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January 26, 2022

Cooper Garbe
Climate Commitment Act Program Rulemaking Lead
Washington State Department of Ecology
300 Desmond Drive SE, Lacey, WA 98503

Re: Informal comment for draft rule Chapter 173-446 WAC, Climate Commitment Act Program

Dear Mr Garbe:

Thank you for the opportunity to provide initial comments on the development of the Climate Commitment Act Program, through Chapter 173-446 WAC. As a statewide advocacy organization, the Washington Environmental Council works to develop, advocate and defend policies that ensure environmental progress and justice by centering and amplifying the voices of the most impacted communities. We have worked on carbon pricing for over a decade here in Washington and are committed to realizing a just and equitable implementation of the Climate Commitment Act.

The rulemaking for Chapter 173-446 WAC is the broadest and farthest reaching of the three formal rulemaking processes currently being conducted by the Department of Ecology. The content of this rule will establish the foundation for the program for decades to come and will be fundamental to achieving our statewide climate goals and improving the health and well-being of all Washingtonians. This comment letter provides an initial set of comments on this critical rule, guided by the following principles:

- Preventing harmful impacts to already overburdened communities.
- Upholding tribal sovereignty in the implementation of the law.
- Ensuring the success of the Environmental Justice Council in reviewing and adapting the law over time.
- Maintaining the integrity of the cap to drive down emissions.
- Strengthening transparency and accountability elements of the law.

The comments in this letter are focused on the draft rule's language on allowance budgets, the distribution of allowances (including the application of 'best available technology'), and elements associated with the allowance auctions. Additionally, we incorporate by reference comments submitted jointly by Washington Environmental Council and The Nature Conservancy, Washington Chapter focused on the offset section of the rule and comments by the Northwest Energy Coalition on the electric and gas utility sections of the rule. We have also attached and incorporate by reference a preliminary assessment of priority and systemic issues completed by the Stockholm Environment Institute (SEI) as part of our overall comment letter.

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ALLOWANCE BUDGETS AND DISTRIBUTION OF ALLOWANCES

Total Program Baseline

The draft language of WAC 173-446-200 (1)(a) states that *"subtotal baselines are calculated individually for each reporter or sector on an annual basis as described in subsection (2) of this section. The total program baseline is the sum of the subtotal baselines."* The draft language of WAC 173-446-200 (1)(b) lists a variety of data sources Ecology may use to calculate subtotal baselines, *"depending on data availability, quality, applicability, and the agency's best professional judgment. Ecology may adjust data and combine information from multiple sources when calculating subtotal baselines."*

Ecology should strengthen this section by addressing the following considerations while moving towards a draft rule:

1) **Ensure transparency in information and create opportunity for public input**: It is important for Ecology to be transparent in the methods and calculations used to arrive at each baseline number. The total number of allowances distributed during the first compliance period will establish the foundation for the long-term functioning of the cap-and-invest program. If too many allowances enter the program in early years, there is a real danger of entities banking an excess of allowances, thereby decreasing the incentive to reduce emissions in later years. Additionally, the total program baseline is - by design - very difficult to change, so getting it right during the current rulemaking is critically important. The public must therefore have a chance to review and provide input on the Ecology's methods and calculations, to support the Department's efforts to arrive at the most accurate numbers.
2) **Build in an opportunity to correct the baseline**: Ecology is proposing to use data provided by the GHG accounting reporting system, along with data provided by facilities themselves and by data or estimates obtained or made by Ecology, to set the total program baseline. Since the baseline is a foundational structure from which the rest of the program is based, it is critically important that Ecology identify data gaps and ensure that the baseline number is not artificially inflated based on those gaps. While we understand the importance of a durable baseline for market predictability, we suggest that Ecology have a clear and transparent way to understand and adjust this baseline if in the future, the emission factors are proven to be inaccurate and/or the data is not as clear as assumed. This will allow the baseline to function as intended, with a correct amount of allowances in the system. Additionally, the initial baseline that is set should include known data gaps into its assumptions and therefore be more conservative.

Distribution of allowances to Emissions-Intensive and Trade-Exposed Entities (EITEs)

While the Climate Commitment Act statute is clear about EITEs receiving free allowances, Ecology has important discretion around how to evaluate over time the impact of those free allowances on the

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overall market, on overburdened communities, and on revenue generated from the program. We recommend that Ecology address the following key points to clarify its approach throughout WAC 173-446-220:

1) **Strengthen oversight of Best Available Technology**: Ecology has important discretion around how to apply the definition of 'best available technology' that exists in the statute to include environmental and community impacts when evaluating potential upward adjustments in free allowances to EITEs. The interpretation of how this definition is applied will have significant implications for how EITEs are treated long term. We expect 'best available technology' to receive a lot of attention and therefore recommend that Ecology build into the rule and its approach to applying 'best available technology' a way for oversight (for example, using an independent and internationally recognized source), for public transparency (for example, documenting requests and the information that goes into making the evaluation), and review (for example, analyzing the impacts of decisions around 'best available technology' on both the program overall and on overburdened communities impacted by specific facilities).
2) **Maintain reduction schedule requirements:** We support and appreciate the language that Ecology has included in this section of the draft rule clarifying that the reduction schedule for a facility may not be adjusted above its reduction schedule for the first compliance period.
3) **Ensure clear role of Environmental Justice Council:** The Environmental Justice Council is statutorily required to adaptively manage the overall cap-and-invest program. The draft rule should be more explicit on how the Council will provide oversight on the allocation of no-cost allowances to EITEs. This clarification will be important to set the Council up for more successful review and oversight of the program and is particularly important to ensure that overburdened communities are not harmed by this law.
4) **Ensure clear role of tribal consultation:** The role of tribal consultation in the allocation of allowances to new EITEs is made clear in RCW 70A.65.110(8): *"For a facility that is built on tribal lands or is determined by the department to impact tribal lands and resources, the protocols must be developed in consultation with the affected tribal nations."* The draft rule should provide for consistency regarding the consultation of federally recognized tribal nations impacted by both existing and new facilities, consistent with the Centennial Accord.

In keeping with these points, we offer the following specific recommendations:

- Section 2(d)(ii) of the draft rule reiterates the Climate Commitment Act's directive that *"prior to the beginning of either the second, third, or subsequent compliance periods, Ecology may make an upward adjustment in the next compliance period's reduction schedule for an EITE facility based on the facility's demonstration to Ecology that additional reductions in carbon intensity or mass emissions are not technically or economically feasible."* The rule then describes specific circumstances that qualify or disqualify a facility from receiving additional no-cost allowances based on this demonstration. We urge Ecology to integrate the following language, adapted and strengthened from its agency request legislation, HB 1682, section 1(3)(f)(iii)(g), into this section of WAC 173-446-220:
  (g) Any adjustment granted pursuant to (f) of this subsection may not:

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(i) Increase the annual allowance budget for the program under RCW 70A.65.070 for any calendar year in the compliance period for which the adjustment was granted or for any future calendar year;
(ii) Reduce the progressively equivalent reductions year over year in the annual allowance budgets under RCW 70A.65.070; or
(iii) Prevent the achievement of the emissions limits established in RCW 70A.45.020, as those limits apply to this chapter;
(iv) Reduce air quality in an overburdened community. The agency must consult with the Environmental Justice Council to determine the impact of any upward adjustment to the achievement of air quality targets determined by the agency according to the process defined in RCW 70A.65.020; and
(v) Negatively impact tribal lands and resources. For a facility located on tribal lands or determined by the department to impact tribal lands and resources, the adjustment protocols must be developed in consultation with the impacted federally recognized tribe or tribes.

- The addition of section (iv) above would bring the Program Rule into alignment with Ecology's proposed Criteria for EITE Industries Rule, specifically draft WAC 173-446A-040 section (2)(c): *"Ecology must consider a facility's location relative to overburdened communities and recommendations, if any, from the Environmental Justice Council when evaluating a petition. Ecology may deny a petition based on this consideration upon a determination that air quality in overburdened communities would be unacceptably impacted."* Adding section (iv) would provide consistency across the code for EITEs: any process for allocating additional no-cost allowances to facilities in Washington must preclude harmful impacts to overburdened communities.
- Separately, the addition of section (v) would ensure the clear role of tribal consultation when considering an upward adjustment in the reduction schedule of no-cost allowances to a facility.

<u>Distribution of allowances to electric utilities</u>

We support by reference the comment letter submitted by Northwest Energy Coalition (NWEC) and encourage Ecology to consider the following while continuing to develop WAC 173-446-230:

1) Adopting multiple emissions factors for natural gas and coal generation that will more accurately account for variations in power plant efficiency.
2) Explore incorporating energy efficiency into the cost burden effect calculation for electric utilities and ensure the rule does not unintentionally create barriers to energy efficiency and electrification.

<u>Distribution of allowances to natural gas utilities</u>

We support by reference the comment letter submitted by Northwest Energy Coalition (NWEC) and encourage Ecology to consider the following while continuing to develop WAC 173-446-240:

1) Ensure the allocation baseline and the declining no cost allowance allocation schedule for natural gas utilities is aligned with the achievement of our state's greenhouse gas reduction

requirements and does not promote expansion of the natural gas system and the risk of stranded assets.

2) Develop additional rule language to provide guidance on the use of the value of no cost allowances for electric and natural gas utilities, to fulfill the CCA's requirement that *"The benefits of all allowances consigned to auction under this section must be used by consumer-owned and investor-owned electric utilities for the benefit of ratepayers, with the first priority the mitigation of any rate impacts to low-income customers."*

Adjustments to allowance budget

We appreciate Sections 4 and 5 of WAC 173-446-250 in the current draft rule and believe they provide a strong foundation for protecting the integrity of the emissions cap. Additionally, they provide clear directives for the adaptive management necessary for adjusting the allowance budget over time. We encourage Ecology to continue analysis and fine tuning of all of the adjustment mechanisms defined in WAC 173-446-250, with a particular focus on the potential for unintended consequences, especially regarding disproportionate cost impacts on consumers in sectors that do not receive no-cost allowances.

We also appreciate Ecology's request for input on Section 2 regarding methods for reducing allowances from the allowance budget. We are continuing to review this section and look forward to ongoing discussion as the rulemaking progresses.

ALLOWANCE AUCTIONS

The management of allowance auctions is important to guard against collusion, promote transparency, and ensure that each auction results in the intended outcomes. Allowance auctions must also be designed to ensure that allowance cost and availability effectively drive the emissions reductions required to meet our state goals. We appreciate the complexity of developing a market that ensures both cost protections and emissions reductions, while maintaining the integrity of the emissions cap. The draft rule contains many elements that will help lay a strong foundation to achieve these goals.

The auction structure described in the draft rule is complex and detailed, and we look forward to continuing to work with Ecology as the draft rule is developed for further public comment. During this informal comment period, we offer the following considerations:

- **Engage Public In Contracted Economic Analysis**: During Ecology's January 11, 2022, stakeholder meeting, staff mentioned a RFP for independent expertise to provide economic analysis. As a follow up to that mention, we urge Ecology to accept public comment on the proposed scope of work of any independent contractor hired to conduct an economic analysis for development of the cap-and-invest program. This is vital for transparency and to allow informed public input to help guide the analysis and inform the market's most important structural components.
- **Set Auction Prices To Help Market Function:** The current draft rule provides only limited information on Ecology's approach to setting a ceiling and a floor (WAC 173-446-335). Given the unique set of constraints within this program, as written by statute, including the generous free

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allowances to EITEs and utilities and the statutorily defined greenhouse gas emission targets, it is important that Ecology build in a way to adaptively manage the ceiling and floor to ensure stability and effectiveness of the program. This should include evaluating the impact on the integrity of the cap and the impact of costs on customers. These considerations will be critically important for maintaining public support and establishing the effectiveness of the program.

Additionally, it is imperative that the auction floor price be set high enough to support the program's emissions reductions requirements. If the price floor is set too low, covered entities will not have a strong enough market incentive to reduce emissions. At the same time, maintaining strict limits on the emissions of covered entities is paramount to the successful implementation of the Climate Commitment Act. Price ceiling units, while an important cost containment measure, have the potential to undermine the integrity of the emissions cap by allowing emissions far beyond the limits set by the total program baseline. For this reason, we strongly support Ecology's intent to set the price ceiling at a sufficient price to ensure that it is only surpassed in extreme circumstances where cost containment is absolutely necessary. We further recommend that Ecology build protections into the rule that would trigger a reconsideration of ceiling price and the implementation of non-price measures if the cap is exceeded repeatedly or for an extended period.

We appreciate the importance and groundbreaking nature of the Climate Commitment Act and all the work required to stand up the program in a just and equitable way. We are committed to working with, and supporting, the Department of Ecology in rulemaking and in the long-term success of this nationally recognized law. Thank you for the opportunity to provide comments and all the work to date to move this law forward.

Sincerely, Rebecca Ponzio and Caitlin Krenn

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Attachment: SEI Assessment

Preliminary Assessment and Identification of Issues Related to the Climate Commitment Act Rulemaking

This brief presents SEI's initial assessment of key design elements of the emissions trading system (ETS) established by Washington's Climate Commitment Act (CCA), focusing on diagnosing the potential for systemic risks – e.g., market instability, adverse distributional impacts, and/or environmental integrity risks that might affect the system's effectiveness and political viability. We also briefly touch on questions related to offset program design, in particular questions related to maximizing participation (through, for example, aggregation mechanisms) and equitable compensation for project developers and landowners.

The purpose of this assessment is to identify key potential points of influence related to regulatory requirements that are now being developed under the CCA, as well as to identify larger structural issues that may specified in the CCA legislation (and therefore not subject to regulatory modification) but which could be important to track as the ETS program progresses – including in the context of future linkage to the California-Quebec ETS. Further analysis will be required to explore the issues identified here in greater depth and to better assess the risks (or opportunities) they present.

1. **Program-wide baseline setting**. Ecology is proposing to arrive at the total program baseline through a "bottom-up" approach of summing covered facility baselines. Ecology has a longstanding greenhouse gas reporting system in place for many covered facilities, but important data gaps may remain for some (including, for example, first deliverers of imported electricity). The program baseline could have important implications initial allowance allocations. In particular, it will be important to avoid methods that lead to overallocation, which could adversely affect the rate at which emissions must decline in later commitment periods, and in turn have impacts on allowance prices, cap integrity, and consumer energy costs.

2. **Distributional implications of no-cost allowance allocations**. The CCA specifies requirements for allocating a portion of allowances at no charge to electric and gas utilities, as well as to energy-intensive, trade-exposed (EITE) industries. Altogether, these entities will likely generate more than half of all emissions covered by the program. Free allocation to utilities is important as a means to manage rate impacts for utility customers. Free allocation to EITEs shields them from cost impacts that might put them at a disadvantage relative to out-of-state, unregulated competitors. At the same time, the degree of free allocation could have unintended consequences related to cost burdens for both regulated entities and consumers. While low income electricity and gas consumers will be most shielded from price increases, gasoline and diesel consumers will bear most of the price burden. This could have some regressive distributional consequences, which the CCA seeks but may not be fully capable of addressing. In the extreme, generous no-cost allocation to EITEs could create windfalls in some industry sectors (especially where low cost emissions intensity reductions are possible) while generating untenable, regressive cost increases in the transportation sector. Possible dynamics here will

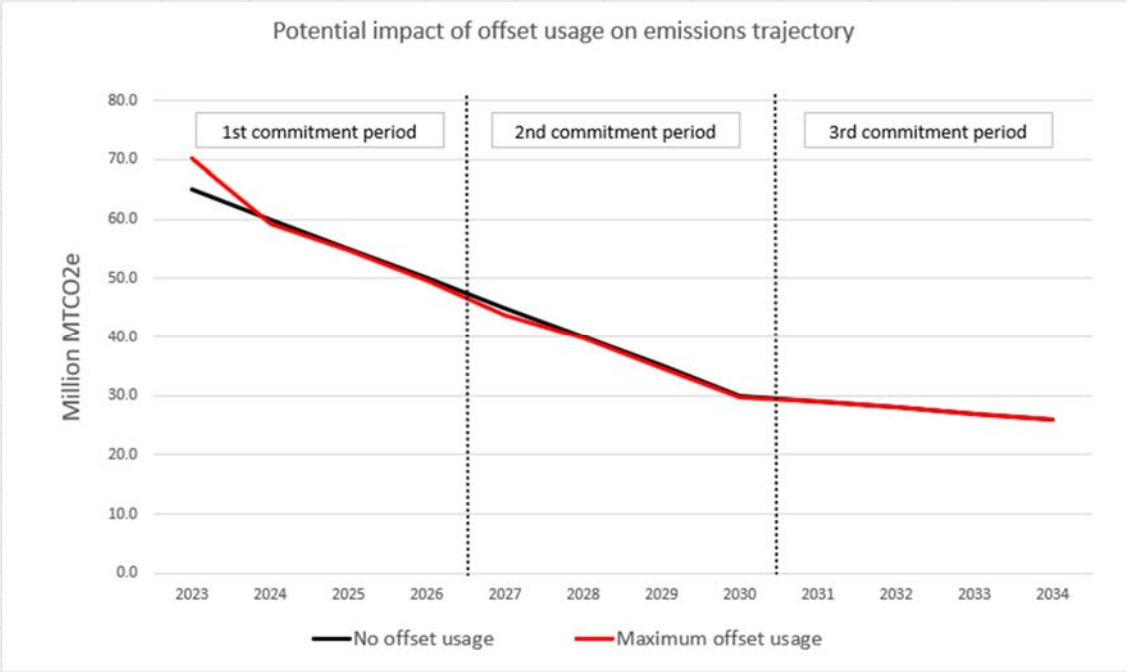
need to be carefully assessed, including potential interactions with Washington's clean fuel standard.

3. **Methods for determining EITE allocations**. Related to issue #2, the CCA stipulates levels of free allocation to EITEs that are more generous than those found in other systems like California-Quebec and the European Union ETS. Ecology has only limited discretion to determine certain details of the allocation formulas, which may be output- or mass-based depending on circumstances. Where Ecology does have discretion, however, it will be important to understand the implications of different choices and methods. Key variables here may include: (1) how Ecology defines the unit of production or output for specific facilities when determining output-based allocations; (2) how Ecology chooses to define "best available technology" when considering whether (and how much) to provide EITE facilities with an upward adjustment in free allocations (per section 13 of the CCA); and (3) other considerations Ecology may make with respect to an EITE facility's emissions performance and abatement potential in comparison to competitors when making allocation decisions. Among other things, these decisions could influence leakage potential, possible windfalls to specific facilities or industries, and overall cost impacts on other regulated entities.

4. **Floor and ceiling prices, and the pace of required emission reductions**. As a consequence of the State's statutorily defined GHG targets, the CCA requires a steeper decline in emissions over the first two commitment periods (through 2030) than in subsequent years. One risk is that this mandated decline could drive too hard too fast, leading to high allowance prices in the first two commitment periods – an effect that could be exacerbated by other program elements, including baseline setting, free allocations, and bringing offsets "under the cap" (see #5). Floor and ceiling prices for the program should ideally be set with this potential in mind, as well as with having an eye to the potential future linkage with California and Quebec. At the same time, risks that the program could drive allowance price spikes, jeopardize cap integrity, and impose untenable costs on consumers (e.g., for transportation fuels) should be carefully evaluated, even if there is little near-term discretion to address these issues in Ecology's rulemaking. Further analysis could explore how proposed floor and ceiling prices for allowances compare to modeled estimates of marginal abatement costs associated with achieving Washington's statutory GHG emissions targets.

5. **The subtraction of offset usage amounts from future allocations.** The ETS established by the CCA is unique in its approach to carbon offset credits, in that it stipulates that any credits issued must be deducted from allowance allocations. Ecology proposes to deduct credits either from allowances unclaimed at auction or from future year allocations. While this provides a failsafe way to preserve environmental integrity (i.e., keeping net GHG emissions at or below targeted levels), it does not provide any aggregate cost containment, and it introduces some potentially novel market dynamics. Two issues to evaluate include: (1) whether offset usage could drive unanticipated distortions in emissions and allowance prices (see possible illustration below; offset usage could increase emissions in the first year or two, balanced by lower allocations in future years); and (2) whether use of offsets could have adverse distributional effects. The latter

risk could arise because buyers of offsets could achieve lower average compliance costs, leading them to reduce emissions less than they otherwise would, while at the same time making allowances more scarce across the entire program (increasing marginal costs for all covered entities accordingly).



6. **Linkage to California-Quebec ETS.** The CCA anticipates a linkage between Washington's emissions trading system (ETS) and the California-Quebec ETS. This could offer opportunities for achieving collective emissions targets at lower cost and reduce the potential for economic and emissions leakage. At the same time, it could have implications for achieving Washington's statutory greenhouse gas targets. Furthermore, certain elements of the CCA program could present obstacles to reaching a linkage agreement and/or have unanticipated consequences related to market dynamics, local pollution, and/or consumer prices in Washington. Any such linkage will not be established immediately, but prospects for linkage may be important to consider in the current rulemaking and – possibly – future legislation related to the CCA.

7. **Exploration of offset rules and aggregation approaches**. The CCA directs Ecology to explore ways to increase participation in the offset program through rules that allow aggregation of smaller offset projects, including forest projects and projects on tribal lands. Aggregation options for forest projects, for example, were explored in the early development of California's Forest Project Protocol. While different options exist, they typically involve tradeoffs between reducing monitoring and verification burdens and maintaining the quantification accuracy and verifiability of (aggregate) project performance. Aggregation may also have implications for additionality and insuring against reversals of stored carbon. Solid aggregation rules should appropriately balance these tradeoffs. Such rules will likely need to be tailored for different

eligible project types and incorporated in approved offset protocols adopted by Ecology. This could be done, for example, by amending and updating California-approved protocols.

8. **Ensuring equitable participation by offset project developers.** One risk of an offset program (related to market dynamics) is that large regulated entities may be able to exert market power when procuring offsets, driving down prices. This would reduce their compliance costs, but could also mean capturing economic surplus that would otherwise go to project developers. As the CCA program develops, prospects for buyers to exert market power should be examined, and possible remedies devised if this is determined to be a risk.