rules to:

- hold auctions of allowances from the Allowance Price Containment Reserve when the settlement prices in the preceding auction approach the auction ceiling price;

- specify holding limits that determine the maximum number of allowances to be held for use or trade by a registered entity at any one time;
- set the reserve auction floor price before the reserve auction and may establish multiple price tiers;
- establish the requirements and schedule for reserve auctions; and
- establish the amount of allowances to be placed in the reserve after the first compliance period ends.

Price Ceiling. A price ceiling and price containment reserve are established to provide cost protection for facilities obligated to comply with the program. The price ceiling shall be set at a level sufficient to facilitate investments to achieve emission reductions beyond those enabled by the price ceiling.

Ecology must issue price ceiling units for sale at a fixed price if no allowances remain in the allowance price containment reserve. Funds raised in connection with sales of price ceiling units must be expended to achieve emissions reductions.

Offset Credits. 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. Off-set projects must be in addition to GHG reductions or removals otherwise required and must be certified by a recognized registry within two years prior to the effective date of the section of the act creating offset credits. At least 50 percent of the offset credits must be from projects that provide direct environmental benefits in Washington State during the first compliance period and the remaining offset projects must be in a linked jurisdiction with Washington. For the second compliance period, at least 75 percent of offset credits must be from projects that provide direct environmental benefits in Washington. However, Ecology may reduce the requirement if it determines there is not sufficient offset supply in the state to meet offset demand.

A covered or opt-in entity may use offset credits to meet no more than 5 percent of compliance obligations during the first compliance period. During the second compliance period, no more than 4 percent of compliance obligations may be met through offset credits. Offset projects on federally recognized tribal land do not count against the off-set credit limits for covered or opt-in entities and may be no more than 3 percent of compliance obligation for the first compliance period and 2 percent for the second compliance period. Beginning January 1, 2031, these limits continue to apply unless modified by rule after a public consultation process.

The offset credit limits may be modified by rule to ensure the proportionate share of statewide emissions limits are achieved and alignment with linked jurisdictions. The offset credit limits may also be reduced for a specific entity if Ecology, in consultation with the Environmental Justice Council, determines the covered entity has or is likely to contribute substantively to cumulative air pollution burden in an overburdened community or violate

any permits where the violation may result in increased emissions.

Ecology must develop rules for protocols to establish offset projects and secure offset credits used to meet compliance obligations. Ecology must take into consideration standards, rules, or protocol for offset projects and credits established by other jurisdictions with comparable programs. Ecology must also encourage opportunities for the development of offset projects in Washington by adopting offset protocols that reduce transaction costs and make use of aggregation or other mechanisms to increase the development of offset and carbon removal projects by landowners, including small forest landowners.

Ecology must adopt a process for monitoring and invalidating offset credits to ensure the credit reflects emissions reductions. If an offset credit is invalidated, the covered or opt-in entity must transfer replacement credits or allowances within six months. A covered or opt-in entity is subject to a penalty if fails to transfer replacement credits or allowances. Offset credits used may not be in addition to, or allow for an increase in established allowance budgets. Offset credits must be registered and tracked as a compliance instrument.

Assistance Program for Offsets on Federally Recognized Tribal Lands. To ensure a sufficient number of high quality offset projects are available, Ecology must establish an assistance program for offset projects on federally recognized tribal lands. The assistance may include funding or consultation to assess a project's technical feasibility, investment requirements, development, and operation costs, expected returns, administrative and legal hurdles, and project risks and pitfalls. Ecology may provide funding or assistance upon request by a federally recognized tribe. The Legislature intends to provide not less than $5 million in the operating budget for this purpose.

Small Forestland Owner Work Group. The Department of Natural Resources must contract with a Washington nonprofit that can demonstrate a membership of at least 1000 small forestland owners and promotes the sustainable stewardship of family forestland to establish and implement a small forestland owner work group. The purpose of the work group is to identify possible carbon market opportunities, including the provision of qualifiable offset credits, and other incentive-based GHG reduction programs that Washington landowners may be able to access, including compliance markets in other jurisdictions, voluntary markets, and federal, state, and private programs for forestlands.

The work group must:
- provide recommendations for implementation and funding a pilot program to develop an aggregator account that will pursue carbon offset projects for small forestland owners in Washington;
- coordinate with Ecology on the development of offset protocols;
- develop a framework and funding proposal for establishing a program to link interested small forestland owners with incentive-based carbon reducing programs that facilitate adoption of forest practices and increase carbon storage and

sequestration in forests and wood products; and
- recommend policies to support the implementation of incentives for participation in carbon markets.

By December 1, 2022, the work group must transmit a final report to Ecology that provides recommendations for incentives, the implementation of incentives, payment structures necessary to support small forest landowners, and whether the work group should be extended or made permanent.

Compliance Obligations. Covered and opt-in entities must meet their compliance obligations over a four-year compliance period. The first compliance period begins January 1, 2023. Covered and opt-in entities must transfer compliance instruments equal to their covered emissions by November 1st for each calendar year with a compliance obligation. Ecology must set by rule the percentage of compliance instruments that covered and opt-in entities must transfer each year, to smooth out their compliance obligation within the compliance period. A covered or opt-in entity may use allowances issued in that compliance year, or allowances issued in any of the seven years immediately preceding that compliance year to meet a compliance obligation.

When the covered or opt-in entity transfers compliance instruments or price ceiling units, on or before the transfer date, from its holding account to its compliance account allowances are considered submitted. A covered or opt-in entity that submits insufficient compliance instruments to meet its compliance obligation is subject to penalties. Older vintage allowances must be retired before new vintage allowances. Covered and opt-in entities may not borrow an allowance from a future allowance year to meet a current or past compliance obligation. Ecology must retire all transferred allowances or offset credits used to meet compliance obligations.

A covered entity whose emissions fall below the threshold has a compliance obligation until the end of the compliance period. An entity is no longer a covered entity when its emissions are below the threshold during the entire compliance period or operations have ceased at its facility that is required to report GHG emissions. However, if Ecology notifies a person that its facility's emissions are within 10 percent of the threshold, the person will continue to be designated as a covered entity to ensure equity among all covered entities.

To coordinate and synchronize the program with other transportation-related investments, compliance obligations for covered and opt-in entities will not take effect until a separate additive transportation revenue act becomes law. An additive transportation revenue act means an act, enacted after April 1, 2021, in which the fuel tax is increased by an additional and cumulative tax rate of at least five cents per gallon of fuel .

Allowance Trading and Tracking Compliance Instruments. Ecology must use an online electronic tracking system to register entities, issue compliance instruments, track ownership and transfers of compliance instruments, facilitate program compliance and

support market oversight.

Covered and opt-in entities must use the following two accounts: a compliance account to transfer allowances to Ecology to retire; and a holding account for allowances to be bought, sold, or traded. The number of allowances in a holding account may not exceed the holding limit of the entity. General market participants are allowed an account to hold, trade, sell, or transfer allowances. Ecology must maintain an account for retired allowances transferred by registered entities and from the voluntary renewable reserve account. A voluntary renewable reserve account is a holding account maintained by Ecology for retiring allowances for voluntary renewable electricity generation, directly delivered to the state and will not be sold or used to meet any other mandatory requirements, on behalf of voluntary renewable energy purchases or end users. Ecology must maintain a regularly updated searchable website that shows the contents of each holding account, including but not limited to the number of allowances.

Enforcement. All covered and opt-in entities must comply with all requirements for monitoring, reporting, holding, and transferring emission allowances and other provisions of this act. If a covered entity 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 that is missing within six months.

If a covered entity or opt-in entity fails to submit penalty allowances, Ecology must issue a civil penalty of up to $10,000 for each penalty allowance that is not submitted per day. Ecology will also issue a penalty of up to $10,000 per day per violation for failure to comply with program rules, and may issue a penalty up to $50,000 per day per violation in cases of market manipulation.

All penalties must be deposited into the Climate Investment Account (CI Account). Appeals of orders and penalties must be to the Pollution Control Hearings Board. An electric utility or natural gas utility must notify its retail customers and the Environmental Justice Council within three months of paying a monetary penalty for failure to comply with the requirements of the program.

Linkage with Other Jurisdictions. Ecology must seek to enter linkage agreements with other jurisdictions with established allowance-based GHG reduction programs under circumstances in order to broaden GHG emissions reduction opportunities to reduce costs of compliance, enable joint allowance markets and unified tracking for compliance instruments, enhance market security, reduce program administrative costs, and provide consistent requirements across jurisdictions.

Linkage agreements must include provisions relating to auctions, holding limits, GHG reporting and verification, offset protocols, enforcement, program registry, compliance instruments, coordinated administrative and technical support, public notice an

participation, and processes to withdraw from the agreement.

Ecology may enter into a linkage agreement with another jurisdiction after conducting an environmental justice assessment. Before entering into a linkage agreement, Ecology must evaluate and make a finding whether the aggregate number of unused allowances in a linked program would reduce the stringency of Washington's program and the state's ability to meet its emissions limits. Ecology must find that the linkage agreement meets certain criteria, conduct a public comment process to obtain input and review of the linkage agreement, and consider the input prior to finalizing a linkage agreement. The criteria must include:

- the linking jurisdiction has provisions to ensure distribution of benefits from the program to vulnerable populations and overburdened communities;
- a determination by Ecology that the agreement will not yield net adverse impacts to either jurisdiction's highly impacted communities, relative to the baseline level of emissions; and
- not adversely impact Washington's ability to achieve statewide emissions limits.

If Ecology determines a full linkage agreement is unlikely to meet the above criteria, it may enter into a linkage agreement with limitations.

The state retains all legal and policymaking authority over program design and enforcement. Ecology must provide agency request legislation if it finds any provision of the act prevents linking Washington's program with another jurisdiction.

Auction Proceeds Distribution. The auction proceeds must be transferred to the state treasurer for specific deposits first to the Carbon Emissions Reduction (CER) Account and the remaining auction proceeds to the CI Account and Air Quality and Health Disparities Improvement Account. The deposits to the CER Account are as follows:

- $127,341,000 for FY 2023;
- $356,697,000 for FY 2024;
- $366,558,000 for FY 2025; and
- $359,117,000 each year for fiscal years 2026 through 2037.

The deposits into the CER Account must not exceed $5.2 billion over the first 16 years. For FY 2038 and each year thereafter, 50 percent of the proceeds must be deposited to the CER Account and 50 percent to the CI Account and Air Quality and Health Disparities Improvement Account.Carbon Emissions Reduction Account. The CER Account is created in the state treasury and is subject to appropriation. Expenditures from the account may only be used for transportation carbon emissions reducing purposes and may not be used for 18th amendment purposes, other than as specified for the account, including investments in alternatives and reductions to single occupancy passenger vehicle use through alternative fuel infrastructure and incentives, and emission reduction programs for freight, ferries, and port activities.

Climate Investment Account. The CI Account is created in the state treasury, and all receipts from the auction of allowances must be deposited there, unless otherwise specified. Projects funded from the CI Account must meet high workforce labor standards, including employer paid sick leave programs, family sustaining wages, pay equity based on gender identity and race, career development opportunities, and maximize access to economic benefits for local workers and diverse businesses.

Moneys in the CI Account may only be used for projects and programs that achieved the purposes of the program and must first be appropriated for the administration of the program, not to exceed 5 percent of the total receipts of funds from the auction of allowances. Beginning July 1, 2024, and annually thereafter, the state treasurer must distribute the funds in the CI Account as follows:

- 75 percent to the Climate Commitment Account; and
- 25 percent to the Natural Climate Solutions Account.

Biennially, the Legislature must review these allocations based on the changing needs of the state in meeting its clean economy and GHG reduction goals in a timely, economically advantageous, and equitable manner. Moneys in either account may not be used for projects that would violate tribal treaty rights or result in significant long-term damage to critical habitat or ecological functions. Investments must result in long-term environmental benefit and increased resiliency to the impacts of climate change.

The Climate Commitment Account. The Climate Commitment Account is created in the state treasury and is subject to appropriation. Projects, activities, and programs eligible for funding from the account must be physically located in Washington State and include the following:

- implementing the working families tax tebate;
- supplementing the growth management planning and environmental review fund;
- supporting programs, activities, or projects that:
    1. reduce and mitigate GHG and co-pollutants in overburdened communities, including strengthening the air quality monitoring network to measure, track, and better understand air pollution levels and trends to inform the analysis, monitoring, and pollution reduction measures required under the environmental justice review;
    2. deploy renewable energy resources, distributed generation, energy storage, demand-side technologies and strategies, and other grid modernization projects;
    3. increase energy efficiency or reduce GHG emissions of industrial facilities;
    4. achieve energy efficiency or emission reduction in the agricultural sector, including grants, loans or financial incentives for eligible funds uses under the Sustainable Farms and Fields Grant Program ;
    5. increase energy efficiency in new and existing buildings or promote low-carbon architecture;
    6. promote electrification and decarbonization of new and existing buildings;

7. improve energy efficiency, including high-efficiency electric appliances and equipment for space and water heating;
8. assist with clean energy transition and assist affected workers or people with lower incomes during the transition to a clean energy economy, or grow and expand clean manufacturing capacity, including improving energy affordability and reduce energy burden for people with lower incomes and higher transportation fuel burden for rural residents; community renewable energy projects that allow participants to own or receive the benefits at reduced or no cost; programs, activities or worker-support projects for bargaining unit and nonsupervisory fossil fuel workers affected by the transition away from fossil fuels to a clean energy economy; direct investment in workforce development; initiatives to develop a forest health workforce; or transportation, municipal service delivery and technology investments that increase a community's capacity for clean manufacturing;
9. allow the diversion of organic materials from landfills and waste to energy facilities or methane capture;
10. deploy carbon dioxide removal; and
11. support efforts to mitigate and adapt to the effects of climate change affecting Indian tribes, including capital investments in support of the relocation of tribes located in areas at heightened risk due to anticipated seal level rise, flooding, or other disturbances caused by climate change and for these purposes the Legislature intends to dedicate at least $50 million per biennium.

Natural Climate Solutions Account. The Natural Climate Solutions Account is created in the state treasury subject to appropriation. Moneys in the account are intended to increase the resilience of the state's waters, forests, and other vital ecosystems to the impacts of climate change, conserve working forestlands at the risk of conversion, and increase their carbon pollution reduction capacity through sequestration, storage, and overall ecosystem integrity. Moneys in the account must be spent in a manner consistent with existing and future assessments of climate risks and resilience from the scientific community and expressed concerns of and impacts to overburdened communities.

Moneys may be allocated for the following purposes:

- Clean water investments that improve resilience from climate impacts, and funding must be used to:
  1. restore and protects estuaries, fisheries, and marine shoreline habitats, and prepare for sea level rise including making fish passage correction investments;
  2. increase carbon storage in the ocean or aquatic and coastal ecosystems;
  3. remediate and adapt to impacts of ocean acidification;
  4. reduce flood risk and restore natural floodplain;
  5. increase sustainable supply of water and improve aquatic habitat;
  6. improve stormwater infrastructure;
  7. preserve or increase carbon sequestration in forests, forested wetland, agricultural soils, tidally influence agricultural or grazing lands, or freshwater,

saltwater, or brackish aquatic lands; or
8. preserve or establish, or both, carbon sequestration by protecting or planting trees in marine shorelines and freshwater riparian areas sufficient to promote climate resilience, protect cold water fisheries, and achieve water quality standards;

- Healthy forest investments to improve resilience from climate impacts, and funding must be used for projects and activities that will:
  1. increase forest and community resilience to wildfire;improve forest health; or
  2. prevent emissions through preserving natural lands from the threat of conversion to development, through actions that include assistance programs such as the forest riparian easement program and the family forest fish passage program. It is the intent of the Legislature that no less than $10 million per biennium from Natural Climate Solutions Account be expended for the Forestry Riparian Easement Program or for riparian easement projects funded under the Agricultural Conservation Easements Program, or similar riparian enhancement programs.

Air Quality and Health Disparities Improvement Account. The Air Quality and Health Disparities Improvement Account is created in the state treasury subject to appropriation. The account is established to fund the air monitoring network and reduce health disparities in overburdened communities. It is the intent of the Legislature that not less than $20 million per biennium be dedicated to the account for these purposes.

Greenhouse Gas Reporting and Verification. Ecology must adopt rules requiring persons to report emissions of GHGs where those emissions from a single facility, or from electricity or fossil fuels sold in Washington by a single supplier or local distribution company, meet or exceed 10,000 metric tons of carbon dioxide equivalent annually. Annual reports must include emissions data for the preceding calendar year and be submitted to Ecology by March 31st of the year in which the report is due. The reporting rules must support implementation of the cap and invest program.

Ecology must establish by rule the methods of verifying the accuracy of emissions reports. Verification requirements apply at a minimum to:

- persons that are required to report GHGs, if those emissions equal or exceed 25,000 metric tons of carbon dioxide equivalent emissions, including carbon dioxide from biomass-derived fuels; or
- persons who have a compliance obligation under the cap and invest program in any year of the current compliance period.

Ecology may adopt rules to accept verification reports from another linked jurisdiction where Ecology deems the methods or procedures are substantively similar.

When a person that holds a compliance obligation under the cap and invest program fails to submit an emissions data report, or fails to obtain a positive emissions data verification statement, Ecology may assign an emissions level for that person.

Ecology may by rule include additional gases to the definition of GHG if the gas has been included in external GHG emission trading programs where Washington has a linkage agreement in effect. Ecology must update its rules whenever needed to ensure consistency with emissions reporting requirements for linked jurisdictions .

Facility Siting. To avoid leakage of emissions to other jurisdictions, in achieving the state's emissions limits, the state must pursue the limits in a manner that recognizes the siting and placement of new or expanded best-in-class facilities with lower carbon emitting processes is in the economic and environmental interests of the state.

In conducing a life-cycle analysis, if required, for new or expanded facilities that require review under the State Environmental Policy Act, a lead agency must evaluate and attribute

any potential net cumulative GHG emissions resulting from the project as compared to other existing facilities or best available technology. . Covered emissions from an entity that is or will be a covered entity must not be the basis for denial of a permit for a new or expanded facility.

A lead agency or permitting agency must allow a new or expanded facility that is a covered or opt-in entity to satisfy any mitigation requirements for GHG emissions under SEPA by submitting the number of compliance instruments equivalent to its covered emissions during a compliance period

Reporting. By December 1, 2029, the Joint Legislative Audit and Review Committee must perform an analysis of the first five years of the cap and invest program. This analysis must include the costs and benefits of the program using specific metrics, an evaluation of the information summarized by Ecology in its 2027 program evaluation, the total statewide costs of the program per ton of GHG emissions reductions achieved, and an evaluation of the impacts of the program on low-income households.

Ecology must prepare a report that identifies all distributions from all accounts, including recipients of funding, amounts, purpose, end use, whether projects produce reductions in GHGs, the cost per metric ton reduced, and a comparison to other projects to facilitate cost-benefit ratios for projects. Ecology must update the report on its web site no less than once a year and annually submit it to the Legislature by September 30th.

Miscellaneous Provisions. Ecology, in collaboration with interested stakeholders, must develop a proposal for assisting households that, for residential home heating, use fuels that are not electricity or natural gas. If Ecology determines the proposal requires legislative action, it must submit its recommendations for proposed legislation to the Legislature no later than September 15, 2022.

The provisions governing the appointment of Washington's members of the Pacific Northwest Electric Power and Conservation Planning Council are amended to allow both members to reside on the same side of the Cascade Mountains, so long as this deviation does not exceed 12 months in any 10-year period.

Rules. Ecology must adopt to implement the program and may adopt emergency rules for initial implementation of the program, to implement the state omnibus appropriations act for the 2021-2023 fiscal biennium, and to ensure that reporting and other program requirements are determined early for the purpose of program design and early notice to registered entities with a program compliance obligation.

Expiration. Rules adopted by Ecology to implement the program are suspended December 31, 2055, if Ecology determines the 2050 statewide emissions limits have been met for two or more consecutive years.

Preemption. A city, town, county, township, or other subdivision or municipal corporation of the state is prohibited from implementing a charge or tax based exclusively on the quantity of GHG emissions. No state agency may adopt or enforce a program that regulates GHG emissions for a stationary source except as provided under this act. The cap and invest program preempts the the Clean Air Rule.

Votes on Final Passage:

Senate	25	24	
House	54	43	(House amended)
Senate	27	22	(Senate concurred)

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