PUGET SOUND ENERGY

Puget Sound Energy
P.O. Box 97034
Bellevue, WA 98009-9734
pse.com

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Adrian Young, Cap-and-Invest Industrial Policy Lead
Department of Ecology
Air Quality Program
P.O. Box 4600
Olympia, WA 98504-7600

RE: Cap-and-Invest: Report to Legislature: No-cost allowances for Emission-Intensive Trade-Exposed Industries (EITEs)

Puget Sound Energy (PSE) respectfully submits the following comments in response to the Washington State Department of Ecology's (Ecology) request for feedback for its report to the Legislature (Document 6: Draft Recommendation)[1] on an approach for allocating no-cost allowances from 2035-2050. PSE's comments are from the perspective of a compliance entity serving electric and natural gas utility customers in the state.

By way of background, PSE is Washington State's oldest and largest investor-owned energy utility, serving approximately 1.2 million electric and over 900,000 natural gas customers with safe and reliable energy services. PSE supported the passage of the Climate Commitment Act (CCA or Cap-and-Invest Program) and has dedicated substantial resources and time to implement and comply with the Cap-and-Invest Program. PSE participated in Ecology's EITE Policy Advisory Group process, providing feedback and a utility perspective as Ecology prepares the mandated EITE allocation report to the legislature. PSE appreciates being included in this process, along with the thoughtful manner in which different policy options and impacts were presented and considered. Going forward, PSE encourages thoughtful consideration of these policy options among Ecology and policymakers given the current dynamics of Washington's carbon market with limited liquidity and high allowances costs for compliance entities and their customers.

Legislative Intent:

PSE would like to highlight the legislative intent language embedded in the CCA with respect to allocating no-cost allowances to natural gas utilities and electric utilities in the interest of their customers:

- *The legislature intends by this section to all consumer-owned electric utilities and investor-owned electric utilities subject to the requirements of chapter 19.405 RCW, the Washington clean energy transformation act, to be eligible for allowance allocation as provided in this section* ***in order to mitigate the cost burden of the program on electricity customers*** *(emphasis added)*[2].

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- *"Cost burden" means the impact on rates or charges to customers of electric utilities in Washington state for the incremental cost of electricity service to serve load due to the compliance cost for greenhouse gas emissions caused by the program[3].*
- ***For the benefit of ratepayers, allowances must be allocated at no cost** to covered entities that are natural gas utilities (emphasis added) [4].*

Given this, policymakers and implementers must thoughtfully balance the legislature's explicit, and foundational, intent to mitigate costs to utility customers, while also focusing on preventing leakage in the EITE sector – all while considering overall impacts to the market including allowance liquidity and environmental justice impacts. Ultimately, it is important that the EITE sector is not prioritized over entities subject to the Clean Energy Transformation Act (CETA) that are working to mitigate costs to utility customers.

Additionally, any further work related to complementary policies should be thoughtfully considered especially as the CCA is an exceedingly complex policy. This is further exacerbated by the fact that electric utilities like PSE are striving to comply with CETA, CCA, and the emerging and complex dynamics of maturing electricity markets in the West.

<u>Draft Recommendations:</u>

PSE offers the following comments as it relates to selected Ecology draft recommendations from Document 6:

***Recommendation 1.1: Maintain Ecology's authorization to provide no-cost allowances to EITEs from 2035 onwards provided it aligns with program objectives, allowance budgets, and emissions limits**.*

PSE appreciates inclusion of the language "provided it aligns with program objectives, allowance budgets, and emissions." This speaks to PSE's earlier points about the importance of balancing legislative intent and required no-cost allowance allocations to other sectors, i.e. natural gas and electric utilities for the benefit of customers.

Recommendation 1.2: Monitor developments in carbon pricing policies and federal policies including developments in carbon border adjustment mechanisms or alternative policies to address leakage risk.

As part of recommendation 1.2, PSE encourages continued coordination with California and Quebec on EITE policy implementation in order to preserve Washington's ability to link programs with these jurisdictions. Per statute, Ecology is directed to consider opportunities to implement the program in a manner that allows linking the state's program with those of other jurisdictions[5].

Recommendation 2.2: Assess the requirements and impacts of providing no-cost allowances for addressing leakage risk associated with purchased electricity.

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PSE again emphasizes that the allocation of EITE no-cost allowances cannot come at the expense of utility customers per CCA legislative intent to mitigate cost burden of the program.

Complementary Policies:

PSE offers the following comments in response to the references made to complementary policies by Ecology in Document 6, Appendix 1:

PSE requests that any pursuit of complementary policies focused on the electric sector be done in careful coordination with electric utilities and the Washington Utilities and Transportation Commission. Electric markets are complex, as is the harmonization of CETA and CCA compliance for electric utilities. Therefore, it is important for electric utilities to be at the table as policymakers consider enabling policies to further industrial decarbonization primarily through the electric sector. This close coordination will help ensure that the design of these policies are effective and enabling with minimal unintended consequences.

Expedite electrical grid enhancements for industrial electrification: Advancing electrical grid reliability, capacity, and affordability improvements outside of adding additional generation capacity can facilitate easier access to the electricity needed for industrial electrification.

Per comments above, this overarching policy goal will require close coordination with Washington's electric utilities who are striving to achieve these advancements given our interest in innovation, as well as regulatory pressures (namely CETA) and rapidly increasing demand. Working closely with electric utilities will help identify specific policies or gaps that could be addressed; or consider increased funding opportunities for electric utilities, including investor-owned utilities, to further reliability and capacity.

Reform industrial electricity tariffs and ratemaking: Utilities accommodating increased electrification-related loads must balance costs to existing ratepayers without jeopardizing progress on clean energy goals. Differentiated large load tariff rates may aid industries to decarbonize while insulating other customers from infrastructure costs.

As it relates to this potential complementary policy, PSE appreciates acknowledgement of our need to balance costs to existing ratepayers without jeopardizing clean energy progress. That being said, investor-owned utilities are regulated by the Washington Utilities and Transportation Commission, and the Commission has existing and adequate authority over these tariff structures.

Accelerate permitting procedures for critical decarbonization projects

PSE encourages continued work to make permitting streamlined and more efficient, especially when paired with meeting the state's clean energy and emissions related goals. While Ecology specifically focuses on industrial decarbonization projects, there continues to be an opportunity

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for Washington State to accelerate permitting procedures for the broader clean energy industry in support of state goals. This could include augmenting existing permitting resources, seeking agency efficiencies by limiting regulatory duplication, and ensuring various regulatory agencies are working towards a common goal of enabling clean energy development and decarbonization.

Hydrogen

PSE is supportive of the development of hydrogen as a technology, seeing its value as a potential peaking resource, and applications for gas decarbonization, among other uses for other industries. Relative to the complementary policies in Document 6, PSE and Modern Hydrogen recently announced a strategic partnership to promote the development of distributed methane pyrolysis technology, a groundbreaking solution that removes carbon from natural gas at the point-of-use for commercial and industrial operations in traditionally hard-to-decarbonize sectors. This technology has the potential to help large gas customers accelerate their decarbonization projects and reduce their greenhouse gas emissions in line with Washington State's clean energy goals. Given this potential, there's an opportunity to make changes to the CCA to ensure that these emissions reduction technologies are incentivized under this program and not penalized with compliance obligations. Changes may include definitional updates and modifications to the emissions reporting to enable these technologies.

While PSE understands the focus on green hydrogen given state goals, PSE cautions that green or renewable hydrogen may not reach commercial scale until significant new renewable energy resources (the principal feedstock) are brought online. This will take some time to robustly develop. Additionally, green hydrogen is projected to get more expensive given the shifting federal tax landscape, and the overall cost increases to renewable generation and necessary build-out of the transmission system. Therefore, PSE would suggest that "all-of-the-above" hydrogen generation be encouraged and incentivized through state policy to make incremental progress on state goals while appropriately managing costs to customers and industry. Something to specific to support this approach could include developing appropriate methodologies for evaluating the carbon-intensity of hydrogen through data-based metrics.

PSE is supportive of the proposed complementary policy related to incentivizing hydrogen investments through tax incentives and grants. Because hydrogen is an emerging technology, tax incentives and grants should not be limited to local municipalities and small businesses. Rather, these incentives should be designed to support the broader hydrogen ecosystem to propel development and manage costs.

As it relates to investing in common carrier infrastructure for the transportation of hydrogen, PSE suggests close coordination with natural gas utilities as these entities have existing pipeline infrastructure and rights-of-ways that can be used for these purposes. A hydrogen pipeline delivery system offers numerous benefits to the region, including the ability to store energy, provide resilience benefits, and an existing skilled workforce that is trained in the installation and safe operation of pipelines.

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Thank you for the opportunity to provide comments to inform Ecology's report to the legislature concerning post-2035 allocation of no-cost allowances to the EITE sector and complementary policies. PSE looks forward to further engagement with Ecology and policymakers as this process evolves. Please contact me if you have any additional questions.

Sincerely,

/s/ Kassie Markos

Kassie Markos
Manager, Public Policy
Puget Sound Energy
PO Box 97034, BELL11
206-258-0308
Kassie.Markos@pse.com