Comments of the Northwest & Intermountain Power Producers Coalition to the
<u>Washington Department of Ecology Draft Cap-and Invest Program Rules</u>

January 26, 2022

The Northwest & Intermountain Power Producers Coalition ("**NIPPC**") appreciates the opportunity to submit comments on the Washington Department of Ecology's'("**Ecology**") Draft Cap and Invest Program Rules (Chapter 173-446 WAC) (the "**Draft Cap and Invest Program Rules**"). NIPPC represents competitive power participants in the Pacific Northwest. NIPPC members include owners, operators, and developers of independent power generation and storage, power marketers, and affiliated companies. Collectively, NIPPC represents over 4,500 megawatts of operating generation and an equal amount permitted or under development.

NIPPC appreciates the hard work to date on the Draft Cap and Invest Program Rules and believes that they are directionally well drafted, but notes a variety of areas that should be clarified or modified. These areas include:

- Further structure and clarifications to ensure that (1) allowances freely allocated to utilities are limited to the utility's retail service and do not create an incentive for leakage; (2) such allowances are consigned or used for compliance, not banked or sold; and (3) the full value of such allocated allowances inures to the benefit of retail ratepayers, with the first priority the mitigation of any rate impacts to low-income customers.

- Clarifications and changes to treatment of electricity traded at the Mid-C market point to ensure Washington's programs do not inadvertently striate the robust and integrated market for electricity on which the state relies.

- Further edits to facilitate linking and the benefits of operating within a larger, integrated market.

- Clarifications on disclosure of holding account balances to clarify publication will be on an aggregated basis.

- Modification to the baseline cap for electric imports.

- Clarifications to the definition of cap and invest investors and advisors to make clear that certain activities, such as participation in a trade group, do not run afoul of regulatory intent.

- Simplification and clarification of rules for use of offsets to ensure a robust market.

Each of these issues is addressed below.

1. **Consistency with potential linkage partners is paramount**.

It is imperative for Washington to design its program to facilitate linking with the analogous California and Quebec programs.[1] The pricing of – and, more importantly, achieving real and verifiable reduction of – atmospheric carbon is best accomplished through market-based programs with a *broad* geographic and economic scope. A broad scope, including robust and liquid trading mechanisms, will optimize Washington's ability to achieve the maximum emissions reduction at the lowest cost over time.

Along with working to ensure timely linkage, NIPPC urges Ecology to ensure that the regulations mimic existing procedures and policies in the existing programs to the maximum extent practical to facilitate development of a seamless market. Wherever possible, definitions, timelines, and procedures should be identical to those currently in place in existing programs unless there is a *specific and definable policy rationale* related to "special characteristics of the state's economy, communities, and industries"[2] to deviate from such program aspects. Any timelines, terms, and procedures that materially deviate from the existing programs – where not *required* by special characteristics of Washington or the CCA – will needlessly striate the market, create unnecessary litigation, and raise the risk of potential program "footfaults,"[3] and may have the unintended effect of limiting market participation.

2. **Modifications of allowance allocation to and use of allowances by utilities.**

NIPPC urges Ecology to clarify and strengthen the draft regulations with respect to free allocation of allowances to utilities in a number of ways: First, the regulations should be clear that allowances allocated to a utility should be solely related to the utility's own retail service in

[1] NIPPC applauds Washington's decision to utilize the WCI to manage its auction platform as an initial step.

[2] Climate Commitment Act, Section 8(3).

[3] "Footfaults" refers to market participants unintentionally failing to remain in full regulatory compliance despite diligent efforts due to inconsistent timelines and definitions between programs.

Washington, and not for wholesale or out-of-state transactions, and done in a manner that does not encourage resource shuffling. Second, the regulation should ensure that any freely allocated allowances are consigned to auction or placed in a compliance account for near-term use, and not banked, sold, or otherwise monetized. Third, the regulation should ensure that utilities include the actual cost of carbon in market and/or investment decisions. Fourth, the rules should specify that the full value of such allocated allowances inure to the benefit of the utility's own retail ratepayers, with the first priority the mitigation of any rate impacts to low-income customers and a secondary priority of further carbon reductions. These changes are necessary to further the goals of the Act and preserve market competition. We urge Ecology to consider more specific and stringent rules similar to those within the California regulations, Section 95892(d), "Limitations on the Use of Auction Proceeds and Allowance Value," and, as an alternative, also offer more limited proposed edits to the draft regulations as addressed below.

a. Ecology should clarify that freely allocated allowances not consigned must be placed in a compliance account for near-term compliance and cannot be further sold or monetized.

The Climate Commitment Act[4] and the draft regulations proposed by Ecology provide electric utilities with the option to consign their freely-allocated allowances to auction, *deposit them for compliance*, or a combination of both.[5] For natural gas utilities, by contrast, the regulations provide that at least 65 percent of all freely allocated allowances be consigned to auction, with the consigned portion increasing to one hundred percent by 2030.

NIPPC submits that significant levels of consignment by utilities is necessary to create a robust marketplace, especially to the extent that Washington's cap-and-invest program has not linked with other sizeable programs. Consignment of significant levels of utility allowances will create price transparency, benefitting the market as a whole, and provides incentives for utilities to pursue additional carbon reduction. At the same time, requiring consignment places virtually no cost burden on a utility or its ratepayers, as the utility can purchase consigned allowance back at a zero net cost if it so chooses.

NIPPC urges Ecology to accelerate mandatory consignment of allowances to the maximum extent allowed under the statute. In addition, NIPPC urges Ecology to clarify that any allowances

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[4] Climate Commitment Act, Washington SB 5126 (2021) (the "**CCA**").

[5] Section 14(3)(a). (emphasis added); Proposed WAC 173-446-230 Section 5.

not consigned be placed in the utility's compliance account, as opposed to a holding account, and used for meeting near-term compliance obligations, not banked or further traded. This could be accomplished with the following edits to Section 173-446-230(5) of the draft regulation:

> Allowance consignment. Allowances allocated at no cost to consumer-owned and investor-owned electric utilities may be consigned to auction for the benefit of ratepayers, deposited **in a Compliance Account** for compliance, or a combination of both. **Amounts deposited in a Compliance Account shall be limited to estimated compliance needs at the next compliance deadline.** …

b. Allocation of allowances to utilities must be based on actual retail load for such utilities and not create an incentive for leakage or otherwise disrupt competitive markets.

NIPPC appreciates that the draft regulations specify that Ecology will "use utility specific forecasts that provide retail electric load" for determining the quantity of allowances to be distributed to electric utilities,[6] and providing some of the sources on which Ecology intends to rely to evaluate the applicable generation resource fuel type.[7] NIPPC urges Ecology to be more specific with respect to both of these issues and ensure that free allowances are allocated assuming that the utilities are using diligent efforts to ensure available low carbon power is utilized in Washington as opposed to other jurisdictions.

With respect to calculating retail load, Ecology should be mindful that utilities may also serve load in other jurisdiction or sell power at wholesale and should not be entitled to free allowances for such service. Such service and sales can occur whether or not a utility is multi-jurisdictional and regulated by, or has retail customers in, other states. Ecology also should ensure that utilities receiving a free allocation of allowances are working diligently to bring the lowest-carbon power to Washington retail customers, and do not take advantage of the free allocation of allowances to allocate (or acquire) higher carbon power for use within the state, where they will not bear any carbon costs as a result of free allowances, and then allocate their lower carbon power to other jurisdictions, or sell it for a premium.

Similarly, and of particular importance, the regulations should be clear that the full cost of carbon attributable to a generation resource that is allocated free allowances must be included in all dispatch decisions, bids into competitive power markets, and procurement and investment

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[6] Proposed WAC 173-446-230 Section 1(a)
[7] Proposed WAC 173-446-230 Section 1(b)

decisions. Absent this clarification, utilities may gain an unfair competitive advantage over their generation and marketing competitors who do not receive free allowances. Proposed changes to the draft regulations to address this issue are included in Section 2(c) of these comments below.

c. **Ecology should strengthen the proposed regulations to ensure that the benefit of all freely allocated allowances inure to the benefit of a utility's own retail ratepayers.**

The value of all freely-allocated allowances – whether or not consigned to auction – should inure to the benefit of a utility's own retail customers. As noted above, utilities often engage in wholesale or extra-jurisdictional sales that can create carbon pricing obligations not related to retail service. Utilities should be barred from using freely-allocated allowances to meet carbon obligations related to these non-retail transactions. Potential modifications to address this issue and issues raised in Section 2(b) of these comments above include the following:

> The benefits of all **freely allocated** allowances consigned to auction **or used for compliance** must be used by consumer-owned and investor-owned electric utilities for the benefit of **that utility's retail** ratepayers, with the first priority the mitigation of any rate impacts to low-income customers. **The full cost of carbon attributable to a generation resource that is allocated free allowances must be included in all dispatch decisions, bids into competitive power markets, and procurement and investment decisions.**

In addition, or as an alternative to this language, Ecology should consider adding an additional provision modeled on Section 95892(d)(3) of California's regulations, which specifies that

> "Allowance value, including any allocated allowance auction proceeds, obtained by an electrical distribution utility must be used for the primary benefit of retail electricity ratepayers of each electrical distribution utility, [] and may not be used for the primary benefit of entities or persons other than such ratepayers,"

which could be used in conjunction with something similar to a provision modeled on Section 95892(d)(7) of the California cap and trade regulations, "Limitations on the Use of Auction Proceeds and Allowance Value."

3. **The regulations should adopt a methodology for addressing imported electricity associated with Mid-C ICE transactions as a centralized power market**

As drafted, NIPPC believes Ecology's regulations may result in a significant but unintended problem with respect to wholesale electricity transactions that must be resolved to maintain a properly functioning regional electric power market. A substantial portion of electricity produced or imported into Washington is traded on the centralized electronic market operated by Intercontinental Exchange, *a/k/a* "**ICE**,"[8] at the Mid-Columbia ("**Mid-C**") market point (or hub) physically located along the Columbia River in central Washington, and those transactions and therefore the liquidity of the Mid-C hub may be compromised based on uncertainty created by the draft regulations.

While the Climate Commitment Act generally prescribes specific treatment of imported and exported power, the Act also mandates that Ecology "shall adopt by rule a methodology for addressing imported electricity associated with a centralized electricity market" by October 1, 2026.[9] NIPPC suggests that this authority may encompass imports associated with Mid-C. NIPPC urges Ecology to further evaluate this rulemaking authority as it relates to Mid-C, invite further public comment on the treatment of Mid-C transactions, and consider whether the problem NIPPC notes here may be most appropriately addressed through regulation or through a potential commercial solution described below.

The problem that must be addressed stems from the fact that buyers and sellers of power at the centralized Mid-C point will not know whether such power will be subject to the Washington Cap and Invest Program, nor what entity will be responsible for meeting compliance obligations, until after the transaction, making it impossible to accurately price the electricity. For example, if electricity sold at Mid-C were purchased on ICE by a Washington utility, the seller would be subject to responsibility for the carbon, but if the electricity were purchased by a utility in Oregon, the seller would not be subject to the same costs. To accommodate the potential risk that offers are picked up by Washington utilities, offerors may elect to include potential carbon costs in all offers. But this would also raise prices for buyers located outside the state and could have the unintended consequence of driving transactions away from Washington market hub at Mid-C to other power markets. This erosion of the Mid-C hub will disrupt the power sector and negatively affect Washington as the host of this hub.

NIPPC recognizes that transactions at Mid-C depend on both a standardized wholesale power agreement (the WSPP agreement), formed on a largely consensus basis through

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[8] See, e.g., www.TheIce.com. According to data from U.S. Energy Information Administration, an average of 44 trades occurred at the Mid-C point each day during 2021, with an average trade volume of more than 21,455 MWh per day. See https://www.eia.gov/electricity/wholesale/#history.

[9] See Climate Commitment Act Section 10(1)(c).

voluntary industry workgroups, and the ability to transact products based on that agreement on the electronic exchange operated by ICE. The industry has already initiated discussions about whether and how to address the issue described here through a modification or addendum to that agreement, but has yet to finalize a workable solution. If a commercial solution is reached, that may settle this issue. But because Ecology is meanwhile under a statutory deadline to complete rules to implement the Climate Commitment Act, NIPPC recommends that Ecology evaluate this issue in more detail.

Pending an alternative commercial solution, NIPPC recommends that Ecology recognize that the first jurisdictional deliverer approach as set out in the draft regulations does not adequately take into account the mechanics of one of the principal wholesale hubs in the West—that happens to be in Washington. NIPPC recommends that Ecology take further public comment on whether and how to use its authority to "adopt by rule a methodology for addressing imported electricity associated with a centralized electricity market" to specify ways to account for transactions at Mid-C that do not ultimately sink in Washington. For example, one approach at least for the interim, could be for the buyer of power at Mid-C that sinks in Washington to bear responsibility for carbon pricing, rather than the seller or any other entity. NIPPC does not at this stage endorse this potential exception to the compliance responsibility otherwise resting with the seller, but notes it as one illustrative way to address Mid-C transactions. NIPPC also notes that any such approach must be weighed carefully against the potential for complicating, if not hindering, the possibility of linkage with other jurisdictions.

4. The Regulations must protect the confidentiality of individual holding account information.

NIPPC urges Ecology to modify proposed WAC 173-446-150(4) to make it clear that the content of holding account information will only be published on an aggregated basis, and not for each individual registered party.[10] Information about an individual entity's account status should remain highly confidential. NIPPC anticipates that the language of this section was intended to reflect publication of information on a market-aggregated basis, as other sections of the draft

[10] Section (4) states that "Ecology will post information about the contents of each holding account, including but not limited to the number of allowances in the account, on Ecology's Cap-and-Invest public website. The website also includes a public roster of all covered entities, opt-in entities, and general market participants."

regulations are clear that such information is highly sensitive.[11] Publishing such information could dramatically disrupt the marketplace, and incent anti-competitive, price gauging behavior. For example, if the marketplace is aware that a given counterparty has far fewer (or far more) compliance instruments than needed for an upcoming compliance period, that party may face prices based not on general market costs, but on predatory pricing by competitors. This issue also complicates issues with respect to Cap & Invest Consultants and Advisors and Shared personnel (addressed further below), as those issues turn, in part, on whether someone has "knowledge of the party's market position." To the extent holding account information is public, virtually everyone would have knowledge a party's – and all other parties' - market positions.

Instead, NIPPC urges Ecology to modify the regulations as follows, making it clear that the number of allowances held in accounts will only be published on an aggregated basis:

> (4) Ecology will post information about ~~the contents of each holding account, including but not limited to the number~~ **the total aggregate number of** allowances **in holding accounts by (1) covered entities, (2) opt-in entities and (3) general market participants** ~~in the account ,~~ on Ecology's Cap-and-Invest public website. The website also includes a public roster of all covered entities, opt-in entities, and general market participants.

5. **Ecology should eliminate or clarify the restrictions on cap-and-invest consultants and advisors.**

NIPPC submits that both the restrictions on cap-and-invest consultants and advisors, and the definition of who would fall into the cap-and-invest consultants and advisors category, should be substantially reduced. As currently drafted, the definition of a "Cap and Invest Consultant and Advisor" set out in WAC 173-446-056 is unworkable: the list of activities triggering consultant and advisor status is so broad that it covers virtually any service provided to a registered entity regardless of whether such service has anything to do with the cap-and-invest program. For example, the current language specifies that service which could trigger consultant and advisor status includes "Appraisal and valuation services, both tangible and intangible." As drafted, this language could be interpreted such that a multinational company with minor assets subject to Washington's cap-and-invest program would be in violation of the regulations for failing to disclose that the company hired a consultant to appraise an office building in a foreign country.

[11] *See, e.g.*, draft WAC 173-446-053(3)(a)(vii), requiring general market participants to identify any employee with knowledge of that entities current or expected holdings of compliance instruments.

NIPPC anticipates that this is not the intent of the provision and recommends it be clarified accordingly.

At a minimum, the draft regulations should be amended to follow the more limited approach used by California, which specifies that the definition of a cap-and-trade consultant or advisor is limited to the defined services provided (1) "in relation to the cap and trade program" as opposed to in general; and (2) "specifically for the entity registered in the Cap-and-Trade Program."[12] Such change can be made as follows:

> WAC 173-446-056 (1) A "Cap-and-Invest Consultant or Advisor" is an individual or party that is not an employee of a registered entity, but is providing any of the following services **in relation to the Cap-and-Invest program and** for **the** ~~a~~ party registered in the Cap-and-Invest Program, regardless of if the consultant or advisor is acting in the capacity of an offset or emissions verifier**[.]**:

6. Ecology should apply a more rigorous approach to establish Baseline Caps for Electric Power Entities

The draft regulations specify that baselines for electricity imports will be determined using information reported by utilities in fuel mix reports:

> Electric power entities. Ecology must calculate subtotal baselines for electricity importers based on their covered emissions as established in WAC 173-446-040. Ecology will use fuel mix disclosure reports generated by the Department of Commerce in accordance with RCW 19.29A.060 to identify and catalog all contracted power and methods from WAC 173-444-040 to estimate GHG emissions. Subtotal baselines for electric generating facilities reporting under WAC 173-441-120 will be calculated as specified under subsection (2)(a) of this section and are not part of the electric power entity subtotal baseline.

Use of fuel-mix information would effectively be a consumption-based inventory for imports[13] and as such is methodologically inconsistent with the way that emissions are attributed to imported electricity during the program's compliance periods. Using clearly incompatible methodologies leads to inaccurate results and could damage program credibility and the possibility of linkage.

[12] See Title 17, California Code of Regulations, Section 95923.

[13] We recognize that Ecology intends to include emissions from in-state generators in the baseline for facilities.

As described in the detailed comments on this topic submitted by the Western Power Trading Forum ("**WPTF**"), Ecology could construct a more accurate and robust data set to establish baseline emissions more consistent with the way emissions will be attributed during the compliance periods using data from Open Access Technology International ("**OATI**") and fuel mix reports submitted by multistate entities. NIPPC supports WPTF's comments on this topic and will not burden the record with repetition, but strongly urges Ecology to adopt the methodology specified in the WPTF filing.

7. The definition of "publicly owned electric utility" should be clarified.

NIPPC asks that Ecology appropriately define, or otherwise replace, the term "publicly owned electric utility" as found in proposed WAC 173-446-105(5). That section currently specifies that:

> A ***publicly owned electric utility*** that is the operator of an electricity generating facility in Washington has a direct corporate association with the operator of another electricity generating facility in Washington if the same party operates both generating facilities. A ***publicly owned electric utility*** that is the operator of an electricity generating facility in Washington has a direct corporate association with an electricity importer if the same party operates the generating facility in Washington and is the party importing electricity.

While the terms "investor owned utility;" "consumer-owned utility;" "multijurisdictional consumer-owned utility;" "multijurisdictional electric company" and others are defined or otherwise in common use, the term "publicly owned electric utility" does not appear to be defined in the draft regulations, the Climate Commitment Act, or elsewhere in Washington Statutes.

8. Offset Issues

(a) Ecology should clarify the difference between Ecology Offset Credits and Registry Offset Credits.

Section WAC 173-446-500 appears to contemplate two different types of offsets: "Registry Offset Credits" and "Ecology Offset Credits." NIPPC is unclear about the intended distinction between these two types of offset credits and recommends that they be defined in the regulations.

(b) Ecology should simplify calculations for offset use

NIPPC urges Ecology to simplify the calculations of the limits for offset use. Proposed WAC 173-446-600, Section 5 specifies limits for the percentage of offsets that may be used for overall compliance, specifying in the first period that **“**no more than 5 percent of a covered entity’s or opt-in entity’s compliance obligation may be satisfied by providing Ecology with offset credits. ***At least 50 percent of these offset credits must be sourced from offset projects that provide direct environmental benefits in Washington***” (emphasis supplied). In the second compliance period, the offset use ramps down to 4 percent, while the percentage that must provide direct environmental benefits to Washington ramps up to 75 percent. This language generally tracks the underlying language in the Act,[14] but the statute also specifies that the limits cited “may be modified by rule as adopted by the department when appropriate to ensure achievement of the proportionate share of statewide emissions limits established in RCW 70A.45.020 and to provide for alignment with other jurisdictions to which the state has linked” (CCA Section 19(3)(c)).

As drafted, this language creates uncertainty because a compliance entity may not know until just before the compliance deadline the total amount of offsets they will choose to utilize as compared to allowances. Even if an entity does not intend to use the full potential amount of offsets, it is impossible to know exactly what amount of offsets would constitute 50 percent of the offsets to be turned in for compliance. NIPPC recommends these limits be modified to provide greater certainty on offset use as follows:

> “no more than 5 percent of a covered entity’s or opt-in entity’s compliance obligation may be satisfied by providing Ecology with offset credits. ~~At least~~ **No more than 2.5 percent** ~~50 percent of these offset credits~~ ~~must~~ **may** be sourced from offset projects that **do not** provide direct environmental benefits in Washington.”

While the difference is subtle, it can provide substantially better certainty as to whether offsets that have been acquired can be utilized in a given year.

[14] The language in this section generally tracks the statutory language in the Climate Commitment Act, which specifies that “at least 50 percent of a covered or opt-in entity's compliance obligation satisfied by offset credits must be sourced from offset projects that provide direct environmental benefits in the state.” CCA Section 19(3)

9. Conclusion

In offering these recommendations, NIPPC recognizes that the regulations promulgated by Ecology must be consistent with, and follow, the statutory requirements of the CCA and believes all of NIPPC's suggestions follow this criteria. NIPPC also notes that the Act provides Ecology meaningful latitude to tailor implementation of the Cap and Invest Program to ensure success, including a mandate that Ecology bring forth a request for revisions to the legislation where necessary to successfully link with other jurisdictions.[15] To the extent Ecology believes it is restricted from making the proposed clarifications and modifications addressed herein due to conflicts with the Statute, NIPPC urges Ecology to seek appropriate legislative changes.

Sincerely,

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[15] *See Climate Commitment Act*, Section 8(6): "The department ***must*** bring forth agency request legislation if the department finds that any provision of this chapter prevents linking Washington's cap-and-invest program with that of any other jurisdiction." Emphasis supplied.