Washington Department of Ecology
Attn: Surabhi Subedi
P.O. Box 47600
Olympia, WA 98504-7600

October 31, 2025

RE: Cap-and-Invest Program Updates and Linkage Rulemaking Informal Comments

Dear Ms. Subedi:

I greatly appreciate the opportunity to provide the attached comments in response to the informal comment period for Cap-and-Invest Linkage Program Updates and Linkage Rulemaking to amend Chapter 173-446 WAC and Chapter 173-441 WAC to make improvements to the implementation of the Cap-and-Invest Program, facilitate the linkage of Washington's carbon market with the California-Québec carbon market, as well as make other necessary updates.

Lombard Odier Investment Mangers (LOIM) is the asset management arm of the Lombard Odier Swiss banking group, founded in 1796, with a core investment conviction in the net zero transition, including through investments in carbon markets. I am part of the carbon team at LOIM, which manages an investment strategy trading across carbon markets globally, including the Washington and California/Quebec cap-and-invest markets. I was also a co-lead author of the PMR-ICAP *ETS Handbook,* including Chapter 6 on price predictability and cost containment relevant to these current comments (ICAP-PMR 2016).[1] I also am an Adjunct Professor teaching Carbon Pricing at Columbia's University School of International and Public Affairs. The views expressed here are mine alone and do not necessarily reflect those of others at any of these organizations.

Thank you very much for your time and consideration.

Sincerely yours,
Ruben Lubowski
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[1] PMR-ICAP (2016). Emissions Trading in Practice: A Handbook on Design and Implementation (First edition), Suzi Kerr and Ruben Lubowski (Co-Lead Authors), Catherine Leining, Leah Murphy, Katherine Rittenhouse, and Gernot Wagner. World Bank Partnership for Market Readiness and International Carbon Action Partnership. Washington, DC. Available at: https://icapcarbonaction.com/system/files/document/icap-pmr_ets_handbook_1st_edition.pdf

Rulemaking to amend Chapter 173-446 WAC

- Number of future vintage allowances placed in APCR

In our opinion, the benefit of a robust APCR outweighs the drawbacks of reduced liquidity from slightly less allowances in the quarterly auctions. The APCR tiers are an important program design element to support price predictability and avoid excessive variability in the evolution of prices. The importance of the APCR as a cost containment mechanism will remain as allowance budgets continue to tighten even in a linked market. A replenished APCR for compliance period 2 (CP2) will thus provide greater price predictability and stability through the coming decade while reducing the chances of prices suddenly rising to the price ceiling, with the potential to increase costs and risk a of weakening environmental integrity.

Nevertheless, it is also important for market functioning to ensure a smooth transition from year to year in the allowance supply available to the market. As a result, we believe that the percentage of allowances being placed in the APCR should not change abruptly and should either remain constant or decline gradually over time to reflect the already tightening caps, rather than increasing and thereby risking disproportionately exacerbating the already increasing scarcity. From a cost containment perspective, it would be counterproductive to remove allowances from the auction supply only to push the price to the APCR level.

In responding to the direction of HB1975 to "Place no less than two percent and no more than five percent of the total number of allowances from the allowance budgets from 2027 to 2040 in the allowance price containment reserve," it is important for Ecology to account for the fact that 5% of the allowances from 2027-2030 were already placed in the APCR for the first compliance period (CP1). We believe the HB1975 language could potentially be read as indicating that no more than 5% can ever be removed in total from each year's budget, such that the 5% limit has already been reached for the 2027-2030 allowance budgets.

In this light, to balance a robust APCR with smooth year-to-year auction supply changes, we recommend that Ecology place into the APCR: 5% of the allowances from each of the annual budgets from 2031-2040 plus the *minimum* allowable from 2027-2030. This minimum would be 0% or 2% of the annual 2027-2030 budgets, depending on the interpretation of the statute, translating into approximately 3% to 3.8% of the cumulative 2027-2040 budgets placed in the APCR for CP2. This recommendation would balance robust cost containment and a smooth continuation of the current annual trajectory of available allowances in the auctions.

- Timing of APCR allowance introduction

We recommend "Option A: Before compliance period 1 quadrennial compliance event." This would maximize the benefits in terms of cost containment, particularly given the uncertainties around the intended linkage with California/Quebec, helping to bridge the market until a linkage is operational in line with the spirit of the price ceiling provisions of HB1975. The ability of the APCR to contain costs is also important from an environmental integrity perspective given that APCR allowances are taken out from under the cap in contrast to potential sales of units at the price ceiling which would involve additional supply over and beyond the supply established by the annual allowance budgets.

Given Option A, there is a further question of how much of the available pool of APCR allowances would be made available from the very beginning versus gradually spread out over multiple years, as well as across multiple potential auctions across each year, as per the APCR guidance in effect for compliance period 1 (CP1).   We recommend that all the APCR allowances for CP2 be made available as of the first possible APCR auction (together with any remaining allowances from the CP1 APCR), with any unsold allowances rolled over to the subsequent APCR auction. This would best achieve the cost containment and environmental integrity objectives described above. This would also have the advantage of aligning with the APCR approach within the California/Quebec market.

• Emissions limits (Dec 31 limits): Timing of introduction of prior year vintage allowances

The most straightforward approach would be, as soon as possible upon finalization of this rulemaking, to introduce the prior vintage allowances (starting with the earliest vintages) through a pro-rata distribution across all the remaining quarterly auctions in advance of the partial compliance date on November 1, 2026. This would minimize creating lumpiness in the auction volumes, while also best matching the vintages to the corresponding compliance obligations and best achieving the goals of cost containment and environmental integrity. Prompt introduction of these volumes would help avoid any potentially unnecessary use of the APCR and price ceiling units. We also recommend that 5% of the added prior-year vintage allowances be added to the APCR allowance pool from CP1 in a pro-rata manner across all remaining APCR auctions corresponding to the 2026 APCR budget.

• Tier 2 price revision

For purposes of consistency, we recommend continuing the current practice of setting the APCR tier 2 price at the midpoint of the APCR Tier 1 and Price Ceiling levels, regardless of whether the ceiling is at the $80 level or another future level as of 2028 or after a linkage agreement.   In the event Ecology chooses to begin offering any APCR units at the Tier 2 level, setting the APCR Tier 2 price even slightly below the ceiling would have the benefit of providing further cost containment to bridge the period ahead of a potential linkage in line with the spirit of HB1975.

Other Feedback

• Clarifications for a linked market

WAC 173-446-020 Definitions state that, "'Linkage agreement' means a nonbinding agreement that connects two or more GHG market programs and articulates a mutual understanding of how the participating jurisdictions," and further "'Linked jurisdiction' means a jurisdiction with which Washington has entered into a linkage agreement." It would be helpful to clarify whether and when the language throughout the Climate Commitment Act Program Rule that refers to Ecology having "linked with an external GHG system" follows this definition of a "linked jurisdiction," which is based on the conclusion of a "linkage agreement," and/or depends on a linkage actually having progressed to one or other operational phase(s) which would be helpful to specify as much as possible. This is particularly important for understanding the exact timing of potential fungibility of offset credits and allowances from "linked jurisdictions."

• Vintage year allowance holding limit for general market participants; 173-446-150(2)

We agree with no differentiating special vintage year allowance holding limits for general market participants versus for covered or opt-in entities, as concerns over market concentration apply equally across entity type. Nevertheless, we recommend that Ecology, potentially in combination with its jurisdictional linkage partners, consider a general rule applied across all market participants that clarifies that the holding limits for advance vintage allowances should be proportional to the volume of these allowances made available to the market, rather than to the total (future) allowance budget for that year. This would better reflect the market size for advance vintage allowances and their lower liquidity than the current vintages.

• Change definition of biofuels to fuels with 30% lower lifecycle emissions (previously 40%) or to align with a linked jurisdiction, and other revisions; 173-446-020

In the context of aligning its definition of "biomass-derived fuels," "biomass fuels" and "biofuels", we encourage Ecology to make clear that changing the definitions to align with a linked jurisdiction means aligning with the lifecycle emissions estimates in that linked jurisdiction, rather than exempting those fuels under any scenario. In other words, it is important for the cap-and-invest program to remain aligned with "lifecycle emissions" estimates, e.g. under Washington's Clean Fuels standard and/or California's Low Carbon Fuel Standard (LCFS) and Canada's Clean Fuel Regulation (CFR), rather than assuming a blanket 100% lifecycle emissions benefit. In this regard, we underscore the importance of the recommendations to CARB in a letter from June 22, 2024 from Environmental Defense Fund (EDF), Nextgen California, and The Climate Center "to align the treatment of biogenic emissions, which are currently fully exempted under the cap-and-invest program in California/Quebec, to account for the full lifecycle impacts of bioenergy production and use."[2]

If Washington is linked with California and Washington's CFS incentivizes substitution of conventional gasoline for renewable diesel, for example, the combustion of the biogenic share of these emissions will fully drop out of the coverage of California's cap-and-invest program under the current biogenic emissions exemption. If the supply of allowances is unchanged but covered emissions thus decline as a result, this allows the remaining covered emissions to rise by potentially more than the estimated lifecycle benefits of using those fuels, increasing rather than decreasing net emissions across the different programs. This potential waterbed effect is a threat to Washington's climate ambition given the important projected impact of the amended CFS and LCFS on the biogenic share of the fuel mix through the end of the decade. To protect the state's climate goals and the expected programmatic benefits, the most direct way to address this issue would be for Ecology and its partners to ensure that the GHG accounting in cap-and-invest and clean/low-carbon fuel programs are in harmony. An alternative fix would be to cut the allowance budgets under the cap-and-invest program, as the quantity of fuel-related biogenic emissions grows, to compensate for the fraction of biogenic emissions that drop out of the program's coverage above and beyond the estimated decrease in lifecycle emissions.

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[2] Available from: https://ww2.arb.ca.gov/form/public-comments/submissions/15231